



88-SBE-014

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
SCHWINN SALES WEST, INC.) No. 82R-1029-RO
)
)

For Appellant: Michael K. Cavanaugh
Attorney at Law

For Respondent: Terry Collins
Counsel

O P I N I O N

This appeal is made pursuant to section 26075, subdivision (a),^{1/} of the Revenue and Taxation code from the action of the Franchise Tax Board in denying the claim of Schwinn Sales West, Inc., for refund of franchise tax in the amounts of \$43,085.23, \$6,616.68, \$7,141.97, \$16,991.02, and \$9,105.85 for the income years 1974, 1975, 1976, 1977, and 1978, respectively.

^{1/} Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the years in issue.

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The issue in this appeal is whether the activities of the appellant's parent corporation in California are immune from taxation under Public Law 86-272.

The appellant, Schwinn Sales West, Inc., is a California corporation engaged in wholesaling Schwinn bicycles and parts. Appellant is a wholly-owned subsidiary of Schwinn Bicycle Company (hereinafter referred to as "**Schwinn**"). Appellant is based in Industry, California. Schwinn, the parent corporation of the appellant, is an Illinois corporation, with its principal place of business in **Chicago**. During appellant's income years 1974 through 1978, Schwinn engaged in the manufacture and sale of bicycles throughout the United States. The bicycles were manufactured in Illinois and sold to independent dealers throughout the country.

Appellant originally filed tax returns as a separate business. Thereafter, it filed a combined report with its parent and the other wholly-owned subsidiaries of its parent. As a consequence of filing a combined report, **appellant** filed claims for refund in amounts presently in controversy. In the combined report, pursuant to the Appeal of Joyce, Inc., decided by this board on November 23, 1966, appellant excluded Schwinn's California sales and payroll from the numerator of their respective factors on the theory that Schwinn was not subject to California **franchise tax** under Public Law **86-272.2/** (See 15 U.S.C.A. § 381 (1976).) In partially disallowing **appellant's** refund claims, respondent determined that Schwinn's California activities exceeded those protected by Public Law 86-272, and, therefore, included Schwinn's California sales and payroll in the numerator of their respective factors.

Based on the record, we find that Schwinn's California sales and property were properly includable in the numerator of their respective factors, **since Schwinn's** activities exceeded the scope of allowable "solicitation" permitted by the statute. (15 U.S.C.A. § 381 (1976).)

Public Law 86-272 provides that the state has no power to impose a net income tax on an out-of-state taxpayer if that taxpayer's activities are limited to the specific activities

2/ In Appeal of Joyce, Inc., this board held that receipts from the sale of goods shipped to California customers by a seller that was part of a unitary business, but was not itself taxable in the state because of P.L. 86-272, may not be included in the California sales factor.

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prescribed therein. The statute provides as follows:

(a) NO State ... shall have the 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; ...

(1959 U.S. code Cong. & Ad. News 613.)

The scope of the exclusion from taxation under Public Law 86-272, since its enactment, remains uncertain. Although the statute is written as a limitation on state power, it does not define affirmatively the activities which create liability. AS a **result, in the areas** NOT covered by the law, the issue of the state's power to tax remains the province of the courts. (Special Subcomm. of the House Comm. on the Judiciary, State Taxation of Interstate Commerce, H.R. Rep. No. 1480, 88th Cong., 2d Sess., p. 145 (1964).)

The extent of the protection afforded by Public Law 86-272 has been widely interpreted. (See Hervey v. Beard, 250 Ark. 147 [464 S.W.2d 557] (1971); Drackett Products Co. v. Conrad, 370 N.W.2d 723 (N.D. 1985); Clairol, Inc. v. Kingsley, 109 N.J. Super. 22 [262 A.2d 2131, affd., 57 N.J. 199 [270 A.2d 7021, app. dismiss., 402 U.S. 902 128 L.Ed. 6431 (1971)]; National Tires, Inc. v. Lindley, 68 Ohio App.2d 71 [426 N.E.2d 793] (1980); Cal-Roof Wholesalers, Inc. v. State Tax Commission, 242 Or. 435 [410 P.2d 2331 (1966)]; cf. Indiana Dept. of Revenue v. Kimberly-Clark Corp., 275 Ind. 378 [416 N.E.2d 12641 (1981)]; State ex. rel. CIBA Pharmaceutical Products, Inc. v. State Tax Commission, 382 S.W.2d 645 (Mo. 1964); Gillette Co. v. State Tax Commission, 410 N.Y.S.2d 65 [382 N.E.2d 7641 (1978)]; U.S. Tobacco Co. v. Commonwealth, 478 Pa. 125 [386 A.2d 4711, cert. den., 439 U.S. 880 [58 L.Ed.2d 1931 (1978)].)

Since the statute sets forth no tests to be applied in determining if an out-of-state taxpayer's activities exceed

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solicitation, each case must be judged on its own facts.
(Appeal of Aqua Aerobic Systems, Inc., Cal. St. Bd. of Equal.,
Nov. 6, 1985.)

In this instance, during appellant's income years 1974 through 1978, Schwinn maintained neither stocks of goods, raw materials nor supplies in California. It had no office and owned neither tangible **personal nor** real property in California during the aforementioned years.

Sales made to California dealers were shipped F.O.B. common carrier from outside the state. Orders from California dealers were accepted outside the state by Schwinn.

According to appellant the activities of Schwinn's employees were:

During 1974 - 1978, Schwinn employed nine regional sales managers who covered the 50 United States. Two such salesman resided in California; one covered Southern California, Arizona, Idaho, Utah, Colorado, New Mexico and part of Nevada; while the other covered Northern California, Washington, Oregon, Idaho, Montana and part of Nevada.

The principal **function of** the regional sales **managers** was to stimulate sales for acceptance by Schwinn. In doing this the regional sales managers also reported the state of the market in California, explained current promotional and advertising campaigns of Schwinn to the dealers, as well as acted as goodwill ambassadors by transferring dealer comments regarding products back to Chicago, Illinois office. These goodwill and sales generation activities of the sales manager consumed the substantive time and effort that the sales managers expended for Schwinn. The regional sales managers also reported on **applications for new dealers received from** time to time in Schwinn's Chicago, Illinois office.

Occasionally, the sales managers investigated sporadic dealer and consumer complaints and certain accident claims. Occasionally, the sales managers also assisted in the store layouts and met with dealership applicants.

Schwinn conducted, from time to time, a service **school** in the various states, including California. The purpose of the school was to instruct dealers on the sale and proper assembly of Schwinn bicycles. The

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schools were conducted by Illinois resident employees of Schwinn who traveled to the various states when such a school was scheduled.

(App. Br. at 4-S.)

Respondent's field auditor obtained information relating to one Schwinn employee, a sales manager, named David Staub. The record indicated his involvement in the following activities:

1. In 1974, he was involved for two days doing store layouts; conducted training for two days; and for a day each, investigated an accident involving a Schwinn bicycle, conducted a dealer meeting and conducted a dealer survey;

2. In 1975, he was involved for two days doing store layouts; involved in an accident investigation and court trial for four days; and for a day each, investigated consumer complaints, conducted a dealership meeting, searched for a potential new store location and was involved in doing **cyclery** write-ups;

3. In 1976, he conducted a service school' for three days; and for a day each, met with dealership applicants, met with a prospective dealer and worked on a store layout.

4. In 1977, he was involved for a day each, in meeting with a dealership prospect and surveying new locations, in assisting in a dealer change of ownership, in meeting with a prospective buyer and discussing an ownership agreement, and in making a cash reimbursement for a customer complaint; and

5. In 1978, he was involved for a day each, in conducting a dealership meeting, in conducting a service school and **in conducting** a dealer shopping test.

Respondent's field auditor also found that personnel from **Schwinn's** facility in Chicago, Illinois, periodically conducted service schools throughout California which were attended by dealers. From 1974 through 1978, the service schools conducted by Schwinn in California were extensive. Service school training sessions held during the appeal years

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are reflected in the following table:

<u>Location</u>	<u>1974</u>	<u>1975</u>	<u>1976</u>	<u>1977</u>	<u>1978</u>
Los Angeles	9 days				16 days
San Jose	5 days		5 days		
Sacramento	5 d a y s				24 days
City of Industry		20 days	49 days	17 days	
San Francisco		2 days	8 days		
San Diego			10 days		10 days
	<u>19 days</u>	<u>22 days</u>	<u>72 days</u>	<u>17 days</u>	<u>50 days</u>

Respondent contends that Schwinn's activities exceed the scope of solicitation as **permitted** by Public Law 86-272. Specifically, respondent contends that Mr. Staub, a Schwinn sales manager, conducted activities in California other than solicitation. Furthermore, **respondent** contends that, apart from Mr. **Staub's** activities, the service schools conducted by **Schwinn's** out-of-state personnel are activities not protected by the statute. Appellant, on the other hand, contends that the activities are protected within the terms of the statute.

This board has adopted an interpretation that **"solicitation"** as used in Public Law 86-272 should be given its generally accepted meaning. (Appeal of Aqua Aerobic Systems, supra; see Miles Laboratories, Inc. v. Department of -Revenue, 274 Or. -395 [546 P.2d 1081, 1083] (1976).) As a consequence, the term solicitation should be limited to those generally **accepted or customary acts** in the industry which lead to the placing of orders, not those which **follow** as a natural result of the transaction. (Appeal of Aqua Aerobic Systems, Inc., supra; Olympia Brewing Company v. Department of Revenue, 266 Or. 309 [511 P.2d 8371, cert. den., 415 U.S. 976 [39 L.Ed.2d 872] (1974); see also Herff Jones Co. v. State Tax Commission, 247 Or. 404 [430 P.2d 9981 (1967) and Cal-Roof Wholesale, Inc. v. State Tax Commission, 242 Or. 435 [410 P.2d 2331 (1966), which limit any broad interpretation of the term "solicitation.") It should also be-viewed in light of the statute's legislative history. (Tjewater Oil Co. v. United States, 409 U.S. 151, 157 [34 L.Ed.2d 375] (1972).)

The record shows that Mr. Staub does more than solicit orders in **California**. In 1974, he conducted two days of training **"in L.A. area,"** investigated an accident case involving a Schwinn bicycle, and conducted a dealership survey. In 1975, he was involved in a "dealership applicant **meeting,**" a **store location search,** a meeting to do **cyclery** write-ups, an investigation and court trial relating to a bicycle accident, and the investigation of a consumer complaint. In 1976, he was involved in conducting a service

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school, and meeting with dealership applicants and a "dealer prospect." In 1977, he was involved in meeting with a dealership prospect, surveying new locations, assisting in a change of ownership of a dealership and reimbursing a customer due to a complaint. Finally, in 1978, he was involved in conducting a service school and a dealer shopping test. We find that these activities **were** not related to solicitation as intended by the legislative history of Public Law 86-272. (S. Rep. NO. 658, 86th Cong., 1st Sess., (1959) [1959 U.S. code Cong. & Ad. News 2548, 2549]; H.R. Rep. No. 1480, 88th Cong., 2d Sess., p. 145 (1964).)

Appellant argues, that with respect to each year, if the activities of Mr. Staub are not solicitation in nature, they are so sporadic and isolated that they should not operate to remove the exemption provided by Public Law 86-272. (Indiana Department of Revenue v. Kimberly-Clark Corp., supra, 416 N.E.2d at 1268.) However, we must look to the totality of facts with respect to Schwinn, examining each year in view of the entire record. In this instance, the facts indicate that the nonsolicitation activities of Mr. **Staub**, from 1974 through 1978, as sales manager, along with Schwinn's **conducting** of service schools, show that Schwinn's activities were regular, systematic and associated with maintaining a business operation. (The Drackett Products Co. v. Conrad, supra; Briggs & Stratton Corp. v. State Tax Commission, 3 Or. Tax Ct. 174 (1968).)

Assuming, arguendo, that Mr. Staub's nonsolicitation activities were isolated and sporadic, the fact remains that Schwinn's service schools were regular and systematic. These schools were conducted by Schwinn personnel who reside **out-of-state** but travel into California. We find that the use of technical representatives as instructors in this instance was not an activity of solicitation accepted or customary in the industry. (Miles Laboratories, Inc. v. Dept. of Revenue, supra; Olympia Brewing Company v. D&t. of Revenue, supra.) The service school instruction provided to the dealers was a regular and systematic activity-of significant duration **beyond** the scope of allowable solicitation. (Briggs & Stratton Corp. v. State Tax Commission, supra.)

Appellant contends that the service schools were required to show how to assemble the bicycles and, therefore, was related to sales. However, the record does not support the appellant's contention. Based on the nature of Schwinn's dealership network, expenditures for warranty work and the **guaranty** Schwinn gives on its bicycles, we find that the service schools related to the assembly and repair of bicycles. The record indicates that Schwinn bicycles have a

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lifetime warranty and its expenditures on warranty work from 1974 through 1978 were **significant.**^{3/}

Appellant relies on State ex rel. CIBA Pharmaceutical Products, Inc. v. State Tax Commission, supra, in support of the proposition that the service **schools** were related to sales.. That case is distinguishable factually from this appeal. In that case, sales representatives of the taxpayer were assembled for periodic meetings to acquire information on products to be sold and instruction on company policy. (Ibid.) In this instance, there are no sales representatives of Schwinn assembled to discuss the sale of Schwinn products, but rather a team of technicians giving mechanical instruction on the assembly and maintenance of a product to independent dealers.

Based on the foregoing analysis, we, therefore, find that the immunity of Public Law 86-272 is inapplicable to Schwinn. The activities of both Schwinn's sales manager and its conduct of service schools for dealers in **California** exceeded protected solicitation. Accordingly, **the** respondent's denial of appellant's claims for refund must be sustained.

3/ Warranty work performed by Schwinn was as follows:

1974	\$727,547
1975	476,798
1976	465,135
1977.	503,064
1978	483,440

