



SC REVENUE RULING #91-16

SUBJECT: The Effect of 15 U.S.C. Section 381 on South Carolina's Imposition of Income Tax

TAX ANALYST: Steve Hallman

EFFECTIVE DATE: Applies to all periods open under the statute.

SUPERSEDES: All previous documents and any oral directives in conflict herewith.

REFERENCE: 15 U.S.C. Section 381
S.C. Code Ann. Section 12-7-210 (Supp. 1990)
S.C. Code Ann. Section 12-7-230(A) (Supp. 1990)
S.C. Code Ann. Section 12-7-1150(2)(c) (1976)

AUTHORITY: S.C. Code Ann. Section 12-4-320 (Enacted June, 1991)
SC Revenue Procedure #87-3

SCOPE: A Revenue Ruling is the Commission's official interpretation of how tax law is to be applied to a specific set of facts. A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.

Question:

What guidelines can the Commission provide that will assist in the determination of whether certain activities are protected by 15 U.S.C. Section 381 (Public Law 86-272) from the tax imposed by Code Sections 12-7-210 and 12-7-230(A)?

Facts:

In 1985 the Multistate Tax Commission (MTC) issued guidelines on the effect of 15 U.S.C. Section 381 on the power of a state to impose a tax on income derived from within its borders. South Carolina has followed these guidelines for the past four or five years. During this period a number of state courts have considered the meaning of 15 U.S.C. Section 381 and we have had a number of questions concerning the meaning of the MTC guidelines. The guidelines in this ruling are not a departure from our past practices. They are being issued to better inform taxpayers of our position and in certain instances to clarify those positions.

Discussion:

Pursuant to Code Section 12-7-210 "a tax is imposed on the South Carolina taxable income of individuals, estates, and trusts".

Code Section 12-7-230(A) reads, in part:

... every foreign corporation transacting, conducting, doing business, or having an income within the jurisdiction of this State, whether or not the corporation is engaged in or the income derived from intrastate, interstate, or foreign commerce, shall make a return and shall pay annually an income tax...

Quoting from 15A Am. Jur.2d, Commerce, Section 11:

...In the exclusive field of interstate commerce, the Federal Constitution and the laws of Congress are supreme. Where a state statute and a federal statute operate upon the same subject matter and prescribe different rules concerning it, and the federal statute is one within the competency of Congress to enact, under the commerce clause, the state statute must give way....

Public Law 86-272, as codified at 15 U.S.C. Section 381, places certain limits on the power of a state to impose a tax on the income derived from within its borders. It reads, in pertinent part:

(a) No State, or political subdivision thereof, shall have power to impose... a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

(b) The provisions of subsection (a) of this section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to -

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual who, under the laws of such State, is domiciled in, or a resident of, such State.

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

(d) For purposes of this section -

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is 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; and

(2) the term "representative" does not include an independent contractor.[Emphasis added.]

In summary, Code Sections 12-7-210 and 12-7-230(A) impose a tax on the income derived within South Carolina by individuals, estates, trusts, and foreign corporations; however, 15 U.S.C. Section 381 prohibits any state from imposing a tax on the income derived from within its borders under certain conditions. In order to benefit from the protection afforded by 15 U.S.C. Section 381, the only permissible business activity within a state by a taxpayer is the "solicitation" of orders for the sale of tangible personal property, which orders must be sent outside the taxing state for approval or rejection, and, if approved, filled by shipment or delivery from a point outside the state. Further, this protection is not extended to corporations incorporated under the laws of the taxing state or individuals domiciled in or a resident of the taxing state.

The term "tangible personal property" is defined in Code Section 12-7-1150(2)(c) as:

...corporeal property, such as machinery, tools, implements, equipment, goods, wares, and merchandise, and shall not include cash on hand or in bank, shares of stock, bonds, notes, accounts receivable, credits, special privileges, franchise, good will or evidence of debt;

Thus, the income derived from the selling or providing of services, and the selling, leasing, renting, licensing or other disposition of real estate or intangibles are not immune from taxation by reason of 15 U.S.C. Section 381 (Public Law 86-272).

Conclusion:

The Commission has approved the following guidelines to assist in the determination of whether certain activities are protected by 15 U.S.C. Section 381 (Public Law 86-272) from the tax imposed by Code Sections 12-7-210 and 12-7-230(A):

Activities by Taxpayer

Non-Immune Activities

For a South Carolina activity to be immune from taxation, it must be limited solely to solicitation with the exception of that activity conducted by an independent contractor which is described separately. Accordingly, if there is any activity unrelated to solicitation, immunity will be lost. The following activities within South Carolina are examples that will cause otherwise protected sales to lose their immunity:

1. Making repairs or providing maintenance.
2. Collection of prepayments or accounts.
3. Investigating credit worthiness or extending credit.
4. Installation or supervision of installation.
5. Conducting training courses, training seminars or training lectures.
6. Providing engineering functions.
7. Remediating customer complaints.
8. Approving or accepting orders.
9. Repossessing property. Property may be repossessed if performed by an unaffiliated third party.
10. Picking up or replacing damaged or returned property.
11. Hiring, training, or otherwise supervising personnel.
12. Owning or leasing a telephone answering service for any purpose. A telephone answering service may be used for solicitation purposes only, provided the service is operated by an unaffiliated third party.
13. Maintaining sample or display room in excess of two weeks (14 days) during the tax year.
14. Carrying samples for sale, exchange or distribution in any manner for consideration.
15. Owning, leasing, maintaining or otherwise using any of the following facilities or property within South Carolina:
 - a. Repair shop.

- b. Parts department.
 - c. Purchasing office.
 - d. Employment office.
 - e. Warehouse.
 - f. Meeting place for directors, officers or employees used on a regular basis.
 - g. Stock of goods for distribution for consideration.
 - h. Mobile stores, i.e. trucks with driver salesmen.
 - i. Real property or fixtures of any kind.
- 16. Consigning tangible personal property to any person, including an independent contractor.
 - 17. Maintenance by the company, directly or indirectly, of an office or place of business for an employee, in home or otherwise.
 - 18. Price negotiation.
 - 19. Maintenance or inspection of customer's inventory for purposes other than re-order.
 - 20. Conducting any activity, in addition to those described below as immune activities, which is not an integral part of the solicitation of orders.

Immune Activities

The following activities within South Carolina by a business will not cause the loss of protection for otherwise immune sales:

- 1. Advertising campaigns incidental to solicitation.
- 2. Carrying samples only for display or for distribution without charge or other consideration.
- 3. Owning or furnishing automobiles to salesmen.
- 4. Forwarding inquiries or complaints to home office.
- 5. Checking customers' inventories for re-order purposes.

6. Maintaining sample or display room for two weeks (14 days) or less during the tax year.
7. Soliciting of sales by an employee of the taxpayer provided the company does not maintain, directly or indirectly, an in-state sales office or place of business, in-home or otherwise.

Activities by Independent Contractors

Public Law 86-272 affords immunity from taxation to certain activities within a state if conducted by an independent contractor that would not be afforded if performed by a business directly. Independent contractors may engage in the following limited activities within South Carolina without the taxpayer's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining a sales office.

Sales representatives who represent a single principal are not independent contractors. Such representatives are subject to the same limitations as employees of the taxpayer. Further, maintenance of a stock of goods within this State by an independent contractor under consignment or any other type of arrangement with the principal shall cause the business to lose immunity.

Nature of Sales

Only the sale of tangible personal property in interstate commerce is afforded protection under 15 U.S.C. Section 381. If there is any other activity, except that described as "Immune Activities" or otherwise incident to solicitation, then immunity may be lost. To qualify as interstate commerce, approval of sales must be made outside South Carolina, except for sales by independent contractors, and deliveries must be made from a point outside South Carolina.

The immunity afforded by Public Law 86-272 does not apply to any corporation incorporated within South Carolina.

In that 15 U.S.C. Section 381 concerns the solicitation of orders for sales of tangible personal property, the selling, leasing, renting, licensing or other disposition of real estate or intangibles is not immune from taxation. Further, sales of services are not protected activities. If a sale consists of a mixture of tangible personal property and services, the immunity is lost. Examples of such mixture include, but are not limited to:

1. Photographic development.
2. Fabrication of customer's materials.

3. Installation of equipment.
4. Architectural and engineering services.

SOUTH CAROLINA TAX COMMISSION

s/S. Hunter Howard Jr.
S. Hunter Howard, Jr., Chairman

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Columbia, South Carolina
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