



SC REVENUE RULING #93-10

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: S.C. Revenue Ruling #91-16 as well as 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. 1991)
S.C. Code Ann. Section 12-7-230(A) (Supp. 1991)
S.C. Code Ann. Section 12-7-1150(2)(c) (1976)

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

SCOPE: A Revenue Ruling is the Department'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 A Revenue Ruling is public information and remains a permanent document until superseded by a Regulation or is rescinded by a subsequent Revenue Ruling.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 Department 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 Public Law 86-272 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 five or six years. During this period a number of state courts have considered the meaning of Public Law 86-272 and we have had a number of questions concerning whether certain activities are protected by Public Law 86-272 in South

Carolina. As a result, guidelines were published September 19, 1991, in SC Revenue Ruling #91-16 to better clarify South Carolina's position. On June 19, 1992, the United States Supreme Court rendered its opinion in the matter of Wisconsin Dept. of Revenue v. Wrigley Co., 112 S.Ct. 2447 (1992), which concerns the protection afforded by 15 U.S.C. Section 381. Certain activities addressed by the Court in this opinion necessitate the modification of SC Revenue Ruling #91-16.

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, Public Law 86-272 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 Public Law 86-272, 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 Public Law 86-272. (See SC Information Letter #93-20)

In Wisconsin Dept. of Revenue v. Wrigley Co., supra, the Court considered, among other issues, the meaning of the phrase "solicitation of orders" and established a "proper standard" for application of the phrase. The Court's opinion states, in part:

...We proceed, therefore, to describe what we think the proper standard to be. Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly essential to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are entirely ancillary to requests for purchases - those that serve no independent business function apart from their connection to the soliciting of orders - and those activities that the company would have reason to engage in anyway but chooses to allocate to its in-state sales force....(footnote omitted)

Accordingly, "solicitation of orders" extends beyond the sole act of inviting an order and includes the entire process associated with the invitation (e.g. a company car or a stock of free samples provided to a salesman). "Solicitation of orders" does not include activities apart from the invitation of orders that the company has reason to do anyway (e.g. repair or services activities by sales personnel). Further, the Court determined that the maintenance of an office in a taxing state was not protected by Public Law 86-272 under any circumstances.

The Court also examined whether de minimis or insignificant activity apart from solicitation of orders by the company within the taxing state resulted in the loss of immunity from taxation. With respect to this issue, the Court held:

...whether in-state activity other than "solicitation of orders" is sufficiently de minimis to avoid loss of the tax immunity conferred by 381 depends upon whether that activity establishes a nontrivial additional connection with the taxing State....

* * * *

...We need not decide whether any of the nonimmune activities was de minimis in isolation; taken together, they clearly are not....

Therefore, if a company engages in business activity other than solicitation of orders, the activity serves an independent business function other than the solicitation of orders, and the activity is not trivial, the protection of Public Law 86-272 is lost. Further, any business activities, other than the solicitation of orders, are viewed in the aggregate, rather than separately.

Conclusion:

Nature of Sales

Only the sale of tangible personal property in interstate commerce is afforded protection under Public Law 86-272. If there is any other activity, except that described as "Immune Activities" or otherwise incident to solicitation, then immunity may be lost. To be immune, 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.

Since only the sale of tangible personal property is afforded immunity under Public Law 86-272, the leasing, renting, licensing or other disposition of tangible personal property, intangibles or any other type of property is not immune from taxation by reason of Public Law 86-272.

In addition, the selling 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 mixtures include, but are not limited to:

1. Photographic development.
2. Fabrication of customer's materials.
3. Installation of equipment.
4. Architectural and engineering services.

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

Solicitation of Orders

For an in-state activity to be immune, it must be limited solely to solicitation (except for de minimis activities described in this section and certain activities conducted by independent contractors described separately). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order.

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders are not considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not, merely by such assignment, make such activities ancillary to solicitation of orders. The conduct of activities not falling within the foregoing definition of solicitation will cause a company to lose the exemption from net income afforded by Public Law 86-272, unless the disqualifying activities, taken together, are de minimis.

De minimis activities are those that, when taken together, establish only a trivial additional connection with the state. An activity regularly conducted within this state pursuant to a company policy or on a continuous basis shall normally not be considered trivial. Whether or not an activity consist of a trivial or non-trivial additional connection with the state is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a non-trivial connection with the state, then such activity exceeds the protection of Public Law 86-272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within this state is not determinative of whether a de minimis level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within this state is inconsistent with the limited protection afforded by Public Law 86-272.

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

Non-Immune Activities

For a South Carolina activity to be immune from taxation, it must be an integral part of or ancillary to solicitation of orders with the exception of certain activity conducted by an independent contractor which is described separately. Accordingly, if there is any activity unrelated to solicitation which is conducted regularly for an independent business purpose, immunity will be lost. Further, if there are any business activities, other than the solicitation of orders, the activities must be evaluated in the aggregate rather than separately. 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. Collecting current or delinquent accounts.
3. Investigating credit worthiness or extending credit.
4. Installation or supervision of installation.
5. Conducting training courses, seminars or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or services, including, but not limited to, engineering assistance or services, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than assisting customers or prospective customers in communicating with the company's appropriate departments.

8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or otherwise supervising personnel other than personnel involved only in solicitation.
13. Maintaining a sample or display room in excess of two weeks (14 days) at any one location during the tax year.
14. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
15. Owning, leasing, or maintaining any of the following facilities or property within South Carolina :
 - a. Repair shop.
 - b. Parts department.
 - c. Purchasing office.
 - d. Employment or recruiting office.
 - e. Warehouse.
 - f. Meeting place for directors, officers or employees.
 - g. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
 - h. Telephone answering service that is formally attributed to the company or the agent(s) of the company in their agency status.
 - i. Mobile stores, i.e. vehicles with drivers who are sales personnel making sales from the vehicles.
 - j. Real property or fixtures to real property of any kind.
16. Consigning tangible personal property to any person, including an independent contractor.

17. Maintaining, by any employee, an office or place of business (in-home or otherwise) that is paid for directly or indirectly by the company and that is formally attributed to the company or to the agent(s) of the company in their agency status, even if such office is for the exclusive use of soliciting orders.
18. Maintenance or inspection of customer's inventory for purposes other than re-order.
19. Replacing customer's stale or outdated inventory.
20. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.
21. Conducting any activity not listed below under "Immune Activities" which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases .

Immune Activities

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

1. Soliciting orders for sales by any type of advertising.
2. Carrying samples only for display or for distribution without charge or other consideration.
3. Owning or furnishing automobiles to salesmen.
4. Passing inquiries and complaints on to home office.
5. Missionary sales activities.¹
6. Checking of customers' inventories without charge (for re-order, but not for other purposes such as quality control).
7. Maintaining a sample or display room for two weeks (14 days) or less at any one location during the tax year.
8. Soliciting of orders for sales by an in-state resident employee of the company; provided the employee maintains no in-state sales office or place of business (in-home or otherwise) that is attributable to the company or to the company's agent(s) in their agency capacity.

¹ Missionary sales activities are: (a) calling upon wholesalers, distributors or prospective customers to solicit orders for the sale of tangible personal property and (b) assisting wholesalers or distributors in obtaining suitable display of the company's products at retail locations. See Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 So.2d 70 (1958).

9. Recruitment, training or evaluation of sales personnel, including occasional use of homes, hotels or similar places for meetings with sales personnel.
10. Maintaining, by any sales employee, an in-home office that is not paid for directly or indirectly by the company and which is not attributable to the company or to the company's agent(s) in their agency capacity.
11. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.

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 or its agents or other representatives 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 considered to be 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 company, except for purposes of display and solicitation, shall cause the business to lose immunity.

NOTE: See SC Information Letter #93-20 concerning income taxes that may be due in connection with revenue derived from intangibles.

SOUTH CAROLINA DEPARTMENT OF REVENUE

s/A. Crawford Clarkson Jr.

A. Crawford Clarkson, Jr., Chairman

s/T. R. McConnell

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s/James M. Waddell Jr.

James M. Waddell, Jr., Commissioner

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