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Developing Jurisdictional Standards for State Taxation of Multistate Corporate Net Income

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Developing Jurisdictional Standards for State Taxation of Multistate Corporate Net Income

By Berndt Lohr-Schmidt*

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PART ONE

Involving as it does the entire liability of the taxpayer, the characteristic vagueness of the jurisdictional provisions has implications which are more far reaching than vagueness in other areas of tax law.¹

On February 24, 1959, the United States Supreme Court decided the companion cases of Northwestern States Portland Cement Co. v. Minnesota and Williams v. Stockham Valves & Fittings, Inc.² This decision raised many doubts in the business community as to the adequacy of the constitutional limitations upon the power of a state to tax

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the net income of a multistate business enterprise. The Court's summary action in two other state income tax cases less than 1 week later\(^3\) gave rise to additional demands that the taxing powers of the states be limited by federal legislation.\(^4\) As a result, Public Law 86-272, the Interstate Income Act, was passed and signed into law by President Eisenhower on September 14, 1959.\(^5\) The new law was designed to prohibit state income taxation in situations for which the business community was most apprehensive at the time.\(^6\)

The substantive provisions of Public Law 86-272,\(^7\) admittedly a stopgap measure,\(^8\) were supplemented by title 2 of the act. Title 2 required the Senate Finance and House Judiciary Committees, jointly or separately, to undertake

full and complete studies of all matters pertaining to taxation by the States of income derived within the States from the conduct of business activities which are exclusively in furtherance of interstate commerce or which are a part of interstate commerce, for the purpose of recommending to the Congress proposed legislation providing uniform standards to be observed by the States in imposing income taxes on income so derived.\(^9\)

Legislative recommendations based upon the authorized studies were advanced. While numerous bills restricting or defining state taxing power have been introduced in Congress during the past 5 years, none have been enacted.\(^10\) Thus, Public Law 86-272 represents the only federal decision in International Shoe Co. v. Fontenot, 359 U.S. 984 (May 4, 1959), denying cert. to 236 La. 279, 107 So. 2d 640 (1958).


5. 73 Stat. 555.


8. Beaman, supra note 4, at 6.11.


10. Over 4 years of hearings and study conducted under the auspices of the House Special Subcommittee on State Taxation of Interstate Commerce led to the publication in 1964 and 1965 of its four volume report titled State Taxation of Interstate Commerce H.R. Rep. No. 1480, supra note 1. Legislative recommendations by the Special Subcommittee's parent, the House Committee on the Judiciary, are contained in volume four of the reports. Based upon these recommendations, H.R. 11798, the first of many measures designed to further regulate various forms of state taxation of multistate business, was introduced in the 89th Congress in October 1965. After further extensive hearings
statutory intrusion to date into the field of state income taxation of multistate business.\textsuperscript{11}

during the first quarter of 1966, an amended measure, H.R. 16491, embodying some of the changes recommended during those hearings, was introduced and reported favorably by the Committee on the Judiciary, but failed to receive full consideration of the House before adjournment of the 89th Congress. HOUSE COMM. ON THE JDICIARY, INTERSTATE TAXATION ACT, H.R. REP. NO. 91-279, 91st Cong., 1st Sess. 5 (1969).

The 90th and 91st Congress saw the introduction and partial modification of similar bills, and although each passed the House of Representatives, both reached the Senate too late in their respective sessions to receive consideration by the latter body. H.R. 2158, 90th Cong., 2d Sess. (1968); H.R. 7906, 91st Cong., 1st Sess. (1970).

11. Mr. Justice Frankfurter commented, in dissenting in Northwestern States, that "today's decision will stimulate, if indeed it does not compel, every State of the Union, which has not already done so, to devise a formula of apportionment to tax the net income of enterprises carrying on exclusively interstate commerce." Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 473-74 (1959). He may well have announced the course of the response of state governments, but Public Law 86-272, the hearings and report of the House Special Subcommittee on State Taxation of Interstate Commerce, and the introduction, beginning in October 1965, of H.R. 11798 and its progeny were the real stimulus for state action.

The statutory revision of state net income tax income allocation and apportionment formulas has been effected by the adoption in 20 states and the District of Columbia of the Uniform Division of Income for Tax Purposes Act (UDITPA). Keesling & Warren, California's Uniform Division of Income for Tax Purposes Act, 5 U.C.L.A.L REV. 156, 158 (1968).


Partially in response to the outcry of business and Congress that the difference in definition of the net income tax base among the states created substantial accounting and filing problems, especially for small multistate companies, the number of states using more or less the Internal Revenue Code definition of income for tax purposes has risen from 9 in the early 1960's to 23 plus the District of Columbia as of mid-1970. Compare H. R. REP. No. 1480, supra note 1, at 256 with CCH STATE TAX GUIDE, ALL STATE UNIT 1043 (1970).

In the jurisdictional area, Public Law 86-272 seems rather to have had the effect of taking away the states' incentive to develop more definite and equitable statutory minimum jurisdictional standards covering all areas of multistate business. See, e.g., comments by Martin Huff, infra note 283.

The introduction of further congressional legislation in 1965 resulted in the drafting, under the auspices of the Council of State Governments, of The Multistate Tax Compact, as of mid-1970 adopted, or conditionally adopted, by 21 states. P-H STATE & LOCAL TAXES, §§ 5101-08, 5801-6312 (1970). The compact represents one of the states' alternatives to further federal encroachment on their taxing prerogatives. The compact deals most immediately with income, capital stock, gross receipts, sales and use taxes and provides for study, recommendations and certain services by the Multistate
This article will analyze one of the central constitutional questions not fully answered by the *Northwestern States* decision, nor by subsequent federal or state legislative action: What "minimum contacts are sufficient to satisfy due process requirements for the valid imposition of a state tax on or measured by the corporate net income of a foreign, out-of-state based corporation?" The analysis of this

Tax Commission that could be applied to other state and local taxes also. The compact is managed by the Multistate Tax Commission, composed of one member from each party state. *Id.*

12. While analogous criteria are applied to unincorporated foreign firms or individuals having business or income contacts with the potential taxing state, most recent cases involving questions of state income tax jurisdiction concern corporate rather than individual taxpayers. *But see* Alaska v. Petronia, 69 Wash. 2d 460, 418 P.2d 755 (1966).

13. For this discussion, a foreign corporation is one organized or incorporated under the laws of a state other than California or under the laws of a foreign country.

14. This article concerns itself with that type of corporate net income which was at issue both in *Northwestern States* and in the subsequent congressional intervention via Public Law 86-272—net income from multistate business activity. The distinction between income from activities in the course of the taxpayer's trade or business ("business income") and income from nonbusiness or investment activities ("nonbusiness income") has received explicit recognition in the Uniform Division of Income for Tax Purposes Act (UDITPA), *supra* note 11 and in the uniform regulations proposed thereunder by the Committee on Uniform Income Tax Regulations of the National Association of Tax Administrators on November 23, 1970. These regulations contain a lengthy proposal and a multitude of examples attempting to distinguish between business and nonbusiness income for purposes of allocating or apportioning income among the states. *See Proposed Regulation 1, Statement of Proposed Regulations 1-11* (1970).

Even though UDITPA, adopted by California in 1966, is a statute prescribing rules for allocation and apportionment rules rather than jurisdictional rules, Franchise Tax Board personnel have informally indicated that they would use UDITPA guidelines in resolving jurisdictional questions. *See note 49 infra*. The regulations indicate that "income of the taxpayer is business income unless clearly classifiable as non-business income . . ." and note that labels "such as interest, rent, royalties, capital gains" will not control the determination of such status. The determinative test seems to be whether or not the property from the ownership, renting, sale or use of which, income is derived was employed or recently employed in relation to the taxpayer's one or more principal business activities. *See also* Sarver & Hynes, *Proposal for a Uniform Regulation on Business Income Under UDITPA*, 22 Hastings L.J. 31 (1970).

If an out-of-state company has sufficient in-state business activity to give the state tax jurisdiction, then investment income will technically pose only an allocation and not a jurisdictional problem. *But if the taxing state is not able to base its jurisdiction upon the out-of-state company's business activities, or if the out-of-state company conducts no business activities in the taxing state, then the question of jurisdiction based on the out-of-state company's derivation of nonbusiness or investment income from a taxing state arises. Because of the existence of definite rules defining real or fictitious location of property, jurisdiction based on receipt of nonbusiness or investment income is generally much more readily determinable and, in any case, involves substantially different concepts of territorial presence than jurisdiction claimed on the basis of business activities within or touching the potential taxing state. A discussion of these concepts is beyond the scope of this article.
question will be three-fold: First, present constitutional guidelines and California's conformance to such guidelines will be examined, and a theory of current constitutional nexus requirements will be suggested.

Second, California's net corporate income tax jurisdictional rules, and their concrete applications, will be discussed in light of the impact of Public Law 86-272 and legislation at the state level. The emphasis will be on the significant problems of interpretation surrounding the application of Public Law 86-272 to which state tax administrators and courts have addressed themselves during the past decade.

Finally, because both California and federal law have largely ignored the important quantitative aspect of constitutional minimum nexus guidelines suggested by the Northwestern States line of Supreme Court decisions, an alternative which incorporates such a quantitative minimum in a practical, visible and understandable manner will be suggested as a preferable solution to the problem of establishing minimum jurisdictional standards for state net income taxation of the multistate corporation.


There must be some play in the joints of the constitutional structure if it is to stand the stresses of a changing civilization. . . . We do better to adapt our minor constitutional tolerances to the needs of the times through the case-by-case judicial process.

If the Supreme Court did not exist, . . . we should have had to create it much in its present form. Law making is a complex and important power, much too important to leave solely to legislators.15

One thing is certain after Northwestern States and its immediate progeny.16 Even though the income of a foreign, out-of-state based corporation is derived entirely from activities wholly in furtherance of interstate commerce, constitutional barriers no longer exist to prevent taxation of such income, so long as the corporation's in-state business activities have some regular, systematic and substantial connection with and physical presence within the taxing state.17 Less certain is the precise point at which the in-state activities of the foreign, out-of-state based corporation would be considered to have fallen below

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that level of regular, systematic, and substantial connection at which, to borrow the Court's language, the corporation was "sufficiently involved in local events to forge 'some definite link, some minimum connection' sufficient to satisfy due process requirements."18

Neither Northwestern States, nor the March 2, 1959, Supreme Court per curiam affirmance in E. T. & W. N. L. Transportation Co. v. Currie,19 nor the Court's dismissal of appeal and denial of certiorari in Brown-Forman20 presented the proper occasion for the establishment of standards of minimally sufficient nexus. The Court wasted few words in disposing of the nexus issue in Northwestern States; such summary disposition, however, meant only that the Court found no minimum nexus question on the facts presented. It did not mean that such a question would not be proper in a different case. Thus, none of these three decisions warrant the conclusion stated by the Chairman of the Select Committee on Small Business at the opening of its hearings on April 8, 1959, "that the Court has ruled finally that a State may levy and collect taxes from out-of-state businesses which have any commercial dealings at all in that state."21

Northwestern States did suggest guidelines as to the various kinds of contacts with the taxing state which would be required to satisfy constitutional due process requirements for the valid imposition of a tax. In addition to requiring a reasonable conceptual relationship between the tax and the object or activity which is the subject of the tax,22 the Northwestern States Court spoke of taxpayers being "sufficiently involved in local events" and of conducting "substantial income-producing activity in the taxing States"23 to point out respectively the local quality and the substantial quantity of income-producing activity or involvement necessary to forge the sufficient nexus.

A. The Qualitative Nexus Requirement

Qualitative sufficiency of nexus requires "local" activity or in-

22. As a preliminary requirement, the Court seems to suggest the necessity of both a logical and practical relationship between the attempted tax levy and the activities of the corporation within the taxing state. 358 U.S. at 452, 464.
23. Id. at 465 (emphasis added).
volvement. The practical question is, what manifestation of local activity or involvement will satisfy this requirement?

Certainly the existence of a local sales or administrative office for the efficient handling of the solicitation of orders for sales of its products, and for the processing and forwarding of such orders for acceptance and filling from out-of-state stocks of goods, would satisfy the requirement; for this would be similar to the office operated by the Northwestern States Portland Cement Company. Also, the existence of a "sales-service office" would satisfy the requirement; for this would be similar to the one in the *Stockham Valves* case. But *Northwestern States* was hardly necessary to sustain the constitutionality of tax jurisdiction based on these kinds of local activity; the Court's per curiam affirmance of *West Publishing Co. v. McColgan* 24 had already established as much.

Although related promotional or customer service activities conducted by the corporations' employees together with the maintenance of in-state corporate sales offices certainly added to the flavor of the taxpayers' physical presence, in this writer's opinion regular and systematic solicitation activity conducted by local representatives is by itself sufficient to satisfy the qualitative nexus requirement of local activity or involvement. In *Northwestern States* the Court's opinion indicates that the qualitative nexus requirement was satisfied in each case by the in-state salesmen's regular and systematic course of solicitation of orders. 25 The Court's denial of certiorari in *International Shoe Co. v. Fontenot* 26 constitutes further evidence that the Court's majority intended to adopt regular and systematic solicitation activity as the constitutional standard for state net income tax jurisdiction over foreign, out-of-state based corporate enterprise. That case was tried and affirmed by the Louisiana Supreme Court on the stipulation of fact that International Shoe's "sole activity within . . . [the taxing state] consists of the regular and systematic solicitation of orders for its product by fifteen salesmen." 27 Thus, personal in-state solicitation activity must have been considered sufficient by the United States Supreme Court to satisfy the "activity in the taxing state" or "involvement in local events" qualitative aspect of the constitutional

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25. *See* 358 U.S. at 460-61.
27. 236 La. at 279, 107 So. 2d at 640.
nexus guidelines suggested by *Northwestern States*. The question still remains, however, whether the local activity or involvement test would require some *physical* as opposed to purely economic involvement.


   While the presence of an out-of-state corporation’s property in the state, or the presence of its employees engaged in solicitation activities, was the precise form of “involvement in local events” in *Northwestern States*, such presence of property or employees may not logically seem necessary in situations where the corporation’s income production depends less heavily on the efforts of real or human capital present within the taxing state. Nevertheless, some local physical presence has generally been required to satisfy constitutional qualitative nexus standards.\(^{28}\)

   **a) Economic Presence**

   The opinion that arguably has gone the furthest in interpreting *Northwestern States* as a carte blanche for aggressive state tax administrators was written by the Oregon Supreme Court in *American Refrigerator Transit Co. v. State Tax Commission*.\(^{29}\) The taxpayer (ART) owned and was in the business of renting or leasing railroad refrigerator cars to railroads for use in their transportation service business. ART itself was not a common carrier, issued no bills of lading, had no dealings with shippers and published no tariffs of rates for shippers. ART had no rental agreements with railroads operating in Oregon, nor, under the interchange procedures used by railroads, did it have control over the presence of its cars in Oregon. No rental agreements or leases were executed in Oregon, nor were cars delivered to junction points in Oregon.

   Under the applicable Oregon net income tax jurisdictional statute, the Tax Commission asserted that ART had “income derived from sources within [Oregon]” since ART’s income included “income from tangible . . . property located or having a situs in [Oregon].”\(^{30}\) The Oregon Tax Court found the contrary on the ground that insufficient nexus existed for the imposition of the tax.\(^{31}\)

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30. *Id.* at 343, 395 P.2d at 129.
31. *Id.* at 343-44, 395 P.2d at 129.
The Oregon Supreme Court reversed the trial court in an opinion which noted that

[The connection between the taxing state and the out-of-state taxpayer necessary to establish nexus is essentially an economic rather than a physical relationship. The theory is that a state is free to exact a reasonable tribute from those using its economic resources.

[T]he nexus exists whenever the corporation takes advantage of the economic milieu within the state to realize a profit.\(^{32}\)

Since the taxpayer’s property was present in the taxing state, perhaps the quoted remarks were unnecessary as a basis for the holding. The Oregon Court recognized the narrower “presence of property” ground upon which tax jurisdiction could have been based,\(^{33}\) as well as the need for imposing some requirement of immediacy or directness in the use by the taxpayer of the state’s economic milieu.\(^{34}\) Nevertheless, the Oregon Supreme Court continued with further dicta as to the extent of Oregon’s taxing jurisdiction:

Nexus may be found even where neither property nor personnel of the taxpayer is employed within the taxing state if it can be said that the state substantially contributes to the production of the taxpayer’s income. Thus, apart from Federal Legislation [such as Public Law 86-272] it would seem to us that income derived from the sale of goods in Oregon by a non-resident corporation relying entirely upon radio or television advertising would be taxable in this state.\(^{35}\)

b. PHYSICAL PRESENCE

Whatever the worth of the Oregon Court’s dictum in *American Refrigerator Transit* in terms of logic and vision of possible future technical innovations which would make physical nexus an inadequate standard,\(^{36}\) any implication that jurisdiction to tax a foreign, out-of-state based corporation requires only an economic rather than a physical involvement goes beyond current constitutional restrictions on allowable state tax jurisdictional reach. The necessity of some non-trivial physical rather than economic local involvement was clearly stated by the United States Supreme Court in *National Bellas Hess, Inc. v. Department of Revenue*.\(^ {37}\)
In *National Bellas Hess* Mr. Justice Stewart, speaking for a six-man majority, denied Illinois jurisdiction to require use tax collections on mail order sales to Illinois residents from a Delaware mail order house domiciled in Missouri. The out-of-state seller neither owned nor rented property, nor maintained any office, warehouse or any other place of business, nor any agent, salesman, canvasser, solicitor or any other representative in Illinois, nor did it advertise on any Illinois broadcast media or in any Illinois publications. Its only contacts with Illinois were biannual mailings of the company's catalogue to active or recent customers, supplemented by occasional flyers. Orders for goods were received by mail and filled from the company's Missouri plant by mail or common carrier. The Court noted:

The case in this Court which represents the furthest constitutional reach to date of a State's power to deputize an out-of-state retailer as its collection agent for a use tax is *Scripto, Inc. v. Carson*, 362 U.S. 207, 80 S.Ct. 619, 4 L.Ed.2d 660. There we held that Florida could constitutionally impose upon a Georgia seller the duty of collecting a state use tax upon the sale of goods shipped to customers in Florida. In that case the seller had "10 wholesalers, jobbers, or ‘salesmen’ conducting continuous local solicitation in Florida and forwarding the resulting orders from that State to Atlanta for shipment of the ordered goods." 363 U.S., at 211, 80 S.Ct., at 621.

But the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States mail...

In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction which [the Court's prior] decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business. But this basic distinction, which until now has been generally recognized by the state taxing authorities, is a valid one, and we decline to obliterate it.38

The "basic distinction" drawn by the majority between out-of

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38. 386 U.S. at 757-58.
state sellers with retail outlets, solicitors or property within the state and those who do no more than communicate with in-state customers by mail or common carrier was totally rejected by Mr. Justice Fortas, speaking for himself, Mr. Justice Black and Mr. Justice Douglas. These dissenters found no meaningful distinction between *Scripto* and *Bellas Hess*. They completely ignored the physical aspect of local activity or involvement and strongly urged the adoption of what, in fact, would be the economic nexus standard of the above-quoted *American Refrigerator Transit* dictum. They stressed the existence of "large-scale, systematic, continuous solicitation and exploitation" of the taxing state's consumer market and the "substantial, regular, and systematic" conduct of business in the taxing state as the factor determinative for finding sufficiency of nexus.

While a division does seem to exist within the Court, the rationale requiring a nontrivial physical activity or involvement in local events in order to fulfill the qualitative nexus requirement seems to have the upper hand. One policy reason for continued adherence to a requirement of some nontrivial "physical" activity or involvement may be the difficulty of defining the boundaries to purely economic involvement.

Another, albeit less realistic policy reason may be found in the reference to the "controlling question" which the Court has repeatedly noted as underlying both the qualitative and the quantitative aspects of minimally sufficient nexus: namely, whether by "the practical operation of [the] tax the state has exerted its [taxing] power in relation to opportunities which it has given, to protection which it has afforded, to benefits which it has conferred. . . ." Thus, state governments can tax outsiders when the outsider takes advantage of the constitutional right of access to local markets and uses in-state facilities. But where the person accorded the commerce clause right of access to local markets uses no facilities and receives no actual or potential tangible protection of person, property or activity within the would-be taxing state, there may be nothing for which the state will be entitled to ask a return.

39. Id. at 764-65 (dissenting opinion).
40. Id. at 761-62.
43. Id.
2. California's Requirement of Physical Presence

California Franchise Tax Board Regulation 23040(b) has, since its promulgation in 1952, provided that California will not claim corporate income or franchise tax jurisdiction over a foreign corporation selling goods to California customers pursuant to telephonic, telegraphic or mail orders or pursuant to orders taken by independent contractors, where the corporation maintains no employees or stock of goods in California and goods are shipped only by mail or common carrier to customers in this state.\(^4\) Although the constitutional question of whether California could have obtained tax jurisdiction on the basis of such activity may not have been settled at the time regulation 23040(b) was first promulgated; such activity now seems to be clearly insufficient for establishing qualitative nexus because of the rule of *National Bellas Hess*.\(^4\)

The importance of this paragraph of regulation 23040(b) lies not only in the early anticipation by California tax administrators of the constitutionally necessary physical presence of the out-of-state corporation by virtue of in-state property or employees, but also in the clear rejection of a purely economic nexus standard\(^4\) of the type announced by Oregon Supreme Court's dictum in *American Refrigerator Transit*.\(^4\) A "Nexus Questionnaire" was sent to state tax administrators in 1963 by the House Special Subcommittee as part of its study leading to the 1964-1965 Report. Responses by California's Franchise Tax Board staff indicate that the above mentioned exemption from California corporate income tax jurisdiction is not destroyed despite the fact that (1) sales catalogues are mailed to prospective customers in this state, or (2) the out-of-state seller's goods are exhibited at space leased in this state occasionally and for short periods of time.\(^4\)

Conversations with Franchise Tax Board staff officials indicate that such immunity from California net income taxation, despite mailing

\(^{44}\) *CAL. AD. CODE* tit. 18, ch. 3, subch. 3, Reg. 23040(b) (repealed Apr. 2, 1970). Initially enacted in 1952, this regulation was enacted in another section of the code in 1960. *CAL. AD. CODE* tit. 18, ch. 3, subch. 3.5, Reg. 23040(b). Consequently, two identical regulations existed under separate subchapters from 1960 to 1970. The repeal of the regulation in subchapter 3 did not affect the position of the Franchise Tax Board because of the continuing existence of the regulation in subchapter 3.5.


\(^{46}\) See text accompanying notes 29-35 *supra*.


\(^{48}\) See 1 H.R. REP. No. 1480, *supra* note 1, at 148-49.
of catalogues or short-term in-state display of catalogues, continues as effective board policy at this time.\textsuperscript{49} Such conversations further indicate that any other type of in-state advertising which does not involve the presence in California of the out-of-state corporation's employees or property will not be taken as a basis for asserting income tax jurisdiction regardless of whether the advertisement appears in national or local newspapers or periodicals, or on national or local broadcast media.\textsuperscript{50} This further confirms the notion that California and constitutional law, as currently interpreted by Franchise Tax Board staff personnel, require some in-state \textit{physical} as opposed to purely \textit{economic} presence of the out-of-state seller for an assertion of California corporate net income tax jurisdiction.

To a large extent the importance of this exemption from California's tax jurisdictional reach, where the only California "presence" of the seller (aside from sales to customers in this state) is mail order, telephonic or telegraphic solicitation, or public newsprint or broadcast media advertising, may have become less important, especially in the sale-of-goods area because of the existence of Public Law 86-272.\textsuperscript{51} Nevertheless, the existence of this exemption may have the effect of providing strong taxpayer argument for similar exemption from California tax jurisdiction in the area of personal services which an out-of-state seller could render to California customers without the presence of its property or employees in this state. "Remote control" rendering of personal services may develop to a much more substantial extent in the not-too-distant future as a result of improvements and innovations in long-distance communication devices.

Suppose, for example, that technical improvements and production economies make electronic transmission of documentary and "live" visual information, via long-distance xerography and picture phones, an everyday business reality. A Cambridge, Massachusetts, based computer firm may then, from its home office, be able to consult with a prospective California purchaser of its complex computer system on all the special use requirements and specifications of the California purchaser. It may also be able to direct and supervise by video phone the California installation of its product by independent California

\textsuperscript{49} Informal comments of Franchise Tax Board legal and audit staff personnel during office conference with this writer at Sacramento, California, on September 8, 1970 [hereinafter referred to as Informal comments]. The positions taken by Franchise Tax Board staff personnel at that meeting were confirmed in several subsequent discussions with individual staff members.

\textsuperscript{50} Informal comments, supra note 49.

\textsuperscript{51} See text accompanying notes 117-99 infra.
engineers and conduct all the post-installation inspection activities. Thus, the potential taxpayer could remain within the exemption of regulation 23040(b). Franchise Tax Board personnel have informally noted that the regulation does not contemplate this sort of situation. Nevertheless, under the regulation as now worded and under the writer's theory of current constitutional minimum qualitative nexus requirements, a taxpayer under similar circumstances may escape California's tax jurisdictional reach.\(^5\)

As technology further overcomes the burdens of effecting sales of goods and services over long distances, and as state tax laws and their administration and collection procedures become more uniform and less burdensome, the Supreme Court may be asked to reexamine its tradition-based decision in \textit{National Bellas Hess}.\(^5\)\(^3\) The Court may find it necessary to allow state tax jurisdiction to extend to situations where physical presence of the out-of-state seller of goods or services is neither a requisite to the conduct of substantial local business nor a bar to the nonburdensome imposition of taxes by the state of sale. Until such time, the exemption from California tax reach under regulation 23040(b), paragraph one, probably represents a fair and accurate interpretation of California law.

\section*{B. The Quantitative Nexus Requirement}

\subsection*{1. Substantiality: Continuous, Regular, Systematic}

Turning to the second or \textit{quantitative} aspect of minimally sufficient nexus suggested by the \textit{Northwestern States} decision—to the requirement of \textit{substantiality} of income-producing activity in the taxing state or \textit{sufficiency} of the involvement in local events therein—the brevity of the Court's comments again requires an examination of the facts underlying this and related decisions. The Court in \textit{Northwestern States} spoke of regular and systematic solicitation by Northwestern States Portland Cement Company employees in Minnesota and their regular and systematic taking and forwarding of those orders for out-of-state approval; the Court also spoke of the regular solicitation, receipt and forwarding of orders for out-of-state approval, and promotion of business and goodwill by Stockham's Georgia representative.\(^5\)\(^4\)

\begin{footnotesize}
\begin{itemize}
\item 52. Informal comments, \textit{supra} note 49.
\end{itemize}
\end{footnotesize}
Although not expressly mentioned, the *continuous* presence of the taxpayer's employees in the respective taxing jurisdictions can be assumed.

The Court further alludes to "sales which are shown to be promoted by vigorous and continuous sales campaigns through a central office" in *Northwestern States* and a "largely identical . . . course of conduct . . ." in *Stockham.* Regular, systematic and substantial revenue producing activity was present in all cases upholding state jurisdiction to tax which the Supreme Court considered in the *Northwestern States* decision. The conduct described in the state court opinions on which the Court subsequently refused to elaborate was equally regular, systematic and revenue productive for the companies involved.

*Miller Bros. v. Maryland,* cited by the Court in *Northwestern States* without embellishment, may indicate the type of quantitative insufficiency of local activity on the basis of which the Supreme Court would continue to deny the existence of sufficient nexus. In *Miller Bros.* the sales had been made at the seller's Delaware retail household furniture store, both on a cash and on a credit basis, to customers, some of whom were Maryland residents. The appellant would make deliveries to the home of his customers, including Maryland residents. Some Delaware broadcast advertising and regular newspapers undoubtedly reached Maryland residents since both broadcasts and newspapers had some audience and circulation in the neighboring state. Regular mail circulars were sent to everyone who had purchased from the appellant and thus reached some Maryland residents. But no resident agents or solicitors were maintained in Maryland; no telephone orders were accepted; and no advertising was conducted in Maryland newspapers or through Maryland broadcasting stations. Under the above facts, the Supreme Court held that Maryland did not have jurisdiction to require that the out-of-state seller collect the Maryland use tax on sales to Maryland residents.

If anything in the repeated language of the decisions does char-

55. *Id.* at 465.
56. *See* Ott v. Mississippi Valley Barge Line Co., 336 U.S. 169 (1949); West Publishing Co. v. McColgan, 328 U.S. 823 (1946); International Shoe Co. v. Washington, 326 U.S. 310 (1945) (here the occasion for taxability was not the derivation of income, but rather the payment of wages; and it was this activity which was conducted systematically and with sufficient regularity and substantiality); Wisconsin v. J.C. Penney Co., 311 U.S. 435 (1940).
57. Cases cited note 12 *supra*.
59. *Id.* at 342-43.
acterize quantitative substantiality, it is the idea of “vigorous and continuous sales campaigns,” “regular and systematic course of solicitation,” “large-scale, systematic, and continuous solicitation and exploitation of the [taxing state’s] consumer market,” the conduct of “substantial, regular and systematic business” and “active and aggressive operation.” Of course, it need hardly be mentioned that the entire formula of substantiality, regularity and systematicity of in-state income-producing activity may have a different meaning for different businesses. Nevertheless, it should not be too difficult in practice to contrast the notion of a regular and systematic in-state conduct of activities, or involvement in local events, to the notion of “occasional” and “incidental” activity or transactions which the Court ascribed to the protesting appellant’s conduct in Miller Bros. v. Maryland.

2. Substantiality: Amount of Revenue Derived from Taxing State

Evidence of large absolute amounts of in-state revenue as well as large percentages of total company revenues allocable to in-state activities may be important evidence in establishing quantitative substantiality of nexus. Proportionately larger absolute amounts or per-

61. Id. at 454.
63. Id. at 454 (dissenting opinion).
65. Id.
66. With respect to the Cement Company’s activities in Northwestern States, the Court noted “almost half of the corporation’s income is derived from the taxing State’s sales.” Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 465 (1959). In E.T. & W.N.C. Transportation Co. v. Currie the North Carolina Supreme Court noted that “the agreed stipulation of facts does not state . . . the amount of money [the taxpayer] receives in North Carolina for bringing in or carrying out freight. However, it would seem from a consideration of the entire agreed stipulation of facts that . . . the money it collects in North Carolina in its business [is] considerable.” 248 N.C. 560, 576, 104 S.E. 2d 403, 414 (1958), aff’ed, 359 U.S. 28 (1959). In Brown-Forman Distillers Corp. v. Collector of Revenue, while the Louisiana Supreme Court rejected the taxpayer’s “belated contention [of deprivation] of due process” without comment on the substantiality of taxpayer’s activity in that state, the taxes assessed against the appellant taxpayer alone amounted to almost $19,000 for a 5-year period. 234 La. 651, 658, 101 So. 2d 70, 72 (1958), appeal dismissed & cert. denied, 359 U.S. 28 (1959). Even though the Louisiana Supreme Court made no mention of the fact in International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640 (1958), cert. denied, 359 U.S. 984 (1959), a Louisiana tax official pointed out that the International Shoe Company had over $5,000,000 in Louisiana sales. Developments in the Law, 75 HARV. L. REV. 953,
centages would probably be required to be shown for smaller companies than for larger concerns to support the existence of quantitative nexus. The policy reason for the quantitative nexus requirement is clearly in part the absolute cost burden imposed by tax law compliance in more than one taxing jurisdiction. The House Special Subcommittee's study of compliance costs as a function of the size of the multi-state taxpayer, while not totally conclusive, has shown compliance costs to be only loosely correlated with business size. A given cost of compliance may be too high relative to a certain percentage of in-state activity for a small company whereas it would not be too high for a large company with the same or lesser in-state percentage of activity.

The basic problem is pointed out in the study published by the House Special Subcommittee:

When compliance cost is compared with tax liability a very different picture emerges. Under the multistate tax system, compliance costs are a large enough proportion of total tax liability to bring the efficiency of the system into serious question. A prime factor in this inefficiency is fragmentation of liability among the states, which results in a large number of returns on which less liability is reported than the immediate cost of preparing and filing returns. The presence of these returns, and others on which cost is a high proportion of liability, helps explain the present low standards of enforcement and compliance. Potential compliance cost has created pressure against performance of all the tax accounting and filing necessary to satisfy the requirements of law.

In addition to amount and percentages of gross receipts, in-state expenditures would probably also be important evidentiary factors in establishing presence, but not necessarily absence, of quantitative substantiality.

3. **Sufficient Nexus for Taxation v. Sufficient Nexus for Service of Process**

The quantitative sufficiency aspect of state income tax jurisdic-

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68. *Id.*

69. *Id.* at 382-84.

70. *Id.* at 382-84.

tional nexus has been confused to some extent by repeated analogies to the constitutional minimum nexus required for acquiring in personam jurisdiction over out-of-state defendants. The most startling obfuscation in this area was performed by Chief Justice Traynor in the case of *West Publishing Co. v. McColgan.*

On the basis of West's substantial income-producing activities in California, the California Supreme Court could have found California's jurisdiction to tax unobjectionable on due process grounds without the reference to *International Shoe Co. v. Washington.* Instead, the California court, after reciting the book publisher's substantial California activities, went on to justify the lack of due process objectionability by comparing the situation before it to that in *International Shoe:* "the activities . . . which served as the constitutional basis for the imposition of the tax there involved were less extensive than the activities of [the West Publishing Company in California]."

The tax involved in *International Shoe* was ear-marked for special purposes (for Washington's unemployment compensation fund) and was measured as a percentage of wages payable annually by each employer for his employees' services in the state. The United States Supreme Court in *International Shoe* accepted the facts in the record that during the years in question the company employed eleven to thirteen salesmen who resided in Washington, whose principal activities were confined to that state, and who were compensated by commissions based upon the amount of their sales. The commissions for each year totaled more than $31,000.

The major portion of the Court's opinion in *International Shoe* was not concerned with the State of Washington's claim of the state's substantive or legislative jurisdiction to tax, but rather with the subject of the corporation's amenability to suit and service of process in that state. To the matter of the state's jurisdiction to tax, the Court devoted one short paragraph summarily sustaining Washington's right to impose the specific-purpose tax. Thus Chief Justice Traynor's reliance on *International Shoe* as implying a much lower nexus than in *West Publishing Co.* between taxing state and corporate activity within that

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72. 27 Cal. 2d 705, 166 P.2d 861, aff'd, 328 U.S. 823 (1946).
73. *Id.* at 711, 166 P.2d at 865.
74. 326 U.S. 310 (1945).
75. 27 Cal. 2d at 714, 166 P.2d at 866.
76. 326 U.S. at 310, 312 (1945).
77. *Id.* at 313.
78. See *id.* at 316.
79. *Id.* at 321.
state was inapposite. There was in fact quite a substantial nexus in *International Shoe* when the relationship between the tax and the transaction for which the tax is exacted is examined. Close functional relationship existed between the activity conducted and the tax imposed in *International Shoe*.\(^8^0\)

A policy behind more substantial nexus requirements for tax jurisdictional purposes in contrast to judicial jurisdictional purposes is supported by a benefits versus burdens analysis. In the courts' furthest reach, in personam jurisdiction over defendants through the medium of long-arm statutes has brought out-of-state defendants before the courts of the forum state because the defendant's availment of the state in connection with the defendant's business created a great risk of loss or potential for serious injury or damage.\(^8^1\) Even slight availment by an out-of-state defendant, such as that represented by shipment of one faulty machine manufactured by the defendant,\(^8^2\) may cause substantial injury. As a consequence, an injured party should be able to bring the manufacturer before a court of his own state. Where the plaintiff alleges a physical injury, courts often require defendants to travel far to answer the complaint.\(^8^3\)

Grave risks of injury or damage justify conferring a benefit on the injured party and casting a burden on the alleged tortfeasor. But in the area of tax jurisdiction, where the substantiality of the out-of-state corporation's activities within the state is so minimal as to be in question, no such risks exist. The loss of revenues of which the state may complain would be insignificant since the revenue lost would bear a fairly direct relationship to the quantitative substantiality of the out-of-state corporation's activities in the state.\(^8^4\) True, this may not be the case in the area of mail order sales or in that of federally protected sales solicitation activities under Public Law 86-272, but here a higher authority (qualitative nexus requirements or congressional

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80. The tax was a contribution to the Washington State unemployment fund, exacted for the privilege of employing persons in Washington and measured by a percentage of wages paid to such employees (in the actual case, by commissions paid to the shoe company's Washington solicitors). *Id.* at 313-14.


84. Thus the tax revenue loss to the state from its failure to obtain tax jurisdiction over a company which has made ten sales of $50 items, or a few hundred sales of $5 items, in the would-be taxing state is hardly comparable to the loss incurred by the explosion of one of those items which destroys the eyesight of the user.
fiat) has determined that the state is not entitled to those revenues.\textsuperscript{85}

Where, however, that right to ask a return exists (because of sufficient qualitative or "physical" presence or lack of congressional protective intervention) there would seem to be little likelihood of great revenue loss unless the out-of-state company has engaged in quantitatively substantial in-state income-producing activity.

The other side of the benefits versus burdens argument also suggests that a higher quantity of activity should be required for tax jurisdiction than is required for judicial jurisdiction. If the right of the state to ask a return has not been forbidden under the commerce clause or under the physical activity or involvement aspect of due process nexus requirements, the question is whether the state has given anything for which, in all fairness, a return ought to be due from the out-of-state company. This return will involve not only a stated dollar amount in tax, but also may involve a greater unstated amount in compliance cost.

An important consideration is that the opportunities, protection and benefits afforded by the would-be taxing state must bear some reasonable relationship not only to the tax sought to be imposed, but also to the potential taxpayer's additional administrative and operational costs, legal and accounting fees and the costs of facing the possibility of audit and other administrative procedures or judicial confrontations in the taxing state regarding a controverted tax liability.\textsuperscript{86} All of these costs are likely to be much greater for an out-of-state company conscientiously complying with in-state tax law requirements than for the in-state company otherwise similarly situated. The congressional study of this matter\textsuperscript{87} seems to bear out the truth of Justice Frankfurter's suggestion that, in the case of small business doing a small amount of business in states other than its home state, "the cost of such a far-flung scheme for complying with the taxing requirements of the different states may well exceed the burden of the taxes themselves."\textsuperscript{88}

Both sides of the benefits versus burdens argument would seem to indicate that the development of quantitative nexus requirements comparable to those which have been developed in the area of in personam judicial jurisdiction should be rejected for want of a good reason to make such extension.


\textsuperscript{86} See note 68 & accompanying text supra.

\textsuperscript{87} 1 H.R. Rep. No. 1480, supra note 1, at 358-59.

\textsuperscript{88} Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 474 (1959) (dissenting opinion).
The lack of comparability between standards applicable to in personam jurisdiction of courts and those relevant for state tax jurisdiction does not solve the problem of what quantum of in-state activity should be required to satisfy tax jurisdictional nexus requirements; nevertheless, it would appear that no policy reason exists to make occasional, incidental or isolated in-state income-producing activity in the would-be taxing state the basis of net income tax jurisdiction even though such policy reasons may exist in the area of judicial jurisdiction.89

4. California's Informal Quantitative Minimum

California tax statutes and regulations contain no formal quantitative minimum restricting assertion of corporate income tax jurisdiction in the case of marginally present out-of-state companies. The Franchise Tax Board staff has, however, indicated that it will not assert net income tax jurisdiction where in-state activities fall below a certain quantitatively minimal level.90

Board staff personnel speak of "isolated or occasional transactions."91 The nature of activities as "isolated or occasional" depends not only on how often the potential taxpayer engages in the activity which, but for the requirement of quantitative substantiality, would be sufficient for a claim of tax jurisdiction, but also on (1) the total amount of the prospective taxpayer's activities of this sort everywhere, and (2) the income attributable to the transactions or activities or to the latter together with functionally closely related transactions or activities.92

Thus, for example, the staff would probably not assert jurisdiction in a case involving the sale of fifty pencil sharpeners per year in California by an out-of-state manufacturer's traveling representative where the manufacturer (with annual sales of ten thousand of such pencil sharpeners in its home state and in a few other states) is engaged in sending traveling salesmen throughout the country to develop new markets, even though the sales are consummated by salesmen in

89. In fact, to this writer's knowledge, no recent major court decision, when squarely confronted with the issue of sufficiency of in-state activity to give a state tax jurisdiction over an out-of-state corporate enterprise, has drawn upon standards of sufficiency of contacts with the forum state for in personam jurisdiction purposes to validate state income tax reach. The language in existing opinions implying comparability of standards between these two areas is misleading and ought to be avoided in future decisions in this area.

90. Informal comments, supra note 49.

91. Id.

92. Id.
California. On the other hand, the sale of one computer system by a foreign, out-of-state based computer manufacturer which annually sells fifty such computers throughout the world would lead the staff to scrutinize the situation much more closely. California corporate income tax jurisdiction would probably be asserted if the sale is concluded in California by the acceptance of an order for the computer, or on any other ground which the staff feels could be used to place the transaction outside the ambit of Public Law 86-272 protection.

This informal policy is more than administrative convenience and practical restraint in enforcement tactics where revenue consequences to the state are marginal. The staff would seem to be in agreement with the proposition that more than quantitatively minimal in-state presence is required to satisfy constitutional nexus standards. As will be noted later, the formalizing of such a policy in California through appropriate legislation would relieve the area of state taxation of multistate enterprise of one of the most nagging ambiguities which presently confronts small businesses doing a small volume of business in each of several states.

PART TWO

II. Public Law 86-272 and Its Effect on California Tax Administration

About the most that can be said in describing this statute [Public Law 86-272] is that it was hastily enacted, is not very clear, and is considerably restricted in its scope. . . .

Had Congress in 1959 truly thought that small companies doing a small volume of business in several states would be overburdened as a result of the Northwestern States decision, it should have responded by setting quantitative minimum nexus standards. Instead Congress, through the substantive provisions of Public Law 86-272, added new problems of applying and complying with definitionally vague tax exemptions and created further inequity between classes and sizes of taxpayers.

Public Law 86-272 federal tax immunity standards have had a substantial impact on California income tax jurisdictional standards.

93. Id.
94. Id.
95. State ex rel. CIBA Pharmaceutical Prods., Inc. v. State Tax Comm'n, 382 S.W.2d 645, 652 (Mo. 1964).
96. See Note, State Taxation, 75 Harv. L. Rev. 955, 1009 (1962).
97. An unofficial California Franchise Tax Board summary statement opposing
The extent to which California has adjusted its law to accommodate congressional standards, and the manner in which California and its sister states, led by Oregon, have interpreted and applied the act, will take up a substantial portion of the ensuing discussion.  

Public Law 86-272 in essence provides that no State or political subdivision thereof may impose, for any taxable year ending after [September 14, 1959] . . . a tax on net income, or a tax measured by net income, on income derived within the State by a company (whether it be an individual proprietorship, partnership, or corporation) from interstate commerce if the only business activities within the State by or on behalf of such company [are] the solicitation of orders within the State for tangible personal property.  

. . . To qualify, however, all such orders must be sent outside the State for approval or rejection, and if approved, must be filled by shipment or delivery from a point outside the State.  

In addition, [the act] provides that no State or political subdivision thereof may impose such a tax merely because a company uses one or more "independent contractors" (a term defined in the bill) making sales in such State, or soliciting orders in such State for tangible personal property on its behalf.  

The chief practical problems that have been encountered in reconciling the federal law with state jurisdictional claims concern the definition of business activities which, but for the federal exemption, would subject the foreign corporation to state taxation.  

Further federal legislation of the type represented by H.R. 7906, supra note 23, indicates that Public Law 86-272 requires California to exempt "a number of companies whose gross sales in California exceed Ten Million Dollars ($10,000,000) annually" and over which California would presumably have had corporate net income tax jurisdiction in the absence of the act. See Franchise Tax Board, H.R. 4178, H.R. 7906, and S.611 The Interstate Income Acts, a History and Summary of the Income Tax Provisions of the Bills, Apr. 2, 1969 (mimeographed pamphlet).  

98. Public Law 86-272, the Interstate Income Act, has been expressly held by the highest courts of three states to be a valid exercise of a long unexercised congressional power. International Shoe Co. v. Cocreham, 246 La. 244, 164 So. 2d 314, cert. denied, 379 U.S. 902 (1964); Oklahoma Tax Comm'n v. Brown-Forman Distillers Corp., 420 P.2d 894 (Okla. 1966); Cal-Roof Wholesale, Inc. v. State Tax Comm'n, 242 Ore. 435, 410 P.2d 233 (1966); State ex rel CIBA Pharmaceutical Prods. Inc. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964). In Georgia the act has apparently been viewed as unconstitutional, while the Alabama Supreme Court in one decision ignored the act completely and chose to base its decision to exempt an interstate wholesaler from the Alabama Franchise Tax on state constitutional grounds. Compare Beaman, supra note 4, at 6.9, with Alabama v. West Point Wholesale Grocery Co., 66 CCH STATE TAX CAS. REP., ALA. ¶ 250-189 (1969). While its wisdom has been and may repeatedly be questioned, the question at this point of the discussion is not Public Law 86-272's constitutionality or its worth as a sensible piece of federal legislation, but its construction and application as a part of California's rules for corporate income tax jurisdiction.  


100. Potential problem areas for both state tax administrators and business tax
areas of uncertainty concerning the application of the Interstate Income Act involve (1) the basic scope of income-producing business activity; (2) the definition of permissible solicitation and the method by which sales, albeit generated within the meaning of protected "solicitation," may be consummated under the act; and (3) the notion of who is an "independent contractor" under the act and what activities he may engage in without causing his supplier to lose protection from state taxation otherwise afforded by Public Law 86-272.

A. The Scope of the Act: Business Activities v. Investment Activities


The Interstate Income Act's thrust is based on isolating those business activities that Congress considered insufficient by themselves to support the assertion of state tax jurisdiction over a foreign, out-of-state based corporation. Specifically, the act prohibits the imposition of a state net income tax on "the income derived within such State by any person from interstate commerce if the only business activities within such State . . ." are of certain enumerated classes. The question is one of locating the exact boundary of these classes of federally protected in-state business activity.

Varying interpretations of the statutory language are possible. Congress could have intended to protect the entire income (not just the income from interstate sales) derived from the potential taxing state by a person engaged in interstate commerce who limits his in-advisors in interpreting Public Law 86-272 in light of existing state jurisdictional claims were outlined by Walter H. Beaman during the early years of the act's existence. Beaman, supra note 4, at 6.3-.25. Certain of the interpretational questions have in the past decade been the subject of judicial decisions; others have not, and the tax advisor may expect that state tax officials will resolve almost every doubtful situation in favor of the existence of sufficient nexus to allow jurisdictional claims. 1 H.R. Rep. No. 1480, supra note 1, at 595.


102. The congressional debates imply that the phrase "interstate commerce" was used to describe activities involving the sale of goods across state lines rather than in the comprehensive sense sometimes used by the Supreme Court to justify congressional legislative power. Compare 105 Cong. Rec. 16,354 (1959) (remarks of Senator Byrd) with Wickard v. Filburn, 317 U.S. 111 (1941). Thus the phrase interstate commerce as used by the act may be interchangeable with the phrase interstate business or interstate sales of goods. Senator Byrd, in commenting on the necessity of congressional intervention following Northwestern States notes that it "may become a real necessity if the states, through their net income taxes, place a severe burden upon net income derived from engaging in interstate commerce. This [intervention] may become necessary to protect the thousands of relatively small or moderate size corporations doing exclusively interstate business spread over the several states." 105 Cong. Rec. 16,354 (1959).
terstate business activities within the potential taxing state to those allowed by the federal statute. At least one commentator seems to be of this persuasion. The preferable interpretation of the act, however, would seem to be that it was intended to restrict a state's net income tax jurisdiction only over that income of foreign taxpayers derived within such state from interstate business activity. In other words, it can be argued that the act protects a foreign, out-of-state based corporation only with respect to its income from business activities, provided in-state business activities are properly limited to the statutorily allowable extent. Under this interpretation, for example, if the potential taxpayer has income from the rental of California-located investment realty unrelated to the corporation's business of selling tangible property, then despite the fact that the corporation conducts its sales activities in strict accord with the safe harbour provisions of Public Law 86-272, California ought to be entitled to claim income tax jurisdiction over the rental income under established principles of tax law allowing states to tax income from property located within their boundaries.

The answer to the converse question, whether the ownership or rental of real or tangible personal property in California, which property is not employed in the out-of-state seller's business, ought to destroy such seller's immunity despite the fact all sales activity is conducted in compliance with Public Law 86-272, should be answered by the same reasoning process. Thus, the existence of investment income derived from the state should not destroy the protection afforded by Public Law 86-272 to income derived from properly conducted (within the immunity categories of the federal act) interstate sales activity in that state.

It may be safely assumed that the concern of Northwestern States and the congressional response thereto was with income from business activity and not with investment income. Thus, the act should not be circumvented by allowing a state to use the income from in-state investment property of a foreign, out-of-state based corporation, as the jurisdictional hook upon which to hang a broad mantle of taxation. One state has attempted, and it is not improbable that other states will follow,

103. See Beaman, supra note 15, at 6.13.

to circumvent the act by adopting a very broad interpretation of business income.\textsuperscript{105}

2. \textit{California's Extension of Taxing Jurisdiction: From Investment Income to Business Activities}

California's law on whether or not a foreign, out-of-state based corporation's ownership of realty or other investment property in California, producing investment income only, would be sufficient nexus for what might be called a "piggyback" assertion of jurisdiction to tax is no longer clear. The California Franchise Tax Board staff's original position in responding to the House Special Subcommittee's 1963 Nexus Questionnaire, as reported by the Special Subcommittee, was that a foreign, out-of-state based corporation regularly shipping goods by common carrier or mail into California, which obtained the sales through telephone or mail orders without salesmen in this state would not be subject to California corporate income tax on income from the sale of goods simply because it owned "realty in the State producing 'investment income.' "\textsuperscript{106} The same result would presumably have followed where, in addition to owning in-state investment realty, the corporation engaged in in-state business activities sanctioned under Public Law 86-272.

The Franchise Tax Board staff position on this matter, however, seems to have changed. In part this is undoubtedly due to California's adoption, for accounting periods beginning on January 1, 1967, of

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\textsuperscript{106} In order to ascertain the positions of the states concerning what type of corporate activity would lead to a claim of net income tax jurisdiction, the House Special Subcommittee staff, during February of 1963, sent a questionnaire to the tax administrator of each state that had a corporate income tax. "In this questionnaire each administrator was asked the position taken by his State as to the application of the jurisdictional rules to each of a number of hypothetical patterns of corporate activity. Thus, the questionnaire represented a series of practical questions of the kind which face a tax administrator when he learns by inquiry from a taxpayer, or upon investigation by his staff, that a corporation has certain activities in his State.

"In determining which activities were to be included in the questionnaire, it was assumed that maintenance of a factory or a retail store in the State is universally considered sufficient to create liability. Therefore, no questions were asked about such extremely localized activities. Instead, proceeding from the baseline of assumed universal liability, a series of questions were formulated to determine the effect of such other activities as the maintenance within the State of a sales office, ownership of goods in storage, and employee activities of various kinds." 1 H.R. REP. No. 1480, \textit{supra} note 1, at 147. A chart which presents the nexus standards for the various states is included. \textit{Id.} at 148-49. The possible impact on California revenue is discussed. \textit{Id.} at 433.
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the Uniform Division of Income for Tax Purposes Act (UDITPA).\footnote{107} Prior to the adoption of UDITPA, California, in apportioning net income of multistate corporations to sources within and without this state through the use of its three-factor formula, assigned sales of tangible personal property (and, thus, in a rough measure, net income from such sales) "to the state where the employee sales activity in connection with the sales occurred."\footnote{108} But under UDITPA, sales are now generally assigned to California if "the property is delivered or shipped to a purchaser" in this state.\footnote{109} Under the former "locus of employee sales activity" test there was little reason from a revenue standpoint to attempt to assert jurisdiction over such sales on the basis of in-state investment real estate ownership since such sales (and the net income associated therewith) would, in any case, be assigned an out-of-state locus for apportionment purposes in those cases where employee salesmen and hence employee sales activity were not present in this state. Under the UDITPA "sales destination" test, on the other hand, mail or telephone order sales to customers in California represent a substantial revenue potential despite the absence of in-state salesmen—\textit{provided} California can obtain tax jurisdiction over such mail or telephone order seller.

Franchise Tax Board personnel have indicated\footnote{110} that California corporate income tax jurisdiction over foreign corporations obtained on the basis of the foreign corporation’s receipt of income from California investment property will be asserted to require the foreign, out-of-state based taxpayer to allocate and apportion its business income among this state and other jurisdictions. Consequently, California will tax a portion of the foreign taxpayer’s business income which would not have been taxable had the taxpayer not subjected its investment activities to California’s jurisdictional reach. The validity of this position is questionable in light of the Board of Equalization decision in

\footnote{108. Franchise Tax Board comments regarding application of UDITPA, 4 \textit{CCH STATE TAX REP., CAL.} ¶ 203-548 (1967).}
\footnote{109. \textit{CAL. REV. \& TAX CODE} § 25135(a). Exceptions to this destination test of allocating sales occur in the case of sales other than sales of tangible personal property. Thus, gross receipts from sales of intangible personal property incidental to the taxpayer’s main business are allocated under section 25136. But if these gross receipts represent the principal business of the taxpayer (\textit{e.g.}, management, advisory or advertising services), they “will be assigned to the state where the income producing activity occurs” under the authority given to the Franchise Tax Board by § 25137. Franchise Tax Board comments, \textit{supra} note 108.}
\footnote{110. Informal comments, \textit{supra} note 49.}
Appeal of Joyce, Inc. 111

The taxpayer (Joyce) was a California corporation engaged in a unitary business with its parent United States Shoe Corporation (U.S. Shoe), an Ohio corporation, and with various other U.S. Shoe subsidiaries. 112 For present purposes, the characterization of Joyce and U.S. Shoe as engaged in a unitary business may be considered the equivalent of treating the companies as one corporation.

Aside from the fact that Joyce was incorporated in California and owned certain leasehold improvements in this state, both Joyce and U.S. Shoe conducted substantially identical operations in California through sales representatives authorized to solicit, but not to accept orders for their employers' shoes. All orders were forwarded to Cincinnati for approval and were filled by shipment from outside California. The Board of Equalization held that Joyce was not protected by Public Law 86-272 from California income tax on the basis of its limited activities since it was a California corporation, but held "the net income U.S. Shoe derived from sources within this state was not includible" in the apportionment formula to determine Joyce's California source income. 113

In effect the Board of Equalization determined that California had no power to tax that portion of a foreign taxpayer's income derived from business activities conducted within the immunizing provisions of Public Law 86-272. Similarly, it could be argued that when California obtains jurisdiction over a foreign corporation on the basis of its receipt of income from investments in California, unconnected with its properly immunized sale of goods business in California, this does not give California the power to tax income derived from interstate commerce if the only business activities within California were conducted in full compliance with Public Law 86-272.

Assume that Joyce involved one corporation called U.S. Shoe which conducted the same shoe sales solicitation operations in California which it conducted in the actual case. Further assume that the basis for jurisdiction over the Cincinnati-based corporation is not its incorporation in California, but its ownership of substantial investment property in California. Then U.S. Shoe's income from interstate shoe sales, solicited in compliance with Public Law 86-272 and as-

112. Id.
sumed to be unrelated to its ownership of investment property in Cali-

fornia, should not become subject to California tax liability to any
greater degree in the hypothetical case than in the actual case. Cer-
tainly the result would be the same as in the actual case if U.S. Shoe
were to hold its California investment property by means of a wholly-
owned California incorporated subsidiary.114 Since the distinction
between a wholly-owned subsidiary and a corporate division is frequently
ignored in other situations where unitariness is in question,115 the re-
sult urged immediately above should be no different where investment
property is owned by the foreign corporation rather than through a sub-
sidiary.

Even if nonbusiness or investment income will not be allowed as
a basis for a piggy-back assertion of jurisdiction to require allocation to
this state of business income, it may be expected that the Franchise
Tax Board staff, in efforts to minimize revenue losses resulting from
UDITPA's apportionment rules, will try to show that property, with
locus or situs in California, which has traditionally been classified as
investment property, is really a part of a potential taxpayer's business
activity. Since it is a business activity in excess of those business activi-
ties allowed by Public Law 86-272, it is cause for withdrawal of the
federal law's protection from actual business activity otherwise qualify-
ing.116 As a counter to such an approach by the California admin-
istrators, a taxpayer must argue for a narrow interpretation of busi-
ness income and for treating business income separately from invest-
ment income in determining a state's power to tax as suggested in
the previous section.

B. Business Activities within the Scope of
Permitted Solicitation

The greatest need for interpretation and clarification of Public
Law 86-272 lies in the activities which will be considered to lie
within the intended meaning of "solicitation of orders within the state
for the sale of tangible personal property" which orders are accepted
out-of-state and filled through the limited in-shipment or delivery al-
lowed by the act.117 Initially, however, it seems important to discuss

114. One member of the California Franchise Tax Board's legal staff has indicated
that the board might follow Joyce in the hypothesized situation if the investment business
were separately incorporated. Informal comments, supra note 49.
the circumstances under which the taxpayer's ownership or use of
property within the taxing state, being activity other than the permissi-
ble activity of solicitation, constitutes business activity outside the pro-
tection of Public Law 86-272.

1. **Ownership or Use of Business Property in California**

Ownership or use in this state of property, real or personal,
not held purely for investment will destroy Public Law 86-272 pro-
tection. This holds true whether the property is rented office
space, equipment used in the manufacture, distribution, or sale of
goods, or whether the property consists of an inventory or supply
of the out-of-state seller's goods. The Franchise Tax Board staff
has indicated that the only exceptions to the in-state property own-
ership or use basis for assertion of tax jurisdiction are the occasional
rentals for short periods of display space, the carrying by salesmen of
samples which are not for sale as part of the solicitation effort, the
use by salesmen of their residences for record-keeping purposes, the
in-state garaging of company-owned cars used by salesmen in their
solicitation efforts or the existence of the company's telephone listing
in the state.

Regular and systematic use of company-owned or rented vehicles

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119. Franchise Tax Bd. Reg. 23040(b) provides in part: "Foreign corporations do
not become subject to the franchise taxes simply because they send goods of California
dealers or brokers on consignment or because they maintain stocks of goods here from
which deliveries are made pursuant to orders taken by independent dealers or brokers.
Such corporations, however, are subject to the income tax, since a portion of their in-
come is attributable to the investment represented by the property located in this State.
"Foreign corporations which make deliveries from stocks of goods located in this
State pursuant to orders taken by employees in this State are engaged in intrastate busi-
ness in this State and are subject to the bank and corporation franchise tax, even though
they have no office or regular place of business in this State. . . . Corporations de-
scribed in this paragraph are doing business in this State. They are not within the pur-
view of Section 101(a) of Public Law 86-272. . . ." (emphasis added).

In its informal Guide to Corporations sent in October 1970 to foreign corporations
which "may be subject to the provisions of the California Bank and Corporation Tax
Law because the corporation owns or rents real or tangible personal property in this State
or its employees perform services in this State," the Franchise Tax Board enumerated
the following property ownership or use activities among those not protected by Public
Law 86-272 immunity: "Maintenance of a sales office, warehouse, inventory, repair
shop, parts department, purchasing office, employment office, meeting place for direc-
tors, ownership of TV films or supervising the making of such films, ownership or rental
of real or tangible personal property."

120. 1 H.R. Rep. No. 1480, supra note 1, at 148-49.
to make in-state deliveries of products sold through otherwise qualifying solicitation would probably, in the view of certain Franchise Tax Board staff personnel, destroy federal immunity. The argument in support of this position is either that the out-of-state seller had business property located in California, or that it was engaged in rendering a service (delivery of goods) outside the scope of protected activity.121 This writer's contention that jurisdiction asserted on the basis of such in-state deliveries represents a questionable interpretation of the scope of immunity provided by the federal law is discussed at a later point in this article.

The congressional proponents of Public Law 86-272 clearly intended that federal immunity ought not to extend to warehousing or maintenance of regular stocks of goods by an out-of-state seller, whether at its own in-state facilities or with independent contractors or public warehouses.122 By its deliberate use of the phrase "making sales," however, Congress must have contemplated that independent contractors would not be limited solely to the acceptance of offers of purchase or orders for goods to be filled by direct shipment or delivery to the customer from out-of-state. It might be argued, especially in light of the commonly accepted commercial law definition of "sale" as the passage of title to goods from seller to buyer,123 that an independent contractor ought to be able to receive goods on consignment from the out-of-state seller pursuant to orders already accepted by the independent contractor for delivery to, or pick up by, specific customers.124 This method of operation would allow an independent

121. Informal comments, supra note 49.
124. Sales by commission agents or brokers are normally made on consignment. The principal delivers goods to the agent or broker, who has the power, right and duty to sell the same for his principal according to the contract of consignment. See, e.g., Moulton v. William Fruit Corp., 218 Cal. 106, 21 P.2d 936 (1933). "The essence of agency to sell is the delivery of goods to a person who is to sell them, not as his own property but as the property of the principal, who remains the owner of the goods and who therefore has the right to control the sale, to fix the price and terms, to recall the goods, and to demand and receive their proceeds when sold, less the agent's commission, but who has no right to a price for them before sale or unless sold by the agent." United States v. City & County of San Francisco, 23 F. Supp. 40, 48 (N.D. Cal. 1938), rev'd, 106 F.2d 569 (9th Cir. 1939), rev'd, 310 U.S. 16 (1940).

It seems highly unlikely that Congress, by the language limiting permissible activity of the independent contractor to "making sales, or soliciting orders for sales, of tangible personal property," without further express limitation, intended anything other than the ordinary and usual meaning of the term "sales." Consignment of goods for sale, if not a necessary prerequisite to sale (goods can be sold directly to the ultimate purchaser,
contractor to transact cash and carry sales—i.e., receive the purchase price from the customer in exchange for the goods consigned for the buyer's benefit—and still avoid such maintenance of regular inventories or stocks of goods in the state as would clearly destroy federal protection.

Regulation 23040(b), paragraph three,\textsuperscript{126} nevertheless indicates that consignment of goods to independent contractors for filling orders which are otherwise qualifying sales would exceed the activity permitted to independent contractors making sales in the state or maintaining a sales office in California. For reasons mentioned in the above paragraph, this may be too restrictive a reading of sales activities permitted to a company's independent contractor. Certainly the entire area of cash or over-the-counter sales would be foreclosed to the independent contractor, and section 101(c) of Public Law 86-272 would have to be construed as allowing independent contractors to engage only in activities consisting solely of "making of contracts of sale" rather than in activities consisting solely of "making sales."\textsuperscript{126}

It should be noted that the portion of the regulation 23040(b) which purports to claim tax jurisdiction on the basis of consigned goods has not been amended since 1952.\textsuperscript{127} It represents a possible interpretation of the then existing constitutional standard. It makes no reference to and presumably does not take a definite position with respect to the exemption provided by the federal act. This paragraph of the regulation, it is submitted, must be interpreted as permitting specific consignment of goods to independent contractors for the benefit of specific buyers, thus allowing independent contractors to complete sales by delivery of merchandise.

Such an interpretation would not open the door to large-scale tax avoidance. The regulation may be validly interpreted to prohibit the general consignment of merchandise to independent contractors in any substantial amount. Either the "stock of goods" in this state could be attributed to the out-of-state seller, or the independent contractor could

\textsuperscript{125} For wording of the regulation, see note 119 supra.

\textsuperscript{126} Nothing in the legislative history of Public Law 86-272 indicates that sales by independent contractors are to be limited only to the closing of contracts of sale or to the acceptance of orders for the sale of goods. See also BEAMAN, supra note 4 at 6.23.

\textsuperscript{127} See note 6 supra.
be considered to be engaged in warehousing.\textsuperscript{128} The regulation could furthermore be validly interpreted as prohibiting consignment of goods with the independent contractor for the benefit of specific customers who were solicited not by the independent contractor, but by the out-of-state seller's in-state solicitors.

2. The Scope of Permitted Solicitation and Filling of Orders for the Sale of Tangible Personal Property

Determining the proper scope of protection accorded to certain business activities by Public Law 86-272, where no in-state business property ownership or use is involved, will be analyzed by distinguishing permissible activity from prohibited activity in four distinct areas: (a) promotional activity designed to increase general goodwill and demand for the company's products; (b) rendering of technical services related to the product sold, whether prior to the actual placing of an order or subsequent to the actual sale; (c) taking steps to assure collection of the sales price, whether by way of presolicitation or presale credit investigation or approval, by way of retention and enforcement of a security interest for the collection of the sales price or by way of repossession of the product sold; and (d) corporate executive, administrative, managerial or other presence not directly and necessarily related to the permitted solicitation of orders.

Some activity in each of the above categories may, to a greater or lesser extent, be a direct and necessary part of the permitted solicitation and sale process—depending, in each particular case, on the nature of the product and practice in the seller's industry. It is nevertheless important in tax planning to alert one's clients to possible distinctions between permissible and impermissible activities in the borderland between allowable solicitation and other activities.

a) Promotional Activity

Promotional activity other than that which takes place between the soliciting representative and the prospective customer is perhaps the area where the greatest latitude is given to the interstate seller or to his local representative. As noted above,\textsuperscript{129} advertising, even through purely local facilities, will not by itself destroy federal immunity for the interstate seller in California. Purchase of advertising space, time

\textsuperscript{128} CAL. COMM. CODE § 7102(h) defines a warehouseman, for document of title purposes, as "a person engaged in the business of storing goods for hire."

\textsuperscript{129} See note 49 & accompanying text supra.
or expertise in local publications, on local broadcast media or from local advertising agencies may require no corporate presence via employees or property in this state and as such may not even meet the level of nexus required under current constitutional standards.\(^{130}\)

A closer question is presented where the out-of-state seller has its own employees in California engaged in promotional activities apart from the actual solicitation of orders. Here the question is whether (a) the solicitation of customer’s customers, or (b) general product promotion by employees other than sales employees may be considered beyond the bounds of permissible solicitation.

\((1)\) Soliciting Customers’ Customers

Despite the fact that solicitation of orders “for the benefit of a prospective customer” is expressly permitted by section 101 (a) (2) of the federal act, the question whether this provision gave the out-of-state seller the license to promote the use of his product through in-state canvassers (variously called missionary men or detail men) was raised soon after the passage of Public Law 86-272. Oregon’s tax administrator in *Smith, Kline & French Laboratories v. State Tax Commission*\(^{131}\) urged that such activity was outside the protected scope of solicitation. The court’s framing of the issue and holding with respect to the activities of Smith, Kline’s detail men in Oregon is instructive:

Defendant contends that P.L. 86-272 creates an “island of immunity” around the solicitation activities expressly described in the statute; that solicitation of orders requires that an actual order be sought by an individual calling upon a potential customer; and that the activities of plaintiff’s employees, which merely encouraged the placing of orders with the wholesale drug firms selling plaintiff’s products, do not qualify plaintiff for exemption.

*Plaintiff contends that its Oregon employees do solicit orders for plaintiff’s customers within the meaning of P.L. 86-272 and that the statute does not require the receipt of an order by plaintiff’s employees so long as they are soliciting and encouraging the purchase of plaintiff’s products.*

In this court’s opinion, plaintiff’s activities in Oregon meet the statutory requirements for exemption. Congressional committee reports support this conclusion. . . . These reports show that Congress intended to exempt not only the specifically described phase of interstate sales efforts but also all lesser, included phases.

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\(^{130}\) Cf. Oklahoma Tax Comm’n v. Brown-Forman Distillers Corp., 420 P.2d 894 (Okla. 1966), where the Oklahoma Supreme Court held that Public Law 86-272 prevented imposition of the state income tax where the out-of-state seller arranged for newspaper, trade publication and billboard advertising through local independent agencies.

\(^{131}\) 241 Ore. 50, 403 P.2d 375 (1965).
Furthermore, the nature of plaintiff's business makes its activities in Oregon the equivalent of solicitation of orders in other, less technical businesses. Ethical drugs are generally purchased by the public from retail druggists. The drug to be purchased is selected, not by the purchaser, but by his physician. An ethical drug sales effort comparable to direct solicitation of orders for shoes, valves, or cement requires "selling" the physician on the wisdom of prescribing the particular product for his patient. By soliciting the stocking of plaintiff's products by druggists and the prescription of those drugs by physicians, plaintiff's detail men perform the same sales function in plaintiff's field that salesmen soliciting actual orders from the ultimate user perform in other businesses. A realistic legal and factual interpretation of P.L. 86-272 requires exemption of plaintiff from Oregon corporation income tax.\(^{132}\)

Despite the seemingly clear applicability of section 101(a)(2) of the Interstate Income Act to the Smith, Kline fact situation, California's 1963 position on this matter would have been in line with that of the Oregon Tax Commission\(^{133}\) and contrary to the opinion expressed by the Oregon Supreme Court. Franchise Tax Board personnel have informally indicated, however, that the result and reasoning of Smith, Kline would be followed in California today.\(^{134}\)

In Smith, Kline the Oregon Court also found that the maintenance of stocks of samples of the seller's products by the detail men at their homes for use in their promotional work was within permitted solicitation.\(^{135}\) In State ex rel. CIBA Pharmaceutical Products, Inc. v. State Tax Commission,\(^{136}\) decided by the Missouri Supreme Court some 9 months before Smith, Kline and also involving detailing activities of representatives of a major pharmaceutical house, a similar result was reached. The Missouri court noted that:

\(^{132}\) Id. at 51-56, 403 P.2d 377-78 (quoting the Oregon Tax Court). The Oregon court in Smith, Kline specifically held that the term "solicitation" was intended to describe not only the solicitation by the foreign seller's representatives of orders to be placed directly with the foreign seller but also all lesser, included phases. The notion of "lesser, included phrases" must be read narrowly in light of the Oregon Supreme Court's later statements. See Cal-Roof Wholesale, Inc. v. State Tax Comm'n, 242 Ore. 435, 410 P.2d 233 (1966), where an out-of-state seller "customarily entered into a cooperative advertising agreement in Washington with its Washington customer." Id. at 437, 410 P.2d at 234. Such cooperative advertisement agreements, in addition to other activities potentially outside the concept of "solicitation," resulted in the decision in that case that the out-of-state seller's "Washington activities clearly encompassed more than 'solicitation' only." Id. at 448, 410 P.2d at 239.


\(^{134}\) Informal comments, supra note 49.


\(^{136}\) 382 S.W.2d 645 (Mo. 1964).
The representatives explain the therapeutic value of CIBA's products to the doctors. They tell what the product is, what it will do, what dosage is desirable and what its side effects may be. The Tax Commission strenuously objected to the detail men's traveling through Missouri not only with promotional and advertising materials which they give to [CIBA's] customers—the retail druggists . . . but also with brochures, pamphlets, daily reminder calendars and drug samples which they give to doctors. Nevertheless, the Missouri Supreme Court affirmed the decision of the trial court, clearly implying that the carrying and distribution of advertising literature and samples for the use of the druggists and doctors solicited did not exceed the minimum activities permitted by Public Law 86-272.

CIBA and Smith, Kline provide persuasive authority for such practice under California law. In fact, Franchise Tax Board staff members have informally indicated that its 1963 position has been modified and that the practice of leaving literature and samples similar to those in the above cases would not by itself be sufficient to sustain California tax jurisdiction.

It should be noted that the products carried in the state must be strictly limited to samples and cannot include items for occasional resale and on-the-spot delivery. California's position seems identical with Oregon's on this point.

(2) General Product Promotion

The New Jersey Superior Court, Appellate Division, in the recent decision of Clairol, Inc. v. Kingsley reached a result contrary to CIBA and Smith, Kline in a closely similar situation involving the activities of a cosmetic producer's detail men and technical representatives in New Jersey. The activities of Clairol's detail men resembled

137. Id. at 648.
138. Id. at 651.
139. Id.
140. Informal comments, supra note 49.
141. See Cal-Roof Wholesale, Inc. v. State Tax Comm'n, 242 Ore. 435, 437, 410 P.2d 233, 234 (1966), where the Oregon court noted as one of the factors which led to the decision that the taxpayer's in-state activities exceeded the permissible limits of solicitation was that the taxpayer's Washington salesman "customarily carried with him a supply of small items which he sold and delivered within the state of Washington" (emphasis added).
142. Informal comments, supra note 49.
those of CIBA's detail men in the Missouri case. But the Clairol case differs from CIBA and Smith, Kline in that Clairol also had a second type of representative in New Jersey whose task was to call not on cosmetic retailers, but on beauty salons for the purpose of explaining uses and effects of Clairol's products and new techniques relative to the use of such products. "These people have a technical background, whereas the people calling on drugstores do not have a technical background." 

To the extent the court meant to stress that detailing activities alone provided jurisdictional nexus not prohibited by Public Law 86-272, the court's position is highly questionable. To the extent, however, that the New Jersey court meant to stress that the instructional functions, activities and services of the technicians calling on beauty salons went beyond "mere solicitation" permitted by Public Law 86-272, a more substantial interpretational question was raised. This issue was resolved in favor of a finding of "mere solicitation" where the technical or instructional activities were performed by the promotional representatives in CIBA and Smith, Kline. The existence of a second force of representatives engaged solely in technical and instructional activities made the New Jersey court's task of finding a business activity which extends "beyond the mere solicitation of orders either on its own behalf or on behalf of its wholesalers" much simpler.

By its conduct in separating the functions of promotional and technical representatives, the taxpayer in Clairol has practically admitted that it was engaged in significant activity which was separate and distinct from the solicitation performed in New Jersey. The California Franchise Tax Board staff's position that the "conducting of training courses or lectures" by a foreign seller's in-state representatives would cause loss of Public Law 86-272 immunity is aimed in part at conduct similar to that of the "technicians" in Clairol.

144. Compare id. at 29-30, 262 A.2d at 217, with State ex rel. CIBA Pharmaceutical Prods., Inc. v. State Tax Comm'n, 382 S.W.2d 645, 648 (Mo. 1964).

145. 109 N.J. Super. at 30, 262 A.2d at 217. The Clairol opinion is not entirely clear whether the above-mentioned technicians were Clairol's employees or those of "beauty jobbers" or "salon wholesalers" who purchase from Clairol and sell to beauty salons so as to qualify potentially as independent contractors. See text accompanying note 243 infra. Furthermore, it is not clear to what extent the decision is based on Clairol's other activities such as ownership of property and maintenance of business offices in New Jersey. See id. at 25, 262 A.2d at 215. The existence of such facts seems to render the comments on the detailing and technical activities of its representatives unnecessary to obtain the tax jurisdictional result reached.

146. See text accompanying notes 128-29 supra.

147. In its informal Guide to Corporations, supra note 119, the Franchise Tax
Clairol's implication with respect to promotional activity aimed at increasing general goodwill for its products and retaining its customers, over and above such promotion as is necessary to secure immediate orders, spells a setback for out-of-state sellers. The New Jersey court made a special point of quoting the testimony of the taxpayer's representative that the promotional material carried by its detail men was "used mostly for public relations, more or less."\[148\] The court noted that increased public favor of Clairol's products will eventually result in increased orders from retail druggists to wholesalers and from wholesalers to Clairol, or as in the case of its hair products from beauty salons to "beauty jobbers" and from the latter to Clairol, does not blanket all Clairol's activities with the protection afforded by the federal act to cases where the only business activity of the taxpayer is the solicitation of orders.\[149\]

Thus Clairol, with its express disapproval of the broad language of Smith, Kline, may portend a strict construction of the term "solicitation." In other words, perhaps promotional activity will be required to be more proximately connected with the placing of orders for the out-of-state seller's products rather than merely to increase public favor for the seller's product.

In *Atlas Foundry & Machine Co. v. State Tax Commission*\[150\] the Oregon Tax Court, following that state's supreme court's decision in *Smith Kline*,\[151\] considered the activities of a foreign seller's Oregon employee who "spent two-thirds of his time in Oregon promoting goodwill and sales."\[152\] The court noted that the representative's work consisted of maintaining contact with plaintiff's customers to encourage them to request bids from his firm... If a customer had a
complaint he ordinarily would contact plaintiff's office in Tacoma, 
but if the salesman was present they would advise him and he 
would send this information to Tacoma. He carried no samples 
because of the nature of the plaintiff's specialized manufacturing 
business which depended on particular orders from the buyers.153

The tax court, noting that the Smith, Kline decision held that
"Congress intended to exempt not only the specifically described 
phase of interstate sales efforts [e.g. direct solicitation of orders] but 
also all lesser, included phases,"154 held that the above-quoted general 
promotional activities were such lesser included phases of solicitation 
and hence exempt under Public Law 86-272 as interpreted by 
Smith, Kline.155 A later decision by the very same court which de-
cided Atlas Foundry sheds doubt on the current validity of the opinion 
expressed therein.156

In view of the Clairol decision, the Franchise Tax Board staff's lib-
erality on permissible advertising placed with or conducted through local 
media or agencies ought not to lead an out-of-state seller to believe 
that pervasive advertising or promotional activity can be conducted by 
that seller through its own employees without loss of federal immunity. 
Where promotional activity engaged in by employees is so extensive 
that it can be characterized as something more than soliciting orders 
from customers, or customer's customers, and especially if this pro-
motional activity is not the usual and established practice for securing 
such orders in the industry, it is likely to be considered as exceeding 
the permissible scope of solicitation under Public Law 86-272.157

b) RENDERING TECHNICAL SERVICES

The rendering of personal services by the out-of-state seller's in-
state employees, even when done in connection with an otherwise

153. Id.
154. Id. at 12,131.
155. Id. at 12,132.
156. Briggs & Stratton Corp. v. State Tax Comm'n, 2 CCH STATE TAX REP., Ore. ¶ 201-929 (Ore. Tax Ct., No. 295, 1968). The court there noted that the "decision of the Tax Court in Atlas, relied upon by plaintiff, must be considered in light of" the limitation placed on Smith, Kline through the Oregon Supreme Court decision in Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 430 P.2d 998 (1967).
157. Informal comments, supra note 49. See also, United States Tobacco Co. v. Mack, 229 Ore. 627, 368 P.2d 337 (1962), where the promotional activities of an out-of-
state seller included advertising of the products, educating retailers to perpetuate their 
sales of such products, and assisting the latter in advertising and merchandising dis-
plays. The Oregon Supreme Court found that this general promotional activity was suf-
cient under Northwestern States to remove the resulting sales from the protection of 
Public Law 86-272.
qualified and exempted solicitation and sales effort, has been expressly declared a basis for California corporate income tax jurisdiction because of activity outside that protected by Public Law 86-272.\textsuperscript{158}

Such sales-related service activity may occur at various times and in various forms during the solicitation-through-sales process. Initially, it may take the form of consultation with respect to specifications and advice on the prospective buyer's technical requirements for products for which orders are solicited.\textsuperscript{159} Such activity is particularly likely to be present where the product is technically complex or must be custom-made to the prospective buyer's requirements.\textsuperscript{160}

Service may continue after the order has been placed and accepted and while the product is being made or delivered.\textsuperscript{161} The seller may perform a service by furnishing guidance during in-state installation or construction, even if such installation or construction is performed by the buyer or by an independent contractor.\textsuperscript{162} Services may involve the inspection and approval of installation prior to operation or merely the availability of advice during start-up operations.\textsuperscript{163}

The Oregon Tax Court decision in Briggs & Stratton Corp. v. State Tax Commission\textsuperscript{164} provides the clearest judicial expression to date on the disqualifying effect of the in-state rendering of technical services as part of an interstate sale-of-goods effort by foreign sellers.\textsuperscript{165} In Briggs & Stratton a foreign manufacturer and seller of

\textsuperscript{158} Franchise Tax Bd. Reg. 23040(b), provides, in part: "Foreign corporations which have employees in this State engaged in providing personal services other than in interstate commerce are engaged in intrastate business in this State and are subject to bank and corporation franchise tax, even though they have no office or regular place of business in this State. Corporations described in this paragraph are doing business in this State. They are not within the purview of section 101(a) of Public Law 86-272, supra." The Franchise Tax Board's informal Guide to Corporations, supra note 119, gives an indication of the type of personal services which would place the out-of-state seller's activity outside the protection of Public Law 86-272.


\textsuperscript{160} Id.

\textsuperscript{161} Id.

\textsuperscript{162} Combustion Eng'r, Inc. v. Arizona State Tax Comm'n, 91 Ariz. 253, 371 P.2d 879 (1962); cases cited note 159 supra.


\textsuperscript{164} CCH STATE TAX REP., ORE. ¶ 201-929 (Ore. Tax Ct., No. 295, 1968).

\textsuperscript{165} "Plaintiff's direct representation in Oregon is by a salaried sales and service supervisor who lives in Washington and spends approximately one week of every eight in Oregon. He does not make collections or repossessions, approve credit, accept payments or make any deliveries of merchandise. The supervisor does no newspaper ad-
gasoline engines maintained direct representation in Oregon (in addition to sales through independent contractors), through a "salaried sales and service supervisor who lives in Washington and spends approximately one week of every eight in Oregon."\textsuperscript{166} The court noted that plaintiff's activities through its sales and service supervisor in Oregon are clearly in excess of solicitation of orders...  
\textsuperscript{166}Id. at 12,497.

The court noted that plaintiff's activities through its sales and service supervisor in Oregon are clearly in excess of solicitation of orders...  
\textsuperscript{167}Id. at 12,498.

Franchise Tax Board staff personnel have noted that this Oregon decision will be followed in California as a matter of administrative practice.\textsuperscript{168}  
\textsuperscript{168}Informal comments, supra note 49.

The California State Board of Equalization decision in Riblet Tramway Co.\textsuperscript{169} sheds light on another aspect of impermissible technical activity, one which may be more for the benefit of the seller than it is a service to the buyer. In Riblet Tramway the appellant taxpayer, a Washington State designer, manufacturer and seller of tramways and ski lifts, was engaged in substantial activities in California in connection with the sale of its product to a California customer. In the opinion of the Board of Equalization, Riblet Tramway Company's activities were not sufficiently restricted to permissible solicitation. The board

\textsuperscript{169}4 CCH STATE TAX CAS. REP., CAL. ¶ 203-786 (State Bd. Equal. 1967).
described the appellant's activity as follows:

In the typical situation appellant received a written solicitation from a prospective customer. In response appellant requested such engineering information as soil samples of the lift site, profile of the site, size, and other specifications of the lift. The information was furnished by the customer's engineers or independent contractors with whom the customer had contracted. After analyzing the information appellant advised the prospective customer of the parts and materials required and the cost. If the customer then wished to buy, an order was placed with the Washington office.\textsuperscript{170}

In rendering its decision the board failed to refer to the above presale activity of the appellant. Rather, its decision rested on a finding that the appellant's post-sale inspection activity exceeded that allowed under the Public Law 86-272 solicitation concept.\textsuperscript{171}

The Franchise Tax Board staff attitude on such solicitation of specifications is not clear.\textsuperscript{172} The recently issued \textit{Guide to Corporations} indicates that the furnishing of engineering functions may result in the loss of immunity under Public Law 86-272.\textsuperscript{173} Conversations with board personnel indicate that in-state consultation on design and specifications will probably be considered the rendering of personal services if such activity involves any significant technical services.\textsuperscript{174} Consequently, it may be difficult for a foreign seller of highly complex and custom-made machinery or equipment to stay within the Public Law 86-272 protected solicitation effort if its sales personnel are trained engineers who customarily consult with a prospective buyer at the latter's California place of business. Certainly, if the corporation has salesmen engaged solely in soliciting orders and technical personnel engaged only in consulting and advising with respect to specifications and engineering data in the state, the reasoning of \textit{Clairol}\textsuperscript{175} would seem to doom Public Law 86-272 immunity.

Under the present state of the law and particularly under the first paragraph of California Franchise Tax Regulation 23040(b),\textsuperscript{176} the problem of specification solicitation and related technical discussion may be solved to the out-of-state seller's advantage through telephonic or electronic transmission of charts and graphs, or long-distance video-

\textsuperscript{170} \textit{Id.} at 13,350.
\textsuperscript{171} \textit{See id.} at 13,351. This may indicate that activities such as the solicitation of specifications engaged in by the Washington seller in \textit{Riblet Tramway} may be considered a part of or incidental to solicitation.
\textsuperscript{172} Informal comments, \textit{supra} note 49.
\textsuperscript{173} See note 119 \textit{supra}.
\textsuperscript{174} Informal comments, \textit{supra} note 49.
\textsuperscript{176} \textit{Cal. Ad. Code} tit. 18, ch. 3, subch. 3.5, Reg. 23040(b).
phone consultation. Whether or not the Franchise Tax Board will take the position that such electronic visual and verbal consultation involves the in-state rendering of personal services must be left for resolution at a later date.

The proper test for determining the scope of federally protected solicitation should consider (1) whether the conduct was reasonably necessary to persuade and induce potential customers or customers of potential customers to place orders for the out-of-state seller's product;\(^\text{177}\) (2) whether the conduct is engaged in by the soliciting representative (not by a second category of pure "good will" promotional or technical personnel);\(^\text{178}\) and (3) whether the conduct precedes the placing of an actual order for the product.\(^\text{179}\)

The Franchise Tax Board staff position, while tending to accept some degree of in-state consultation on specifications, is not totally clear as to what degree would be allowed.\(^\text{180}\) The staff would clearly follow the Oregon Supreme Court's decision in a situation similar to that presented by Iron Fireman Mfg. Co. v. State Tax Commission.\(^\text{181}\) In Iron Fireman an Oregon-based seller engaged in substantial consultation with the Washington buyer in Washington. Services included special-problems indoctrination and training of the seller's engineers and metallurgist (the latter selected jointly with buyer's officials) at the buyer's Washington plant, as well as substantial course-of-production inspection, testing, repair, redesign, installation and other problem-

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\(^{177}\) Whether the activity is reasonably necessary for such persuasion or inducement ought to depend on the technical complexity of the product sold, on legal restrictions governing its sale or the solicitation of orders therefore, and on the generally accepted or customary manner used in the industry to obtain orders for the product through employee solicitation.


\(^{179}\) Conducting informal sessions to educate distributors or users of the product on techniques in the use of the product after the product has already been sold would appear to be a personal service outside the protection of Public Law 86-272. If such services are rendered, it may be safer to render them in the state of seller's domicile or in other states in which the seller is clearly subject to net income tax jurisdiction rather than in every state of sale of the product.

While after-sales service such as that performed by the technicians in Clairol may lead to future orders—and, in any case, is designed to retain customers and obtain reorders—it may be too far removed from the actual solicitation process to meet immunity standards. Courts could reasonably conclude, as is implied in Clairol, that maintenance of customer goodwill through the free furnishing of after-sale "continuing education" is not within the concept of solicitation, even though formally conducted in a manner akin to solicitation and promotion, where some substantial customer service activity is being performed under the guise of promotion.

\(^{180}\) Informal comments, supra note 49.

\(^{181}\) 251 Ore. 227, 445 P.2d 126 (1968).
The Oregon Supreme Court found that the taxpayer had engaged in more than Public Law 86-272 permissible solicitation in Washington.

Pre- and post-sale engineering and consultation work may not be clearly separable in the Oregon court's view of the situation. The continued reference to "more than solicitation" would seem, however, to indicate that the court chose to base its decision on the notion that permissible solicitation activity had been exceeded.\(^{182}\)

c) **Shipment or Delivery of Goods into the State of Sale**

Public Law 86-272 expressly provides immunity for "shipment or delivery from a point outside the State."\(^{184}\) The law does not indicate when or with what acts the immunity extended to delivery is lost. Under the Franchise Tax Board's 1963 staff position, California would have asserted corporate income tax jurisdiction where delivery of goods into the state is made in company-operated vehicles.\(^{185}\)

A good argument can be made that delivery of products into the state in company-operated vehicles should not destroy federal immunity otherwise present. Beaman notes that the words "shipment or delivery" in Public Law 86-272 suggest two different modes of getting goods to the purchaser without a loss of federal immunity:

[S]hipment would indicate sending [the goods] by a carrier, such as a railroad or a truckline. Delivery implies that the vendor takes them to the vendee himself, or that the employees of the vendor take them, or that they are taken there in conveyances owned by, or hired by the vendor.\(^{186}\)

Even discounting Beaman's argument based on the distinction between interstate and intrastate commerce, the fact that Congress used the term delivery, in contrast to and as alternative to shipment, would indicate that the 1963 Franchise Tax Board staff position may not comport with congressional intent. While delivery in company-operated vehicles may be a significant in-state activity akin to the rendering of a personal service, its protection seems expressly contemplated by the federal act.\(^{187}\)

This seems to be the expressed position of Oregon's tax admin-

\(^{182}\) Id. at 231, 445 P.2d at 127-28.

\(^{183}\) Id. at 231-32, 445 P.2d at 128.


\(^{185}\) See note 106 supra.

\(^{186}\) BEAMAN, supra note 4, at 6.18.

\(^{187}\) Id.
istrators. A published opinion of the Oregon State Tax Commission notes that:

Deliveries into Oregon by an out-of-state corporation do not render it subject to the state corporation income tax. Such activity alone is not considered as establishing sufficient nexus to enforce corporation income tax liability. It would normally appear to be a part of the solicitation of orders which would be exempt under Public Law 86-272, or it would come within the protection of Miller Bros. Co. v. Maryland, 347 U.S. 340, 74 S.Ct. 535.188

The Riblet Tramway decision is silent as to whether delivery is a protected activity.189 The Franchise Tax Board's recent statement of activities which may result in loss of Public Law 86-272 immunity,190 however, does not include delivery in company-operated vehicles. There is some indication that the staff has modified its 1963 position. The modification is desirable, at least where the delivery vehicles are not owned by the out-of-state seller and hence cannot be classified as significant company in-state property.191

Until the position of the Franchise Tax Board is clarified, the safest course is to ship goods into the state by common carrier. The informal comments of some Franchise Tax Board personnel indicate that the official staff position is still that delivery of goods into this state in company-owned vehicles will destroy federal immunity if such delivery is a systematic and substantial part of the sales process.192

188. 2 CCH State Tax Cas. Rep., Ore. ¶ 201-816 (1967). See also Atlas Foundry & Mach. Co. v. State Tax Comm'n, 2 CCH State Tax Rep., Ore. ¶ 201-604 (Ore. Tax Ct., No. 128, 1965). In this writer's opinion the reference to Miller Bros. v. Maryland, 347 U.S. 340 (1954), is unnecessary and inapposite. Miller Bros. seems to be based on the quantitative rather than the qualitative insufficiency of the delivery activities there conducted. It is submitted that delivery is a protected activity, regardless of the frequency with which it is conducted, not because of constitutional but because of federal statutory protection accorded to such activity.


190. See note 147 supra.

191. Both the property interest in the delivery vehicles and the presence of the vehicles in the state should be limited as much as possible. Thus, the out-of-state seller should seriously consider leasing the delivery vehicles outside the state of delivery, and should make certain that they are not garaged in the state of delivery and do not spend any more time there than is necessary to make the actual delivery.

192. Informal comments, supra note 49. Interesting questions are presented by the 1970 Consumer Warranty Act (new California Civil Code sections 1790-95) effective March 1, 1971, which, by imposing broad liability for repair, replacement or reimbursement upon the out-of-state seller or manufacturer of defective consumer goods covered by express warranties or representations as to their fitness or value, encourages foreign sellers to maintain or engage in-state repair, replacement or pick-up facilities. If the out-of-state manufacturer, distributor, or seller maintains an in-state pick-up service for defective goods covered by express warranty, is the seller outside the
Clearly, if a separate charge is made for the delivery, it will be considered a local personal service sufficient to destroy the out-of-state seller's immunity.  

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d) In-State Aid in Installation and Inspection of Products Sold

Another type of activity which may be outside the protected scope of solicitation and of permitted shipment or delivery of the product sold involves the degree of technical advice or aid which the out-of-state seller may render in connection with the installation of the product sold. Technical advice with respect to installation, assistance in setting up the product shipped into the state or inspection of the assembled product would probably be considered activity unprotected by Public Law 86-272.

Both the Franchise Tax Board's Guide to Corporations and recent informal conversations with staff personnel indicate that in-state assembly and installation of products properly solicited, sold and delivered in accordance with Public Law 86-272 may cause loss of federal immunity. This is especially true if such activities are a regular and substantial part of the total sales effort and are performed by the foreign seller's in-state representatives.

In Riblet Tramway the California State Board of Equalization opinion notes that "after delivery of the parts and materials the erection of the entire ski lift would be performed by the vendee or by independent contractors hired by the vendee." Apparently none of the erection work was done by the out-of-state sellers. But the Board of Equalization stated that mere "inspections constituted significant activity which was separate and distinct from the solicitation performed in this state." The same panel, therefore, would in all probability have considered that any actual aid or engineering advice in the erection of the ski lifts likewise would have exceeded permissible solicitation.

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193. Informal comments, supra note 49.
194. Id.
195. Id.
197. Id. at 13,351 (emphasis added).
The board distinguished inspection from permitted solicitation, rather than from permitted delivery or shipment into California. This may indicate a belief on the part of the board that shipment or delivery into California are acts which must be strictly limited to the plain meaning of the words and allow for no interpretational latitude. Such an attitude limits Public Law 86-272 protection in the sale of complex machinery or equipment requiring on-site erection or installation at the buyer's place of business. Franchise Tax Board staff personnel have informally indicated that they will press for this limitation.\footnote{198}

A certain amount of in-state installation or set-up work involving highly complex machinery or equipment should be allowed, if only because the out-of-state company may be subject to substantial liability in tort for injury or loss resulting from improperly installed equipment. At least in the case of products where sufficient knowledge of the technical intricacies requisite to proper functioning is available only to the seller, he ought to be allowed to perform such supervision and post-installation inspection as is reasonably necessary to protect himself against traditional liability for negligence, if not strict liability in tort, or from liabilities on account of breach of implied or statutorily imposed warranty.\footnote{199}

3. Credit Checks, Securing the Sales Price, Maintaining and Enforcing Purchase Money Security

The third category of activities closely related to, but potentially outside Public Law 86-272 protected activity involves the extent of employee in-state activity in (a) closing sales or (b) protecting the seller's rights under the agreement of sale. Public Law 86-272 protection is afforded only where the sale is technically made or closed at the out-of-state office.\footnote{200}

California Franchise Tax Regulation 23040(b) indicates that

\footnote{198}{Informal comments, \textit{supra} note 49.}

\footnote{199}{Riblet Tramway Co., 4 CCH \textit{STATE TAX CAS. REP., CAL.} ¶ 203-786, at 13,350 (State Bd. Equal. 1967), expressly recognizes that the right of inspection reserved under the sales contract involved in that case was "provided in order to prevent any possible liability to third persons and to disclaim any liability under the parts warranty to the customer if an improper installation was not corrected by the customer." Nevertheless, the Board of Equalization found that such inspections were "a significant activity which was separate and distinct from the solicitation performed in the State." \textit{Id.} at 13,351. It is suggested that better public policy, consistent with California's extension of responsibility in the area of products liability, would be to allow inspection without destroying Public Law 86-272 protection.}

\footnote{200}{15 U.S.C. § 381(a) (1964).}
salesman "taking orders" for products of the out-of-state seller in this state will destroy the selling company's federal immunity from California tax jurisdiction. This, however, is vestigial language retained from the pre-Public Law 86-272 wording of the regulation when California, following a broad reading of West Publishing Co., considered systematic and regular in-state solicitation of orders for the sale of goods through local representatives sufficient for jurisdictional nexus. At present, mere physical taking and receipt of the order by the employee contemporaneously with or subsequent to the solicitation effort, where the receipt of the order is only for the purpose of transmittal or forwarding the same for approval or rejection to the seller's out-of-state office, would seem to be a protected activity. The recent California Board of Equalization decision in Appeal of E. F. Timme & Son, Inc. seems to assume without express comment that the ministerial functions of in-state salesmen who take orders for out-of-state forwarding is not a ground for denial of Public Law 86-272 protection.

The acceptance of a deposit with the order taken, the giving of assurances that any order submitted will be accepted or negotiation of the price or terms of sale by the seller's representative are all signs that a binding agreement between the out-of-state seller and prospective in-state purchaser has been concluded within the state. Therefore, these activities would arguably fall outside the protected scope of solicitation. But the extent to which such activities indicate an in-state commitment to accept the order is uncertain.

On the one hand, orders are obviously solicited for the purpose of accepting as many as possible with due regard to the seller's credit requirements. Congress must have been aware of this function of solicitation. On the other hand, the requirement of sending orders out of the state for approval or rejection must be intended to have some substance. Therefore, in-state acts which tend to diminish the need

201. See note 44 supra.
203. Informal comments, supra note 49.
204. "Section 101(a)(1) states that the order must be sent outside the state for approval or rejection. Since it does not specify the identity of the sender, it appears to be immaterial whether the customer sends it, or gives it to the salesman who does the sending. Likewise the mode of sending is immaterial." BEAMAN, supra note 4, at 6.14.
205. 4 CCH STATE TAX CAS. REP., CAL. ¶ 204-045 (State Bd. Equal. 1969).
206. Id. at 13,605.
207. Informal comments, supra note 49.
for or make a total sham of the already highly formal out-of-state approval or rejection phase of the interstate solicitation process would seem to be properly outside the protection intended by Congress.

In *Herff Jones Co. v. State Tax Commission*\(^{208}\) the Oregon Supreme Court considered the effect of taking deposits upon Public Law 86-272 tax immunity. Certain agents, characterized by the court as the out-of-state seller's representatives, solicited orders for the plaintiff-appellant's products (apparently school rings) at Oregon schools. The court noted that these representatives were "required by plaintiff to secure a five dollar deposit on each ring sold."\(^{209}\) To be sure, receipt of deposits was not the sole activity characterized as in-state activity exceeding permissible solicitation, but it was one of three or four factors expressly noted by the court.\(^{210}\) The staff opinion of the California Franchise Tax Board seems to be that *Herff Jones* will be relied upon by California to deny Public Law 86-272 protection to the foreign corporation whose in-state solicitors regularly accept deposits.\(^{211}\)

Similarly (although no decided cases have addressed themselves directly to this problem), where the out-of-state seller's representatives give assurances that out-of-state acceptance of the order is a mere formality, logic dictates that federally permitted in-state activity has been exceeded. It can be argued, however, that so long as the employees use order forms which indicate that the order is subject to out-of-state approval, the out-of-state seller would seem to have done enough to avoid a charge of having clothed its in-state solicitors with apparent authority to accept orders and to bring itself within the formal requirements of the federal law.\(^{212}\) The resolution of problems such as this must await future court decisions or administrative rulings.

Two recent Oregon decisions shed some light on the status of in-state negotiations of price and terms of sale. In *Iron Fireman*\(^{213}\) the substantially of the Washington negotiations seemed to provide an al-

\(^{208}\) 247 Ore. 404, 430 P.2d 998 (1967).
\(^{209}\) Id. at 407, 403 P.2d at 999.
\(^{210}\) The Oregon Supreme Court noted as follows: "Aside from the actual solicitation of orders, the salesmen also collect an initial deposit on merchandise ordered, and forward such deposits to plaintiff. The sales representatives on occasion also collect the balance due on the merchandise when it is delivered to the school. The sales representatives may also do occasional collection work for plaintiff in order to prevent their own commission from being reduced." Id. at 412, 430 P.2d at 1002.
\(^{211}\) Informal comments, supra note 49.
\(^{212}\) BEAMAN, supra note 4, at 6.17.
ternative ground for the court’s finding of conduct outside the scope of Public Law 86-272 solicitation, even though the court’s primary emphasis was on the engineering, testing and supervisions activities of the Oregon seller in Washington. Seller’s representatives in Herff Jones, while they were required to contact their out-of-state office “if the salesman [desired] to lower the price,” nevertheless had some in-state negotiation discretion which could have been additional reason for the court’s finding of “more than solicitation.”

Conversations with Franchise Tax Board personnel indicate that any regular and systematic in-state negotiation of price and terms of sale would lead the board to treat such activities of the out-of-state company’s local representatives as more than solicitation of orders and disallow Public Law 86-272 immunity.

Complex transactions may require extensive negotiation between the prospective buyer and the seller or his representative. Extensive negotiating activity conducted in the prospective taxing state may of itself destroy federal immunity. Immunity will most certainly be lost if the seller’s representative has the power and apparent authority to commit the seller on any part of the overall transaction. All negotiations should be clearly prefaced by written and oral disclaimers on the part of the company or its representative as to the required out-of-state approval of any points negotiated on behalf of the seller.

The Franchise Tax Board staff has indicated that credit investigation and approval, while it could be considered an integral part of the pre-sale solicitation, may destroy federal immunity if conducted in this state by the foreign seller’s employees or representatives. Beaman indicates that because of the decision in B. F. Goodrich Co. v. State, "many advisers still recommend that the service of credit approval be purchased from independent agencies until the point is cleared up."

The Franchise Tax Board staff's position is simply that credit investigation by the out-of-state seller's personnel, like in-state manufacturing or administrative activity, is not solicitation and therefore not protected.

While sale on credit and retention of a purchase money security

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215. Informal comments, supra note 49.
216. Id.
217. See notes 106 & 147 supra. Informal comments of Franchise Tax Board Staff personnel, supra note 49, confirm that position.
219. BEAMAN, supra note 4, at 6.14-.15.
220. Informal comments, supra note 49.
interest in the product sold will not destroy federal immunity. Franchise Tax Board personnel have indicated that enforcement of an installment sales agreement through informal methods involving in-state representatives, by in-state legal action on behalf of the out-of-state seller or by repossession of goods for the seller's benefit will be considered in-state activity beyond the protection of Public Law 86-272. Consequently, the best course of action for the prudent out-of-state seller may be to sell installment sales contracts or open accounts to independent financing or collection agencies.

4. Corporate Managerial or Supervisory Presence Related to the Solicitation Effort

Finally, some consideration should be given to the organization of the in-state sales solicitation effort. Clearly, any type of regularly maintained sales or administrative office in this state would destroy Public Law 86-272 protection. The difficult question is the extent to which the salesmen may meet for regular briefing or instruction sessions and the extent to which an out-of-state company may supervise in-state solicitation efforts through the nontransient in-state presence of supervisory or administrative personnel using their homes or temporary quarters such as hotel or motel rooms or apartment houses. The recently distributed Guide to Corporations indicates that the "supervision of personnel . . . conducting training courses or lectures, investigation or apportionment of agents or distributors . . ." may all be activities not within the protection of the federal act.

In CIBA the court noted that those of the drug company's twelve Missouri detail men who covered the St. Louis area were

221. See notes 49 & 106 supra.
222. Informal comments, supra note 49.
223. In National Bellas Hess Inc. v. Department of Revenue the three dissenters noted that a substantial part of Bellas Hess' sales was on credit. 368 U.S. 753, 761 (1967). The majority's failure to comment on this use of credit would seem to indicate that mere sale on credit, without more, would be insufficient for nexus purposes either under constitutional law or under the federal act's "solicitation plus" standard.
224. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 454, 456 (1959). See also BEAMAN, supra note 4, at 6.15-16 discussing the Talmadge Senate floor amendment which struck from the committee print of S. 2524 a third paragraph of section 101(a) of what later became Public Law 86-272. This paragraph would have granted protection to an office the primary use and purpose of which was to receive and forward orders for sales of the out-of-state seller's goods. Beaman notes that while the sales office provision might have been considered surplusage by some Senators who voted for its deletion, the more likely interpretation is congressional intent not to exempt such operations from state tax jurisdiction.
225. See note 119 supra.
assemble periodically for sales meetings. These meetings are called by the district manager, also a representative, and are held in St. Louis, usually in motel rooms. These meetings are of an educational nature. Representatives acquire information on particular products to be sold and also are instructed on company policy. California Franchise Tax Board personnel have informally indicated that similar activity conducted in California would be challenged as "solicitation plus," in excess of that activity permitted under Public Law 86-272. In-state representatives soliciting orders are of course neither prevented from meeting with each other nor from exchanging information among themselves. However, the designation by the out-of-state seller of one of its in-state solicitors as a sales supervisor or manager charged with any organizational, supervisory or administrative duties would trigger the Franchise Tax Board's claim of California activity outside the scope permitted by Public Law 86-272. The regular or systematic presence in California of any administrative or managerial personnel in addition to sales solicitors would likewise assure such a jurisdictional claim.

Similarly, the regular and systematic hiring and firing of personnel by the out-of-state seller's personnel manager who is either in the state or who enters the state for such purpose or for the investigation and appointment of agents and distributors would indicate corporate presence in more than the solicitation context. This should be true, however, only where the agents or distributors do not qualify as "independent contractors" under Public Law 86-272.

The Oregon decision in Briggs & Stratton is relevant on the issue of in-state presence of personnel with some administrative or managerial discretion. There the tax court repeatedly referred to the

226. State ex rel. CIBA Pharmaceutical Prods., Inc. v. State Tax Comm'n, 382 S.W.2d 645, 648 (Mo. 1964).
228. Informal comments, supra note 49.
229. Id.; Guide to Corporations, supra note 119.
230. Obviously, the federal protection accorded to the seller for sales made by properly qualified independent contractors might mean little if the out-of-state seller were not entitled to enter the state for the purpose of investigating and appointing agents and distributors who could qualify as independent contractors under Public Law 86-272. The Franchise Tax Board staff opinion on whether such in-state investigation or appointment of persons sought to be qualified as independent contractors would disqualify the out-of-state seller from Public Law 86-272 seems to be divided.
representative's title as sales and service supervisor. It was pointed out that he had certain supervisory powers in relation to the inspection of dealers' tools, shops and inventories, the conduct of training courses and lectures, including proper attendance by dealers' personnel, and that "he also gives approval to the appointment by [the seller's chief independent Oregon distributor] of service distributors and service dealers."232 The implications of this decision for disallowing immunity in cases of in-state managerial or supervisory activity are certain to be followed by the California Franchise Tax Board.233 It should be pointed out that the decision did not consider in-state activity in appointing prime independent contractors. While the sales and service representative's Oregon activities in approving the appointment of subdistributors and dealers might have shed some doubt on the prime distributor's status as an independent contractor,234 no question was before the court as to whether such appointment-approval activity would have been outside Public Law 86-272 if it had been conducted with respect to a prime contractor.

C. Independent Contractors and Their Permitted Activities

The federal act allows an out-of-state seller to consummate in-state sales through independent contractors—who are in turn permitted to have sales offices in the state—without loss of federal immunity.235 Two questions arise: (1) what is necessary to retain protected "independent contractor" status under the federal act; (2) what are the limits of the activity permitted, within the meaning of the federal act, to independent contractors in the state which are not permitted to the out-of-state seller's representatives.

1. Problems Underlying the Employment of a Related Independent Contractor

Public Law 86-272 provides a general definition of an independent contractor, but it does not restrict the affiliation which an in-

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232. Id. at 12,497-98.
233. Informal comments, supra note 49.
234. The Oregon Tax Court expressly noted that "it is not necessary to decide whether plaintiff's activities through Tracey as an independent contractor serving more than one principal are in excess of sales or the solicitation of order for sales under 15 USCA sections 381(a)(1)(c) . . . because plaintiff's activities through its sales and service supervisor in Oregon are clearly in excess of solicitation of orders." Id. at 12,498.
dependent contractor may have with the out-of-state seller. The most obvious question is whether an out-of-state seller's wholly owned subsidiary may be an independent contractor within the meaning of the act. 238

According to Franchise Tax Board Legal Ruling No. 91, issued prior to the enactment of Public Law 86-272, stock ownership alone does not destroy the independence which distinguishes a broker, dealer or contractor from the corporation's agents or representative "if the subsidiary may deal with corporations other than [the out-of-state seller], maintains separate offices and exercises independent discretion."

237 The extent to which it may be practical for an out-of-state seller to allow its in-state subsidiary to act as broker for other companies than its parent and to exercise "independent discretion" depends to some extent on the federal act's requirement that the independent contractor be "engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities . . . ." 238 Must the tangible personal property handled by the independent contractor for more than one principal involve the same or similar product lines, or may the independent contractor handle complementary, noncompeting or totally unrelated product lines for more than one principal and still be accorded protected status? 239

236 See also Developments in the Law—Federal Limitations on State Taxation of Interstate Business, 75 Harv. L. Rev. 953, 1008 (1962): "[T]he statute [does not] adequately define 'independent contractor'; it is unclear whether, for example, that term includes a subsidiary corporation [citing 105 Cong. Rec. 16,493 (1959)]."

237 1 CCH State Tax Cas. Rep., Cal. ¶ 10-064-a.20 (1958) [hereinafter cited as FTB Ruling No. 91].


239 The status of an agent as an "independent contractor" under prior California tax law did not require that an "independent contractor" be engaged in selling for more than one principal. Thus where a distributor for an out-of-state manufacturer of hand tools (1) invested his own capital in the distributorship, (2) had the authority to determine the price at which goods were sold by him, (3) had control over the hiring, direction and compensation of his employees, (4) retained the accounts receivable, (5) bore the risk of operating expenses and losses and (6) retained the opportunity for greater profit from sound management, the State Board of Equalization found the distributor to be "an independent contractor operating a business on his own behalf and for his own benefit" despite the fact that he sold only the goods of a single out-of-state manufacturer. Snap-On Tools Corp., 4 CCH State Tax Rep., Cal. ¶ 201-200 (State Bd. of Equal. 1958). This case, read in light of FTB Ruling No. 91 indicating that stock ownership alone does not destroy "independence," would seem to indicate that the handling of only noncompetitive product lines by a subsidiary otherwise qualifying as an independent contractor would not destroy Public Law No. 86-272 immunity.
If the federal act is given a broad reading, an in-state distributor of equipment and furniture would seem to qualify for independent contractor status although wholly owned by X, an out-of-state manufacturer of office desks and chairs, where he sells not only X's desks and chairs but also sells Y's typewriters and adding machines. The same system of distribution would not, however, qualify his principal for federal immunity if the act is interpreted narrowly and the in-state independent contractor is required to sell office desks and chairs for more than one out-of-state seller of such furniture.

The policy underlying the federal immunity accorded to the in-state consummation of sales by independent contractors ought to be that their income from such activity is in any event taxable in the state of sale. So long as independent contractor and principal are dealing at arm's length, the independent contractor would normally obtain a fair portion of the profit which would have gone to the out-of-state seller on direct in-state sales without a contractor. This "fair portion" probably represents a fair approximation to the out-of-state seller's total net income attributable to sales activity in the taxing state which the seller would have had in the absence of the independent contractor. Thus, selling through independent contractors is a practical way of letting the marketplace determine what portion of the aggregate net profit on any item of sale is attributable to the in-state activity. This marketplace determination of the sales-activity profit properly allocable to the state of sale is not likely to be substantially biased, regardless of whether the item of sale is competitive or non-competitive with items handled by the in-state contractor for other manufacturers. The in-state contractor will have the same incentive to obtain the maximum sales commission or the minimum wholesale price for himself regardless of whether the item is competitive or non-competitive. The proper interpretation of the federal act ought to permit a local distributor to handle noncompeting product lines without destroying the protection accorded his out-of-state principal.240

240. Even if the Franchise Tax Board recognizes the independent contractor status of a subsidiary of the out-of-state seller engaged only in sales of noncompeting products for principals other than the parent, the board may urge that the subsidiary is engaged in a unitary business with the parent principal under tests such as unity of (1) ownership, (2) operations and (3) use. For a recent affirmation of that test, see Chase Brass & Copper Co. v. Franchise Tax Bd., 4 CCH STATE TAX REP., CAL. ¶ 204-306 (Cal. Dist. Ct. App., 1970), appeal denied for want of jurisdiction, 32 U.S.L.W. 3272 (U.S. Dec. 21, 1970). See also Keesling & Warren, The Unitary Concept in the Allocation of Income, 12 HASTINGS L.J. 42, 45-59 (1960). If this back door attack on a subsidiary's independent contractor status is successful, then independent contractor status for an out-of-state seller's in-state subsidiary is likely to be very short lived.
In California the Franchise Tax Board staff is likely to insist on strict observance of the requirements of the federal law that an independent contractor be engaged in making or soliciting sales for more than one principal and that he hold himself out as such in the regular course of his business activities only where the principal and the claimed "independent contractor" are affiliated through stock ownership. Where no such affiliation exists, such dealing and holding out for more than one principal is not likely to be required so long as the other tests of "independence" as developed under California case law are satisfied. Thus, as was seen in the case of an out-of-state seller’s in-state advertising, so long as it does not involve an out-of-state seller’s in-state use of company employees or property, the extensive use of truly independent in-state exclusive dealers or distributors is another aspect of California tax jurisdictional practice which is more favorable to the out-of-state seller than necessarily required by Public Law 86-272 as the same has been applied by other jurisdictions.

2. Permissible Activities of Independent Contractors

An independent contractor may make sales and may maintain an in-state sales office “on behalf of” his out-of-state principal in addition to conducting the solicitation activities permitted to the out-of-state seller. It may be argued, however, that the unitary business line of attack should be as unsuccessful in avoiding federal immunity as it was in Appeal of Joyce, Inc., 4 CCH STATE TAX REP., CAL. ¶ 203-523 (State Bd. Equal. 1966). Thus, if an out-of-state seller can establish that its in-state subsidiary was an independent contractor, the fact that it was engaged in a unitary business with that independent contractor should no more allow California to claim income tax jurisdiction over properly executed in-state sales by the independent contractor than the fact of properly solicited sales by U.S. Shoe’s sales representatives did in the actual case. *But see* Tonka Corp. v. Commissioner of Taxation, 284 Minn. 185, 169 N.W.2d 589 (1969), where the court, in finding that certain representatives were not independent contractors noted that “these representatives had an exclusive territory and [were] forbidden by . . . contract with Tonka from handling any competing product lines.” *Id.* at 187, 169 N.W.2d at 591. Moreover, Tonka’s New York representative, while he “had many of the attributes which characterize an independent contractor,” was not held to be independent for several reasons, one of which was that “he could not deal in competing products.” *Id.* at 191, 169 N.W.2d at 593-94.

241. FTB Ruling No. 91, *supra* note 237 (emphasis added). This would seem—at least in the case of principal and agent related through stock ownership—to imply the requirement of such dealing and “holding out” for more than one principal even in the absence of federal law.

seller's direct representatives. It might be argued that any other additional activity of independent contractors must be strictly limited to the language of the federal law to retain immunity status. Thus, promotional, technical and other service activities prohibited to in-state representatives could likewise be prohibited to the independent contractor of an out-of-state seller. Since an independent contractor would, however, be entitled to complete sales, he ought not to be subject to the limitations on contractual negotiation, execution of offers, acceptances or actual sales contracts, nor to those limitations preventing solicitors from accepting either deposits or the entire sales price.

The question of what activities—other than making or soliciting sales—an independent contractor may perform on behalf of his out-of-state principal under the federal act may currently be a moot point under the California law. Informal comments of Franchise Tax Board's legal staff indicate that for tax jurisdictional purposes, the business activities of an independent contractor are not to be equated with the business activities of his principal. Thus, an advertising, promotional, technical, installation or collection service or other activity performed by the independent contractor with respect to the out-of-state seller's goods or customers will not be attributed to the out-of-state principal for tax jurisdictional purposes.

244. It has been correctly pointed out that “the maintenance of an office by an independent contractor does not [destroy Federal immunity] if the sole activities of the independent contractor in the host state on behalf of the interstate seller consist of making sales of tangible personal property, or soliciting orders for such sales. The italicized words mean that the independent contractor may conduct other types of activities on behalf of himself or other vendors.” See Beaman, supra note 4, at 6.21. The federal statute, nevertheless, could be construed to foreclose federal immunity if other activity is undertaken by the independent contractor which also benefits the out-of-state seller. Thus the performance of exclusive promotional activity by the contractor to increase his sales could conceivably benefit the out-of-state seller's in-state representatives even though these representatives otherwise had no contact with the independent contractor. See id. at 6.21-22 as to the possible immunity-destructive effect of representatives utilizing the independent contractor's in-state office.
246. Informal comments, supra note 49.
247. In this respect the Franchise Tax Board personnel seem to recognize the policy which has been suggested as underlying the express federal immunity provided by section 101(c) of the Interstate Income law. See text preceding note 240, supra.
248. Informal comments, supra note 49. It should be noted that even in jurisdictions which have not adopted California's broad policy of activities allowed to independent contractors, activities other than making or soliciting of sales for other principals or for its own benefit may practically give the independent contractor greater latitude to act for the out-of-state principal than would be accorded to the latter's soliciting representatives. Thus, for example, if the independent contractor actually purchases not
Franchise Tax Board staff personnel would claim jurisdiction over the foreign, out-of-state seller (1) if any of its property is at any time in the independent contractor's possession, or (2) if any of the foreign, out-of-state based seller's in-state soliciting representatives use any of the independent contractor's facilities to further their sales solicitation effort.249

D. Nexus and Reverse Nexus

The passage of Public Law 86-272, and the introduction of further proposed federal legislation to restrict the states' taxing power under the recommendations of the Special Subcommittee's 1964 Report, contributed in no small part to the adoption by California of the Uniform Division of Income for Tax Purposes Act (UDITPA), substantially as recommended by the National Conference of Commissioners on Uniform State Laws.250 Under UDITPA, a corporation based or organized in California may escape the California net income tax on a portion of its total world-wide income to the extent that it has "income from business activity which is taxable both within and without this state. . . ."251 Formerly, income was allocated among the states or countries in which the business was conducted.252 Whether or insubstantial amounts of its out-of-state principal's goods, advertising and promotional activities engaged in by the contractor with respect to those goods could be argued to be activities conducted in its own behalf, and thus not destructive of immunity, even though such advertising and promotion aid the direct sale or solicitation of goods on behalf of the out-of-state seller which the contractor has not himself purchased for resale. See also Beaman, supra note 4, at 6.21-22.

249. Informal comments, supra note 49. But see Beaman, supra note 4, at 6.21-22.


252. Allocation or apportionment of income away from California's tax reach is possible when "income is derived from or attributable to sources both within and without" California. Cal. Rev. & Tax. Code § 25101. When income is so attributable to this and to other states, the California tax "shall be measured by the net income derived from or attributable to sources within this state. . . ." Id.

Prior to the adoption of UDITPA the determination of source of income for allocation and apportionment purposes was made under the following statutory language: "Such income shall be determined by an allocation upon the basis of sales, purchases, expenses of manufacture, payroll, value and situs of tangible property or by reference to any of these or other factors or by such method of allocation as is fairly calculated to determine the net income derived from or attributable to sources within this State. Income from business carried on partly within and partly without this State shall be allocated in such a manner as is fairly calculated to apportion such income among the states or countries in which such business is conducted." Cal. Stat. 1955, ch. 17, § 25101, at 1649 (emphasis added). Prior to 1939 the determinative factor for allo-
not a California company was considered to be "conducting business" outside of California was determined on the basis of whether the out-of-state activities would have subjected the same company to California corporate income tax jurisdiction if it had been an out-of-state company conducting those activities in California. Just exactly what constituted "conducting business" outside California was uncertain. It was probably something less than the pre-1939 "doing business" test, but something more than the test now applied under UDITPA. As a result of UDITPA's more liberal and certain test, the question of sufficient nexus to support tax jurisdiction outside California is certain to take on increased importance for California-based companies.

At present whether a California taxpayer is taxable outside of California is determined by Revenue and Taxation Code section 25122, which provides:

For purposes of allocation and apportionment of income under this act, a taxpayer is taxable in another state if (a) in that state it is subject to a net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (b) that state has jurisdiction to subject the taxpayer to net income tax regardless of whether, in fact, the state does or does not.

Thus, the extent of taxability of income of California-based corporations (with respect to which no tax jurisdictional nexus question exists) depends on the existence of possible taxability elsewhere. This basis of actual or hypothetical taxability elsewhere may for convenience be referred to as "reverse nexus." 253

253. See 1 H.R. REP. NO. 1480, supra note 1, at 400-03.
Thus the problem of minimally sufficient nexus is faced not only by the foreign corporation with tenuous California contacts in deciding whether to file a California corporate income tax return, but also by the California corporation with tenuous out-of-state contacts in deciding whether another state's actual or potential taxing powers are such that income can either be allocated or apportioned out of California. California tax administrators, and eventually the courts of this state, will be called upon to determine standards upon which California-based corporate taxpayers can rely in making such a decision. The determination of standards for deciding whether another state's jurisdiction to tax reaches California-based corporate taxpayers will inevitably influence the development of standards in the area of minimum presence and activity sufficient to subject a foreign, out-of-state based corporation to California income tax jurisdiction.

1. The Effect of Definitional Considerations

Section 25122 raises definitional questions wholly distinct from the problem of determining the sufficiency of nexus for tax jurisdiction. Thus, the question has arisen as to whether a California taxpayer must be actually or merely potentially taxable in the foreign jurisdiction. It has been suggested that application of UDITPA's "taxable in another state" standard must satisfy a two-step test:\(^\text{254}\)

(1) if the out-of-state jurisdiction does actually levy one of the income-related taxes listed in section 25122(a), the in-state taxpayer must actually have complied with the out-of-state jurisdiction's tax laws by filing a return and paying the tax due under that jurisdiction's laws; and (2) if the out-of-state jurisdiction does not actually levy one of the taxes listed in section 25122(a), the taxpayer will be allowed to allocate-out income pursuant to section 25122(b) so long as the taxpayer could constitutionally be subjected to such a tax if it were to be enacted. The effect is to convert section 25122 into a multistate income tax compliance provision for the in-state taxpayer seeking to apportion or allocate its total net income. In short, only if the out-of-state jurisdiction could have, but did not impose one of the enumerated income-related taxes, or if the in-state taxpayer actually complied with the out-of-state jurisdiction's tax laws, would the in-state taxpayer be entitled under section 25122 to show that its out-of-state activities would subject it to another jurisdiction's taxing power.

254. The informal comments of Franchise Tax Board personnel indicate that one influential tax administrator in Oregon is of this opinion. See note 49 supra.
California Franchise Tax Board officials take a different view. They do not consider the matter of actual compliance with the foreign jurisdiction's tax laws of determining significance. The crucial factor, as seen by the Franchise Tax Board staff, is whether the foreign jurisdiction (be it a state or foreign country) could impose one of the specifically described taxes under the Constitution and laws of the United States upon the California-based corporation "by reason of its activities in such other state."\(^{255}\) The fact that potential tax jurisdiction elsewhere must be based on the California taxpayer's "activities in such other state" precludes California taxpayers from allocating or apportioning in situations where California taxpayers place themselves under another state's tax jurisdiction by voluntarily filing returns in or paying taxes to other states, and where such filing or paying would not be required on the basis of the California corporation's activities in such a state.\(^{256}\) But if another state does impose one of the specifically enumerated income related taxes, a failure of the California-based corporation to file tax returns or to pay tax to the foreign jurisdiction may be some evidence against the California-based corporation claiming taxability in another state.\(^{257}\)

\(^{255}\) Franchise Tax Board comments regarding application of UDITPA, 4 CCH STATE TAX REP., CAL., ¶ 203-548 (1967).

\(^{256}\) Informal comments, supra note 49. See also Signal Thread Co. v. King, 222 Tenn. 241, 435 S.W.2d 468 (1968), where the Tennessee Supreme Court refused to allow assignment of a portion of the total net income of a Tennessee corporation out of that state on the ground that the corporation was not "doing business" elsewhere for purposes of Tennessee's apportionment law. The fact that the Tennessee corporation voluntarily paid North Carolina corporate income and franchise taxes was held insufficient to allow apportionment. The court noted that "the bare fact the payment of applicable taxes elsewhere was voluntary will not deprive a taxpayer of a lawful right to apportion, [but] such a belated payment cannot absolve a taxpayer of liability to Tennessee unless it has carried the burden of showing that it actually was doing intrastate business elsewhere." Id. at 256, 435 S.W.2d at 474.

\(^{257}\) Such nonreporting may be used as a type of admission against the taxpayer's interest to show that the corporation itself did not consider itself taxable in the other state. In practice, the Franchise Tax Board could determine that the California based corporation was not taxable in the foreign jurisdiction, and thus shift to the taxpayer the burden of proving taxability (in essence, the burden of proving the existence of activities in the foreign jurisdiction which would have caused the loss of constitutional or federal tax law immunity). Where the other jurisdiction has taxes of the income-related types enumerated in section 25122 of the California Revenue and Taxation Code, the California-based corporation's failure to file a return and pay tax to the foreign jurisdiction actually imposing a tax of the enumerated type could present a substantial hurdle to be overcome in meeting the burden of proof thus shifted to the taxpayer. Naturally, testimony to this effect in a formal hearing before the State Board of Equalization would constitute the type of public admission against interest which the out-of-state jurisdiction could thereafter use to assert its own tax jurisdiction against the previously noncomplying California taxpayer.
Despite the above difference of opinion among state tax administrators as to the importance of compliance when one of the taxes enumerated in section 25122(a) actually exists in the foreign state, there seems to be no disagreement about the meaning of taxability under 25122(b): the potential taxability of a corporation is measured as though the foreign state chose to exercise its taxing power under the full reach allowed by the Constitution of the United States and by federal law.\textsuperscript{258} In other words, even if the state to which the California taxpayer sought to allocate or apportion income failed to take advantage of its power to tax to the extent allowed by the Constitution or by federal law, out-of-state taxability is nevertheless established if the activities in the other state are sufficient to overcome constitutional and federal statutory immunity standards.\textsuperscript{259}

\textsuperscript{258} Informal comments, \textit{supra} note 49. The Committee on Uniform Income Tax Regulations of the National Association of Tax Administrators, in its Statement of Proposed Regulations, takes a similar position in Proposed Regulation 3(B): “(1) A taxpayer is ‘subject to’ one of the taxes specified in [the Uniform Act] only if it carries on business activities in another state. If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but (a) does not actually engage in business activities in that state, or (b) does actually engage in some activity, not sufficient for nexus, and the minimum tax bears no relation to the corporation’s activities within such state, the taxpayer is not ‘subject to’ one of the specified taxes within the meaning of [the Uniform Act].

“(2) The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activities may impose an income tax even though every state does not do so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in [the Uniform Act] which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is ‘taxable’ in another state.”

\textsuperscript{259} Thus, the question of taxability elsewhere does not present true conflict of laws issues. The question is purely one of California local law with possible constitutional law overtones on the question of fair apportionment. See note 321 \textit{infra}. The resolution of such constitutional questions is, of course, in the first instance, likewise a matter of California law. U.S. Const. art. VI, § 2.

The National Association of Tax Administrators’ Uniform Tax Regulations Committee’s proposed Regulation 3(C) likewise views the matter of "taxability elsewhere" as a subject to be determined by looking at the potential taxability of a foreign taxpayer to the full extent allowed by the Constitution and laws of the United States: “The second test in the [Uniform Act (e.g., \textit{Cal. Rev. \\& Tax. Code} § 25122(b))] applies if the taxpayer’s business activities are sufficient to give the state jurisdiction to impose a net income tax under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. §§ 381-385. In the case of any ‘state,’ as defined in Section 1(g) of the Act, other than a state of the United States or political subdivision of such state, the determination of whether such ‘state’ has jurisdiction to sub-
2. Uniform Standards for Nexus and Reverse Nexus

California's criterion for allowing allocation or apportionment is not actual taxation of income outside California, but rather the full hypothetical jurisdiction of another state or foreign country to tax a California-based company on the basis of activity or income arising there. If California were to take full advantage of the tax jurisdictional power it ascribes to other states in its attitude towards allocation or apportionment by California-based companies with respect to foreign corporations doing business within California, uniformity in standards would be achieved. A uniform standard to determine the satisfaction of both nexus and reverse nexus requirements would be easier to apply. It also has a certain ring of elemental "fairness," and would tend to further the goal of uniform apportionment of corporate income tax among the states.

Neither constitutional principles nor the Federal Interstate Income Act require application of the same standard for both reverse nexus and nexus purposes. Thus the standard for reverse nexus is purely a matter of California law, subject to certain implied constitutional requirements of fair apportionment.

ject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that 'state.' If jurisdiction is otherwise present, such 'state' is not considered as without jurisdiction by reason of the provisions of a treaty between that state and the United States."

260. See note 258 supra.

261. Hawes v. William L. Bonnell Co., 116 Ga. 184, 156 S.E.2d 536 (1967). In this case the Supreme Court of Georgia affirmed a decision in favor of a Georgia corporation that had allocated and apportioned its total net income between Georgia and other states in which, under the court's interpretation of Georgia law, it would have been "doing business" in Georgia if it had been a foreign company engaging in activities in Georgia which were identical to its actual out-of-Georgia activities. The Georgia Revenue Commissioner conceded that the Georgia law definition of "doing business" in Georgia would be equally applicable to "doing business" outside of Georgia but contended that the federal act must be read into the Georgia law, "compelling the conclusion that activities such as are here set out are not taxable insofar as a foreign corporation with such activities in Georgia are concerned, a fortiori, preventing an exclusion of a Georgia corporation's income where its similar activities are conducted out of state. Id. at 190, 156 S.E.2d at 541.

"Regardless of the soundness of the first proposition the second does not of necessity follow and is demonstrably fallacious. . . . The federal act at best impliedly modified the 1950 Act insofar as a foreign corporation's activities within the state are concerned. The fact that attempting to tax a foreign corporation under that provision might now run afoul of the federal statute would not affect the provision as to Georgia corporations with described activities in other states. The federal law does not endeavor to pre-empt that area. It did not in any manner relate to the Act's provisions insofar as a domestic corporation was concerned." Id. at 191, 156 S.E.2d at 541.

262. See note 259 supra.
In answers to the “reverse nexus” portion of the Special Subcommittee’s nexus questionnaire, California tax administrators indicated that a dual standard, favoring California-based corporations seeking to allocate or apportion income out of California’s tax reach, was in effect.\(^{263}\) This duality of standards has apparently been rejected by California since 1963. Recent conversations with Franchise Tax Board personnel indicate that the developing California jurisdictional rules will be applied equally to the nexus and reverse nexus situations.\(^{264}\)

Of course, practical difference in treatment may still arise. For one thing, the California tax administrators’ means of verifying activity claimed to be taking place in other jurisdictions are limited. Where revenue consequences are not substantial, the administrators may be more inclined to accept at face value the domestic taxpayer’s claim of out-of-state activity than to accept a foreign concern’s statement as to in-state activities, which can more easily be verified by inspection of in-state operation and perusal of local records.\(^{265}\) Nevertheless, the development and application of uniform standards for nexus and reverse nexus would be not only commendable, but also an important step towards reducing the aggregate burden of taxation of multistate business.\(^{266}\)

As will be noted shortly, nexus and reverse nexus standards would be nonequivalent at the lower levels of marginal California or out-of-state contacts in the event that California adopts minimum quantitative jurisdiction rules to supplement existing constitutional, federal and state qualitative rules. This lack of equivalence at the lower levels of contacts aside, uniformity in nexus and reverse nexus standards should be retained as far as possible.\(^{267}\)

\(^{263}\) 1 H.R. Rep. No. 1480, supra note 1, at 239-42. Thus California’s tax administrators in 1963 considered certain of the activities described in the chart which is referred to in note 106 supra, which, if conducted by a foreign, out-of-state based corporation in California would not have been sufficient for a claim of tax jurisdiction by California to be a sufficient contact with another state to allow apportionment by a California-based company whether it engaged in such activities regularly, occasionally or rarely. As has been noted, this may have been due to the fact that under the then existing “locus of employee sales activity” test, little assignment of income away from California would in any case have been possible.

\(^{264}\) Informal comments, supra note 49.

\(^{265}\) Id.

\(^{266}\) See 1 H.R. Rep. No. 1480, supra note 1.

\(^{267}\) See id.
PART THREE

III. Summary and Recommendations

California's present jurisdictional standards are vague and unenforceable. When there is ambiguity in the tax law, the taxpayer is at the mercy of the tax administrator. And for years California tax administrators have ignored the collection of legally collectible taxes where tax liability of out-of-state firms was small.268

The foregoing discussion has sought to clarify first the constitutional standards of minimum nexus required for state net income tax jurisdiction, and second, the income tax jurisdictional standards actually being applied—particularly in California—as a result of state legislative, judicial and administrative response to Public Law 86-272. An analysis of the Northwestern States line of cases has suggested that the basic constitutional minimum nexus criterion for state income tax jurisdiction over foreign corporations is the physical presence of the foreign company within the potential taxing state through in-state property, employees or activities. "Economic presence"—the mere receipt of income from sales of property or services to a buyer in the potential taxing state, without more—is a criterion advocated by a Supreme Court minority, by various commentators and by at least one state's highest court. But it has not yet received the Supreme Court's approval.

Superimposed upon the criterion of physical presence seems to be a less definite secondary requirement: The foreign company's activity within the would-be taxing state must be sufficiently substantial to warrant the imposition of the hidden costs of tax reporting and tax law compliance. The appearance of this quantitative nexus criterion may be traced to the realization that a loosening of the qualitative restraints on state tax jurisdiction has, for smaller companies, created burdens that outweigh the need for making interstate business bear its fair share of the cost of local government.269 In other words, the Supreme Court, by indicating that sales plus some transient corporate presence in the state of sale would be a sufficient basis for tax jurisdiction270—and thereby loosening the qualitative jurisdictional requirements—has imposed hardships upon smaller businesses with only marginal sales

and transient in-state presence in the would-be taxing state. The hardship is alleviated if some minimum of transient presence is made prerequisite to the exercise of state income tax jurisdiction.

More and more states are adopting a uniform income base, together with uniform and simplified reporting requirements. The future may possibly see the adoption, through an organization such as the Multistate Tax Commission, of a centralized state tax return filing, auditing, reviewing and tax collecting system. Consequently, the problem of small interstate businesses confronted by overlapping, conflicting and otherwise burdensome state tax reporting and compliance requirements may, for practical purposes, disappear. But so long as state revenue-gathering efforts through net income taxes imposed on out-of-state businesses with marginal in-state contacts remain significant, and so long as the aforementioned uniformity and centralization of state tax bases and compliance mechanisms remain beyond the horizon, a practical solution to the dilemma of small interstate enterprise remains a most urgent goal.

A. Proposed Solutions

1. Federal Proposals

Federal lawmakers have recognized the problem, but they have not been able to agree upon a solution. In a discussion presupposing the use of a sales or gross receipts factor in a state apportionment formula, the 1964-1965 House Report considered a proposal requiring a minimum amount of in-state gross receipts before a foreign, out-of-state based corporation that fails to meet the qualitative exemption requirements of Public Law 86-272 could be subjected to state income tax. However, the House Report also found that the “gross receipts” or “sales factor” test based on sales destination, as used in many states’ division-of-income or apportionment formulae, posed sig-

271. Repeated congressional efforts to legislate further in the state tax area stem from the notion of many Congressmen and Senators that “[T]he future [does not] hold out any prospect of improvement. The number of income tax jurisdictions increases. Laws seem to become more complex rather than less. . . .

“Fifty years ago, as the first of the States adopted the income tax, forward-looking tax men warned of the dangers of each State taxing interstate commerce in its own way. For 50 years, State tax administrators have been discussing ways of achieving simplicity and uniformity. One proposal after another has been formulated, discussed, revised, and in spite of the expenditure of enormous efforts, discarded. And, today, the States appear to be as far from a solution as they have ever been. In short, the history of 50 years of State income taxation leaves no room for optimism that the States will be any more successful in the future than they have been in the past.” 1 H.R. Rep. No. 1480, supra note 1, at 599.

272. Id. at 508-13.
significant compliance and enforcement problems.\textsuperscript{273} It further found, as far as state revenue consequences were concerned, that there would be little loss of tax revenues to market states if a two-factor apportionment formula (property and payroll) were to be used in place of the traditional three-factor formula (property, payroll and gross receipts).\textsuperscript{274} It therefore struck a questionable blow for simplicity in proposing a two-factor (property and payroll) apportionment formula together with purely qualitative ("business location") jurisdictional rules and ignored its own discussion of quantitative standards in the final legislative recommendations.\textsuperscript{275}

In 1965 Professor Hellerstein analyzed the 1964-65 House Report and its recommendations. He raised substantial questions concerning both the validity of the report’s conclusion on revenue consequences and the merits of eliminating the gross receipts factor from state income apportionment formulae. His analysis resurrected the discussion of a quantitative minimum nexus standard for net income tax jurisdiction and recommended its serious consideration by Congress.\textsuperscript{276} Nevertheless, neither House Bill 11798 nor its successor bills offered a quantitative minimum nexus approach of the sort that would eliminate the compliance and enforcement problems for small companies doing a small volume of business in several states.\textsuperscript{277}

2. Multistate Tax Compact

The states, individually and collectively, have been equally slow in responding to compliance and enforcement problems left unsolved by existing qualitative nexus standards. The first concrete attempt on the part of the states to reduce compliance costs of small interstate tax-

\textsuperscript{273} 4 id. at 1126-28, 1144-45.
\textsuperscript{274} 1 id. at 560-63; 4 id. at 1150.
\textsuperscript{275} 4 id. at 1133-34, 1144-58.
\textsuperscript{277} However, the following types of corporations, among others, are excluded from the effect of the congressional limitation on jurisdiction: transportation, utility, insurance, financial companies, and corporations with an annual taxable income, for federal tax purposes, exceeding $1 million. H.R. 7906, 91st Cong., 1st Sess. 13-19 (1970). The effect of this “quantitative limit” on the availability of the federal protection under House Bill 7906 is hardly responsive to the needs of small business. Assuming arguendo that “average annual income for Federal tax purposes” represents two percent of total gross sales, the protection provided by the bill would be available to corporations with as much as $50 million in aggregate gross sales. Using H.R. Rep. No. 1480’s net profit estimate for manufacturers (12 percent), one would still find companies with gross sales over $8 million to whom the bill’s protections are available.
payers was article III, paragraph 2 of the Multistate Tax Compact.\textsuperscript{278} The compact does not provide jurisdictional standards, but does attempt to use the notion of minimum quantitative nexus to reduce compliance costs. This provision would allow a taxpayer subject to a state's taxing jurisdiction solely on the basis of sales activity within the state to elect to pay a tax based on a specified percentage of its gross receipts from sales made within the taxing jurisdiction instead of the state's income tax, provided gross receipts from sales made in that jurisdiction do not exceed $100,000 during the applicable tax year. The purpose of the provision was obviously to simplify the small out-of-state taxpayer's net income tax record-keeping, reporting and other compliance problems. As of mid-1970, of the 20 states that had unconditionally adopted the compact or parts thereof, 8 have adopted the small-taxpayer option—as has 1 nonmember state. Seven have effectuated the option through the adoption of specified optional gross sales tax rates.\textsuperscript{279}

The chief problem with the compact's small taxpayer option is that it alleviates one burden by imposing another: the burden of ascertaining which option will most effectively minimize taxes. In order to satisfy itself that it is not paying an unreasonably large tax in

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{278} "Each party State or any subdivision thereof which imposes an income tax shall provide by law that any taxpayer required to file a return, whose only activities within the taxing jurisdiction consist of sales and do not include owning or renting real estate or tangible personal property, and whose dollar volume of gross sales made during the tax year within the State or subdivision, as the case may be, is not in excess of $100,000 may elect to report and pay any tax on the basis of a percentage of such volume and shall adopt rates which shall produce a tax which reasonably approximates the tax otherwise due. The Multistate Tax Commission, not more than once in five years, may adjust the $100,000 figure in order to reflect such changes as may occur in the real value of the dollar, and such adjusted figure, upon adoption by the Commission, shall replace the $100,000 figure specifically provided herein. Each party State and subdivision thereof may make the same election available to taxpayers additional to those specified in this paragraph." P-H \textit{STATE \& LOCAL TAXES, ALL STATES UNIT \[ 6313 (1968).}}
\item \textsuperscript{279} The member states which have adopted the small taxpayer option and their rate of tax on in-state gross sales are as follows: Alaska (no rate set); Arkansas (no rate set); Colorado, 1% (1969); Hawaii (no rate set); Idaho, 1% (1969); Illinois (no rate set); Kansas (no rate set); Michigan, special formula (total Michigan sales times ratio of operational net income to total sales per federal income tax return or 2/5\% of total Michigan sales (1967)); Missouri (no rate set); Montana (no rate set); Nebraska, special formula (product of corporate income tax times business income times gross sales in or into Nebraska, all divided by gross sales (1969)); New Mexico, 1/2\% (1969); North Dakota, up to $20,000, 6/10\%; $20,000-$55,000, 8/10\%; over $55,000, 1\% (1969); Oregon, 1/4\% (but if return on sales is less than 5\% then gross sales tax rate is 1/8\% (1969); Utah, 1/2\% (1969). Maine, although not a member state, adopted the option in 1969 at 1\%. Id. at \[ 5105.
\end{enumerate}
\end{footnotesize}
relation to local business with similar gross sales, the out-of-state taxpayer will probably calculate its effective tax both under the compact's option and under the otherwise applicable net income tax. It will then file under whichever method results in a lower tax. Even if the taxpayer makes only a rough estimate of its potential net income tax in the option state, the existence of the option may not have substantially served its purpose; it would still necessitate the tax law research, tax computation and other associated compliance costs which, it is hoped, a small taxpayer quantitative minimum nexus requirement would eliminate.

A more recent approach by a Multistate Tax Commission Ad Hoc Committee likewise reflects an overzealous concern over the complete loss of income tax revenues from a large number of smaller taxpayers. The Ad Hoc Committee's plan (which was intended as a compromise alternative to the Rodino Bill\(^{280}\)), as first proposed at a special Multistate Tax Commission meeting in June 1970, would have adopted the Public Law 86-272 qualitative jurisdictional standards.\(^{281}\) Pursuant to changes suggested at the regular July meeting of the commission, a quantitative test, to be superimposed on the Public Law 86-272 jurisdictional standards,\(^{282}\) was put before the commission members at the October 1970 meeting. The Ad Hoc Committee's jurisdictional proposal, however, is no more than a self-serving effort by the states to remove the unwarranted state tax exemption provided to numerous large companies by Public Law 86-272. The proposal does nothing to grant relief to smaller corporations for which compliance with the formalistic criteria of Public Law 86-272 is itself a substantial cost burden.

3. The Huff Proposal

In this writer's opinion, the most effective and desirable plan yet


\(^{281}\) 31 CCH STATE TAX REV. No. 24, at 2 (June 16, 1970).

\(^{282}\) The jurisdictional standards of the Ad Hoc committee's plan are: "Sec. 101. Jurisdictional Standards. (a) Income Tax—For the purpose of imposition of a net income tax by any state, or political subdivision thereof, it shall be conclusively presumed that a corporation has not derived any income from within a state, or political subdivision thereof, in any taxable year if that state or political subdivision is denied the power under Public Law 86-272 to impose a net income tax on that corporation; provided that any state or political subdivision may impose, on any corporation or affiliated group exempt solely by reason of Public Law 86-272, a net income tax with respect to any taxable year in which that corporation or affiliated group has derived more than $300,000 in gross sales in that state or political subdivision if the total sales of such corporation or affiliated group for that year and for each of the three next preceding years exceeded $2,000,000. [Footnotes omitted.]"
proposed for the elimination of substantial small business compliance costs through the legislative prescription of minimum quantitative nexus standards was suggested by Martin Huff, Executive Officer of the California Franchise Tax Board. While testifying before the California Assembly Revenue and Taxation Committee on an alternative to Public Law 86-272 and the Willis Bill then before Congress, Mr. Huff proposed an express exemption from California’s corporate income tax

283. Statement by Martin Huff, Executive Officer of the Franchise Tax Board, entitled Bank and Corporation Tax Law Jurisdictional Standards, presented to the California Assembly Revenue and Taxation Committee during Hearings on H.R. 16491 at San Diego, California, on November 17, 1966 (mimeograph on file with the Hastings Law Library) [hereinafter cited as Martin Huff]:

“(a) No corporation shall be subject to the tax imposed by this part upon net income derived from sources within this State from interstate commerce if such corporation:

(1) is a manufacturer, producer, fabricator or vendor of tangible personal property;
(2) does not maintain a permanent business establishment within this State; and
(3) the combined total gross receipts of such corporation and of its affiliates for the income year from sales made within this State do not exceed $100,000.

“(b) For purposes of this section—

(1) The term ‘does not maintain a permanent business establishment’ means that the person or its affiliates do not have:

(A) Real or tangible personal property located within the State or political subdivision, except that which is directly connected with and used in sales activities; or
(B) Employees permanently located within the state or political subdivision. For purposes of this subdivision an employee means (i) any officer or a corporation, or (ii) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee.

(2) The term ‘sales made within the state or political subdivision,’ means sales of tangible personal property if the property is delivered or shipped to a purchaser or to the designee of the purchaser within the state, regardless of the f.o.b. point or other conditions of sale.

(3) The term ‘affiliate’ as used in subsection (a) means a corporation which owns or controls, directly or indirectly, or is owned or controlled directly or indirectly by a person as defined in subsection (b), or is related to such person, directly or indirectly, through ownership or control by another person. For purposes of this subdivision direct or indirect ownership or control of more than 50 percent of voting stock shall constitute ownership or control.

(4) The term ‘person’ means any individual, firm, partnership, association, corporation, company, syndicate, estate, trust or organization of any kind, trustee, trustee in bankruptcy, receiver, executor, administrator, or assignee.

“(c) The provisions of this section shall not apply with respect to any corporation which is incorporated or qualified to do business under the laws of this State.”
for all out-of-state based manufacturers, producers, fabricators or vendors of tangible personal property that do not maintain a permanent place of business in California (other than offices essential to their interstate selling activities) and are not incorporated or qualified to do business in this state, provided the particular company's annual gross sales in California is $100,000 or less. The limitation of the exemption to sellers of tangible personal property not incorporated or qualified to do business in California and having no permanent place of business in this state reflects a recognition that quantitative minima ought not to be applicable to qualitatively local business. The limit on the dollar amount of annual in-state sales necessary for exemption reflects the notion that compliance cost as to sales below this amount may be unreasonable in relation to the tax liability. In arriving at this arbitrary amount, it is assumed that the net margin of profit is 5 percent and that sales in this State are the only significant activity. If this is so, the tax of such a corporation in most cases will be approximately $100 under existing California tax rates.

Because the tax on sales of $100,000 or less in most instances will be less than $100, it is suggested that if sales of such amounts are exempted, small businesses will know in advance the extent of the activities in which they can engage in this State before they will incur a State income tax liability.

Mr. Huff proposed such voluntary quantitative tax jurisdictional restraint for consideration by this state's legislature "if P.L. 86-272
can be repealed or if jurisdictional standards contained in the Willis Bill are replaced by more flexible and reasonable standards.” Mr. Huff noted that states could not be expected voluntarily to curtail their jurisdiction “so long as P.L. 86-272 is operative and serves to exempt from state income tax multistate businesses with annual sales in excess of $7,000,000.”

The quantitative minimum suggested above could be implemented using very simple reporting requirements for any company making any more than isolated sales to customers in the taxing state. The availability of such a simplified suggested information return would enable the company to know with certainty whether it has met the taxing state's legal requirements. It would also assure the taxing state that the identity of all but the most brazen or uninformed potential taxpayers would regularly be available for audit and investigation purposes. The law's reporting requirements should be complemented by appropriate statutes of limitations, and by audit procedures and penalties for misstatement or omissions to encourage honesty in reporting.

The quantitative formula proposed by Martin Huff does present certain conceptual problems. The first has to do with the use of the

288. Id.
289. Perhaps isolated sales involving insubstantial gross receipts would in any case fail to meet the "regular and substantial income producing activity" test of constitutional law. Thus truly "isolated and occasional" sellers could simply rely on the existing constitutional protection afforded foreign, out-of-state corporations having contacts with the taxing state which are quantitatively insufficient under the theory of Miller Bros. v. Maryland, 347 U.S. 340, 344-45 (1954). If a foreign corporation feels uncertain as to whether its activities are quantitatively insufficient it would be well advised to file the information return.

The out-of-state seller's filing of a simplified information return would be a condition to the assurance that the state will not later seek to exert its tax jurisdictional reach under the uncertain state of the law as it now exists.

Under this simplified information return, the foreign, out-of-state based company could be required to list the following: its exact name, its legal domicile, the date of its incorporation, the address of its principal office, the industries or lines of business in which it is engaged, a complete description of the activities of its employees in California, the dollar amount attributable to gross receipts from sales made to customers in California during the reporting period, and the names and addresses of its ten largest customers in this state. The information return could also provide for the out-of-state seller's affirmation, under penalty of perjury, that it provided no personal services in this state (other than sales related services which would be allowed under this law and would be clearly enumerated in the instruction sheet to the information return) and that it owned no property and maintained no inventory in this state other than that permitted under the law. E.g., the sales office and such major items as delivery vehicles and a limited inventory for the making of in-state over-the-counter sales such as those suggested in this article, and that it engaged in no other activities which would be specifically prohibited by law.
gross receipts from in-state sales as the relevant measure for determining when a business has satisfied the quantitative nexus requirements. The second problem involves the location of the dividing line between businesses which do or do not fall below the minimum quantitative nexus. The last concerns a state constitutional problem peculiar to California and to several of its sister states.

a) Problems with the Gross Receipts Yardstick

The use of gross receipts as the measure for determining the quantity of income-producing activity obscures the obvious fact that different taxpayers in the same industry—and, even more significant, different industries—operate on different profit margins. The reason for using gross receipts as the measure of quantitative presence is that this enables foreign taxpayers to ascertain the amount of their in-state sales with relative ease.

A weighted average margin of profitability could be determined on the basis of empirical data for those taxpayers likely to fall into the category of protected interstate sellers. While benefiting some taxpayers or industries more than others, such an average margin of profitability to determine the proper gross receipts cut-off point for the quantitative nexus standard would nevertheless be of some benefit to every foreign, out-of-state based corporate taxpayer and would definitely benefit the interstate business community in the aggregate. A more refined quantitative minimum nexus rule could be produced either (1) by determining average margins of profitability applicable to different industries and by using the same to determine different minimum in-state gross receipts requirements for tax jurisdiction over corporations in such different industries or (2) by relying on the reporting companies to indicate their own margin of profitability with supporting data and by establishing a sliding scale of gross receipts jurisdictional cut-off points based on varying margins of profitability.

It should be noted, however, that too much detail and sophistication in determining minimum gross receipts standards may destroy the sim-

290. See 1 H.R. Rep. No. 1480, supra note 1, at 503-04, noting profit margin as a percentage of gross sales of the multistate corporations studied ranging between zero (or less than zero) up to 25 percent. The report notes, however, that such profit margins “may be expected to be under 4 percent for more than two-thirds of the manufacturing corporations and for more than three-quarters of the wholesalers.”

291. The gross receipts tax rate provided for taxpayers electing the small taxpayer option under the Multistate Tax Compact as adopted in Oregon (1/4%, but if return on sales is less than 5%, the rate is 1/8%) is a very simple example of the latter alternative. See note 279 supra.
plicity and visibility of the minimum gross receipts approach for the community of small to moderate-sized interstate sellers sought to be benefited.

b) Where to Set the Limit

Determination of the exact gross receipts cut-off point presents similar problems of arbitrariness. Nevertheless, the fact that some arbitrariness is involved in devising a mathematical standard ought not to deter legislators from providing the standard if, as applied in practice, it will substantially serve the purpose for which it has been devised.

The House Report of 1964 briefly considers a suggested $100,000 gross receipts minimum quantitative standard. Using rate-of-return on gross sales percentages ranging from 2 to 15 percent (depending on whether the interstate seller's business is in the wholesale or retail area or in manufacturing) and a 5 percent tax rate, the amount of tax of the interstate company having approximately $100,000 in annual gross receipts (which would be forfeited by the taxing state under a $100,000 quantitative minimum) would range from $33 at the 2 percent rate-of-return level to $250 at the 15 percent rate-of-return level.

When the tax thus potentially forfeited by a state adopting a $100,000 gross receipts quantitative minimum nexus rule is compared to the House Report's estimate of $93 as the median of the range of total cost of compliance with state income tax provisions for companies grossing from $50,000 to $200,000, it seems that Mr. Justice Frankfurter was correct when he stated that subjecting small or moderate-sized corporations doing interstate business spread over several states to different income tax record-keeping and compliance requirements in each of the several states "may well exceed the burden of the taxes themselves."

Regardless of the fairness or accuracy of existing apportionment formulae or specific allocation rules, they fail to apportion or allocate the cost of tax law compliance. The problem is not unfair apportionment or allocation, but tax rates that do not reflect the burden of multiple compliance. By gearing the small interstate taxpayer exemption to the same order of magnitude as total state tax compliance cost, at least the more blatant instances of effective multiple taxation through hidden compliance cost would seem to be alleviated.

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292. The report notes that "the $100,000 figure has been selected fairly arbitrarily."
293. Id.
Any cut-off point chosen would provide some relief to small interstate taxpayers, since no relief exists at present.

c) CONSTITUTIONAL PROBLEMS

The final problem with the Huff proposal involves article XII, section 15 of the Constitution of the State of California, which provides:

No corporation organized outside the limits of this State shall be allowed to transact business within this State on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State.

The problem is whether enactment of a tax jurisdictional standard prescribing a quantitative minimum nexus measured by gross receipts attributable to California activities would run afoul of this constitutional prohibition. The simplest answer to such a potential constitutional conflict would be a determination by the California Legislature that quantitative minimum nexus standards are constitutionally required under the commerce or due process implications of the Supreme Court's *Northwestern States* line of decisions. Such California legislative action, declarative of existing United States constitutional law in terms designed to reduce existing confusion among taxpayers and state tax administrators as to the legal responsibilities of interstate taxpayers with quantitatively marginal California contacts, would be a creative alternative to the congressional intervention suggested by Justice Frankfurter. The possible contention that the California Legislature cannot make this determination under the prohibitory mandate of article XII, section 15 should be rejected. In exercising its lawmaking function in this area the legislature must look not only to article XII, section 15, but also to the basic constitutional source of its power to tax corporations. In reconciling any possible conflict, the legisla-

295. Cases cited note 3 supra.
296. 358 U.S. at 473-75 (Frankfurter, J. dissenting).
297. "[T]he legislature may provide by law for the taxation of corporations, their franchises, or any other franchises, by any method not prohibited by this Constitution or the Constitution or laws of the United States." CAL. CONST. art. XIII, § 16, cl. 2. Thus, in considering the "method" of its taxing measures, the legislature must look not only to California's Constitution, but also to that of the United States.

The fact that "[t]he legislature shall pass all laws necessary for the enforcement of the provisions of [article XII]" (CAL. CONST. art. XII, § 24) would seem to give further force to the proposition that the legislature has some interpretive discretion, especially where potential legislation may skirt conflicting constitutional demands, allowing a legislative declaration that the suggested quantitative nexus standard legislation is constitutionally "necessary" under article XIII, section 16, and not prohibited by article XII, section 15.
ture ought to exercise the broad discretion inherent in the notion of legislative power—the discretion and power to find facts\textsuperscript{298} upon which to declare the public policy of this state\textsuperscript{299} and the necessity, expediency and reasonableness of legislative means and methods to further such policy.\textsuperscript{300}

An examination of the effect of the double-barreled approach of the Bank and Corporation Franchise Tax Law\textsuperscript{301} clearly indicates that the legislature has recognized certain reasonable and constitutionally required distinctions between foreign and domestic corporations.\textsuperscript{302} For purposes of corporate taxation, California's franchise and corporation income tax statutes distinguish between (1) corporations, both domestic and foreign, “doing business within the limits of this state” and thus subject to the Bank and Corporation Franchise Tax\textsuperscript{303} and (2) corporations, both domestic and foreign, not “doing business with this state, but deriving income from sources within the state and thus subject to the corporation income tax.\textsuperscript{304} Language equivalent to the article XII, section 15 criterion—“to transact business within this State”—is employed as the jurisdictional criterion only under the franchise tax and not under the corporation income tax.\textsuperscript{305}

\textsuperscript{298} See Parker v. Riley, 18 Cal. 2d 83, 90, 113 P.2d 873, 877 (1941).
\textsuperscript{300} See Watson v. Division of Motor Vehicles, 212 Cal. 279, 285-86, 298 P. 481, 484 (1931).
\textsuperscript{301} CAL. REV. & TAX. CODE § 23101.
\textsuperscript{302} See id. The California Legislature's power to draw such distinctions through varying jurisdictional standards can hardly be questioned. See Oliver Continuous Filter Co. v. McColgan, 48 Cal. App. 2d 800, 804, 120 P.2d 782, 785 (1942). Furthermore, it has never been held that article XII, section 15 of the California Constitution prevented such reasonable distinctions from being made. See Francioni v. Soledad Land & Water Co., 170 Cal. 221, 225, 149 P. 161, 163 (1915).
\textsuperscript{303} CAL. REV. & TAX. CODE § 23151.
\textsuperscript{304} Id. § 23501. This latter category of corporations subject only to corporation income tax may in turn be subdivided into (a) corporations deriving income from the passive ownership of some property which has locus or situs in this state and (b) corporations deriving income from “activities in this State” even though such corporations are not “doing business” in this state (intrastate business) but are solely “engaged in carrying on business between this state and other states or countries...” exclusively in foreign or interstate commerce. These latter corporations are not subject to the franchise tax, but only to the corporation income tax on that portion of their income attributable to property with locus or situs in this state or to business activities in this state. See CAL. AD. CODE tit. 18, ch. 3, subch. 3, Reg. 23040(a).
\textsuperscript{305} The phrase “to transact business within this State” as used in section 15 has been held to be the equivalent of the phrase “to do business” as found in many state statutes prohibiting a foreign corporation from “doing business” in the State until the cor-
It may be argued, therefore, that legislative treatment of corporations over which California obtains jurisdiction under the looser nexus standards of the latter taxing measure is not restricted by article XII, section 15. The fact that the corporation income tax, with one exception, reaches only foreign corporations not doing business in California provides further support to that argument.

The activities which, if kept under a certain quantitative minimum, would be permitted to the interstate seller in California under the Huff proposal have consistently been deemed sufficient only for California corporation income tax jurisdictional purposes. California has never squarely confronted the issue whether such activities would...
be sufficient to reach a foreign corporation under the franchise tax law.\textsuperscript{310}

It could therefore be argued that quantitative minimum nexus legislation—which only limits the applicability of corporation income tax law's qualitative jurisdictional standard—would discriminate solely among different categories of foreign corporations under the reach of the corporation income tax whose qualitative jurisdictional standards do not trigger the criterion for applying article XII, section 15 of the California Constitution. No discrimination between domestic and foreign corporations "doing business within the limits of this state," would be introduced into the corporation franchise tax to impair its constitutionality under article XII, section 15.\textsuperscript{311}

d) Effect on California's Revenue

In addition to the potential technical problems which might be raised by the Huff proposal, its effect on California corporate income tax receipts ought to be noted. The proposed minimum quantitative standard of $100,000 in gross receipts would cause California to suffer only a minimal loss of revenue. For purposes of simplicity, assuming that a 5 percent profit margin represents a fairly accurate approximation of the actual profit margin of the weighted mean of all foreign, out-of-state based corporate taxpayers reporting net income for California tax purposes,\textsuperscript{312} such a quantitative minimum would eliminate California corporate income taxes for all those foreign, out-of-state taxpayers reporting $5,000 or less in California net taxable income. During the 1968 income year, out of 1,936 out-of-state corporations filing corporate net income tax returns, 1,267 reported losses or net taxable income of less than $5,000.\textsuperscript{313} These same corporations paid a total of slightly over $90,000 in California corporate

\textsuperscript{310} The court in \textit{West Publishing} probably failed to mention the Bank and Corporation Franchise Tax Act because it was unnecessary to reach the decision. It is suggested that the Huff proposal can avoid California constitutional conflict by consistent judicial and administrative interpretations holding the sales-related activity of the type found in \textit{West Publishing} and suggested by Mr. Huff, while it is clearly sufficient for corporation income tax jurisdictional nexus, is not the equivalent of "doing business" as that term may be employed for purposes of Bank and Corporation Franchise Tax jurisdiction. See notes 283 & 309 supra.


\textsuperscript{312} See note 290 supra.

This amounts to less than 3.3 percent of the total corporate income taxes and to less than .02 percent of the total of corporate income and franchise taxes paid in that income year.

Any revenue loss from foreign, out-of-state corporations who would be taken out of the tax-paying category would probably be eliminated entirely—in fact, added revenues would probably be gained—if the minimum gross receipts quantitative standard were also incorporated in the reverse nexus rules of California's allocation and apportionment statute. Thus, California could disallow assignment of income away from this state's tax reach by those of California's 128,505 corporate taxpayers who are sufficiently present in this state in order to have reported and paid the Bank and Corporation Franchise Tax and whose out-of-state sales activities produce less than $100,000 in gross receipts in any other state.

This elimination of assignment of income would not be possible without amendment of Revenue Code sections 25121 and 25122. As previously noted, reverse nexus standards are essentially a matter of California law, and are not restricted by constitutional or federal criteria. Likewise, constitutional requirements of fair allocation and apportionment of income to all the jurisdictions in which a company does business are not applicable to domestic corporations to the same degree as foreign corporations. In any case, mathematical exactness is not required. The adoption of similar $100,000 quantitative tax jurisdictional minima by all other corporate income taxing states would eliminate any substantial danger of multiple tax burdens on California corporations with less than $100,000 in sales in any other jurisdiction. Until such parallel minimum quantitative

314. Id.
315. Id.
316. Id. at 87 (table 2) & 104 (table 6).
317. CAL. REV. & TAX. CODE §§ 25120-39; see id. § 25101.
319. See text accompanying notes 250-67 supra.
320. See text accompanying notes 258-60 supra.
321. Mathematical exactness in apportionment formulas is not a constitutional requirement. International Harvester Co. v. Evatt, 329 U.S. 416, 422 (1947) ("rough approximation rather than precision is sufficient"). Furthermore, there are obvious policy reasons for treating domiciliary corporations somewhat differently from foreign corporations having only transient physical nexus with the taxing state. In essence the argument is that the benefits and protections afforded domiciliary corporations and their property and employees are greater than those afforded foreign corporations and that this difference in benefit and protection creates the basis for a reasonable tax classification distinguishing domiciliary from foreign corporations.
nexus standards are established in other jurisdictions, a tax credit for taxes actually paid by California corporations to other states could be enacted to eliminate the residual possibility of double taxation of part of California-based companies' total net corporate income where that corporation was disallowed the right to apportion income out of the state because its aggregated gross sales outside California are less than $100,000.

In any case, the elimination of the most marginal two-thirds of the taxpayers now reporting under the California corporation income tax would significantly reduce the paper work involved in filing and auditing their returns. The simplified report of gross receipts and related information under the procedure suggested above could be handled with much greater efficiency and would provide the same basis for selective audit and compliance checks with respect to out-of-state taxpayers as the present full returns provide.

B. Conclusion

The following solution to the interstate tax jurisdictional problem is therefore proposed: First, Congress should leave to the Supreme Court the responsibility for delineating appropriate qualitative standards of state tax jurisdictional nexus requirements. These requirements could be defined and refined in light of the changing technology which is likely to shape the course and methods of interstate business in the coming decades. Second, California and other major taxing states using the corporate net income tax should lead the way in enacting quantitative minimum nexus standards.

Quantitative minimum nexus standards should arise through state self-restraint with respect to the marginal out-of-state taxpayer. Federally imposed uniformity may not be desirable and may take away the experimental forum and innovative function which the states can provide in the area of income taxation. Since the integrity of state governmental functions may depend largely on state fiscal independence from Washington, the solution to minimizing the state income tax burden for small interstate business should come through independent state rather than federal action.

In light of the persistent efforts in Congress to further control the tax jurisdictional reach of the states—which efforts come closer and closer to success with each Congress—322—it seems advisable that the

322. H.R. 7906 did not die quietly in the closing days of the 91st Congress. It was sought to be amended into an omnibus bill on the Senate floor by Senator Charles
recognized leader among the states, with respect to aggressive and substantial net income tax revenue gathering, take steps to correct present deficiencies. As suggested above, a major step in this direction would be the adoption of quantitative jurisdictional minima.

Mathias (Md.) in the hope of pressuring Senator Long into agreeing to early hearings on the bill which will certainly be reintroduced in the 92d Congress.

323. "The State of California has been the most aggressive in its endeavors to enforce its laws and has been most successful in obtaining compliance. As other States either rewrite their laws (Idaho, Tennessee and Utah have already done so) or step up their enforcement activities, many marginal firms . . . will either be forced out of business or will withdraw from the jurisdiction of some taxing states.

"As previously stated, California has been the most aggressive state in enforcement of its laws. It is referred to in some of these examples only because of this." SENATE SELECT COMM. ON SMALL BUSINESS, 86TH CONG., 1ST SESS., STATE TAXATION ON INTERSTATE COMMERCE 313 (Comm. Print 1959).