



BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of }
THE OLGA COMPANY)

Appearances:

For Appellant: James G. Phillipp
Attorney at Law

For Respondent: Carl G. Knopke
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of The Olga Company against proposed assessments of additional franchise tax in the amounts of \$46,381 and \$49,864 for the income years 1974 and 1975, respectively.

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The issue presented is whether appellant's sales to customers in certain states outside California are immune from taxation by those states under, Public Law 86-272.

Appellant is a California corporation engaged in the manufacturing and wholesaling of high quality lingerie. Its headquarters and principal offices are located in Van Nuys, California, but appellant operates throughout the United States, primarily through employee-salesmen.

Appellant filed its corporate tax returns for the income years 1974 and 1975 as a unitary **business**, calculating its California income by means of the standard three-factor apportionment formula. In computing its sales factor, appellant included in the numerator only its sales to purchasers within California. Upon audit, respondent determined that appellant's activities in approximately **33 states and the District of Columbia** (hereafter referred to as the "foreign states") were immune from taxation by those jurisdictions by virtue of Public Law 86-272. (15 U.S.C. §381 et seq.) Therefore, in accordance with section 25135, subdivision (b)(2), of the Revenue and Taxation Code, respondent "threw back" those sales into the California sales factor. It recalculated appellant's tax liability and issued proposed assessments for the income years 1974 and 1975. After considering appellant's protest, respondent determined that appellant's sales in Texas were taxable by that state, removed those sales from the sales factor, and adjusted the proposed assessments accordingly. It then affirmed the proposed assessments, giving rise to this appeal. Respondent now concedes that appellant's sales in Washington were taxable by that state and, if it prevails in this appeal, agrees to modify the proposed assessment to remove those sales from the sales factor.

Appellant is represented in the foreign states by its salesmen, who are employees rather than independent contractors. Appellant does not maintain an office in any of the foreign states; rather, each salesman works from his home. Nor does appellant maintain stock in the foreign states; all orders are forwarded to appellant's offices in California and filled from there. In addition to calling on appellant's customers to display its products, the salesmen hold "mini markets." These are the local counterpart to appellant's "major markets" which are held four times per year, solely in New York and Dallas. At both the major and mini markets, new lines

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of products are presented to potential and existing customers. Each salesman is responsible for organizing and handling the mini markets in his area. He must either rent space, usually a hotel room, or hold it in his home. Appellant's management sales staff often attend the mini markets to promote goodwill and receive feedback on the latest lines. Orders for goods are generally not taken at the mini market.

Due to the high quality of appellant's products, many of its customers are large department stores that have carried appellant's line for many years. It is in particular the activities engaged in by appellant's salesmen with regard to these customers that appellant contends go beyond mere solicitation. The services appellant's salesmen perform for these large customers include taking inventory of the customer's Olga stock to determine their reorder needs and assisting the customers to effectively display Olga products. The salesmen also have some involvement in appellant's cooperative advertising program, through which appellant reimburses certain advertising expenses incurred by some of its larger customers.

A unitary business is generally required to determine its California income by multiplying its business income by a fraction, the numerator of which is the sum of the property, sales, and payroll factors, and the denominator of which is three. (Rev. & Tax. Code, § 25128.) The sales factor is a fraction, the numerator of which is the total of the taxpayer's sales in this state during the income year and the denominator of which is the taxpayer's total sales during the income year. (Rev. & Tax. Code, § 25134.) Whether a sale of tangible personal property is in this state or not is determined in accordance with section 25135 of the Revenue and Taxation Code. That section provides, in pertinent part, as follows:

Sales of tangible personal property are in this state if:

* * *

(b) The property is shipped from an office, store, warehouse, factory, or other place of storage in this state and (1) the purchaser is the United States government or (2) the taxpayer is not taxable in the state of the purchaser. (Emphasis added.)

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A California taxpayer is taxable in another state if it is either subject to one of several types of taxes or if the state "has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not." (Rev. & Tax. Code, § 25122, subd. (b).) A state does not have jurisdiction to tax if it is prohibited from imposing a net income tax by virtue of Public Law 86-272. (Cal. Admin. Code, tit. 18, reg. 25122, subd. (c) (art. 2.5).)

Public Law 86-272 limits the power of a state to impose a net income tax on income earned from interstate commerce by an out-of-state taxpayer. Subdivision (a) of section 101 of that law provides, in pertinent part:

No State, . . . 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 ... 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: ...

Respondent contends that the sales to purchasers in the foreign states are properly classified as sales in California because the property sold was shipped from this state and because Public Law 86-272 prohibited the foreign states from taxing appellant. Appellant's position is that the foreign states had jurisdiction to subject it to a net income tax because its activities in those states exceeded the solicitation of orders.

In enacting Public Law 86-272, Congress carved out a specific area of immunity from state taxation. Courts and this board have held that immune activities are strictly limited to solicitation or activities incidental to solicitation. (See Appeal of Nardis of Dallas, Inc., Cal. St. Bd. of Equal., April 22, 1975, and the cases cited therein.) Public Law 86-272 sets forth no test to be applied when determining whether an employee's activities go beyond solicitation. Each case must be judged on its own facts, with particular emphasis placed

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on the totality of the taxpayer's activities within the state. (Iron Fireman Manufacturing Co. v. State Tax Commission, 251 Ore. 227 [445 P.2d 126] (1968); Department of Revenue v. Kimberly-Clark Corp., 375 N.E. 2d 1146 (Ind. App. 1978).) Activities which have been held to go beyond mere solicitation include: giving spot credit and collecting delinquent accounts (Cal-Roof Wholesale, Inc. v. State Tax Commission, 242 Ore. 435 [410 P.2d 233] (1967)); collecting deposits and advances (Herff Jones Co. v. State Tax Commission, 247 Ore. 404 [430 P.2d 998] (1967)); maintaining a permanent sales office (Appeals of CITC Industries, Inc. and Bob Wolf Associates, Inc., Cal. St. Bd. of Equal., June 28, 1979); retaining the contractual right-to inspect the product after installation (Appeal of Riblet Tramway Co., Cal. St. Bd. of Equal., Dec. 12, 1967); exchanging technical information (Briggs & Stratton Corp. v. State Tax Commission, 3 Ore. T.R. 174 (1968)); and maintaining personal property within the state (Olympia Brewing Co. v. Department of Revenue, 266 Ore. 309 [516 P.2d 837] (1973), cert. den., 415 U.S. 976 [39 L.Ed.2d 872] (1974)).

When a taxpayer claims that it is subject to tax in another state, it is incumbent upon that taxpayer to provide evidence to support its assertion. (Cal. Admin. Code, tit. 18, § 25122, subd. (b) (art. 2.5).) Respondent's regulations further provide as follows:

The Franchise Tax Board may request that such evidence include proof that the taxpayer has filed the requisite tax return in such other state and has paid any taxes imposed under the law of such other state; the taxpayer's failure to produce such proof may be taken into account in determining whether the taxpayer in fact is subject to one of the taxes specified in Section 25122(a) in such other state.

(Cal. Admin. Code, tit. 18, § 25122, subd. (b) (art. 2.5).)

Appellant was asked to prove that it filed a return required by any of the foreign states and paid any tax imposed. In response, appellant admitted that it filed no returns in any of the taxing states and presented no reasonable explanation as to why it did not file any returns. Therefore, we must conclude that appellant is representing to those states that its activities within those states are merely solicitation and that it is immune from taxation by reason of Public Law 86-272. We believe that this weighs heavily against appellant and that, in

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order to prevail, appellant must clearly establish that its activities within the foreign states go beyond mere solicitation.

Appellant's first argument is based on the fact that its salesmen are residents of the foreign states and use their residences as their offices. The operation and maintenance of a sales office in the foreign state by the seller removes the seller from the protection of Public Law 86-272. (Appeals of CITC Industries, Inc. and Bob Wolf Associates, Inc., supra.) Appellant argues that the same result should follow when the salesmen in foreign states work from their homes. Appellant has provided no support for this position. Nor has appellant attempted to establish that the salesmen's homes were used as offices to any greater extent than a salesman without an office would ordinarily use his home, that is, to receive mail, write **orders**, and use the telephone; If these activities were held to remove the employer from the immunity of Public Law 86-272, no out-of-state seller employing resident salesmen would be protected. This does not appear to have been the legislative intent in enacting Public Law 86-272. (Hellerstein, State Taxation: I. Corporate Income and Franchise Taxes (1983) Jurisdiction to Tax, ¶ 6.12, pp. 250-251.) The Indiana and Missouri courts apparently concluded that a resident salesman can work from his home without subjecting his employer to taxation since they have held employers to be immune from taxation under Public Law 86-272, although they employed resident salesmen who operated from their homes. (Department of Revenue v. Kimberly-Clark Corp., supra; State ex rel. CIBA Pharmaceutical Products, Inc. v. State Tax Commission, 382 S.W.2d 645 (Mo. 1964)) For the foregoing reasons, we must also reject appellant's first argument.

Appellant's next contention is that its salesmen in the foreign states extend spot credit, an activity which has been held to exceed solicitation. (Cal-Roof Wholesale, Inc., supra.) Appellant has, however, failed to establish that its salesmen actually have that authority. Appellant bases its claim on the fact that since many of its customers have long-standing relationships with appellant, "[t]he orders are automatically filled as they arrive in the home office. ..." (App. Br. at 9.) The record reveals, however, that final authority to approve or disapprove an order rests with the home office and not with the salesmen in the foreign states.

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Appellant argues that its salesmen have major responsibility for its cooperative advertising program and that the salesmen's activities connected with that program exceed solicitation. Appellant has not cited, nor have we found, any legal authority for the proposition that such advertising activities exceed solicitation as contemplated by Public Law 86-272. We need not decide this question since appellant has failed to establish what role its salesmen play in connection with the company's cooperative advertising program. Respondent contends that all decisions concerning the program are made by the home office and that the salesmen in the foreign states have little if any involvement in the program. Appellant contends the contrary: that its salesmen in the foreign states have virtually unlimited authority to approve or deny advertising, to determine how the advertising budget is to be spent, and to decide which customers participate in the program. However, appellant has not submitted any evidence of its salesmen's involvement in the cooperative advertising program. Since appellant bears the burden of proof, we must agree with respondent that the home office directly operates this program. The program, therefore, has no impact on whether the activities of appellant's salesmen exceed solicitation.

The question presented by this appeal is thus narrowed to whether appellant has established that its salesmen's activities related to organizing the mini markets, taking inventory of customers' Olga products, and assisting customers to display Olga stock exceed solicitation.

Appellant relies primarily on the case of Clairol, Inc. v. Kingsley, 109 N.J. Super. 22 [262 A.2d 213], affd. per curiam, 57 N.J. 199 [270 A.2d 702] (1970), app. dismissed, 402 U.S. 902 [28 L.Ed.2d 643] (1971), in which the activities of Clairol's employees in New Jersey were found to have exceeded solicitation. Appellant stresses that Clairol's salesmen, like appellant's, visited customers, which were retail stores; reviewed the display of Clairol products; sometimes rearranged displays or made up displays; and took inventory so they could suggest what the customer's order should be. However, the Clairol case is distinguishable from the instant appeal. In addition to the salesmen, Clairol had other employees, called technicians, located in New Jersey. These employees visited beauty salons which did not order directly from Clairol and took no orders. Rather, they merely gave technical advice and elicited comments about Clairol's products. The precise holding in Clairol is unclear

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since the court did not decide whether the activities of the salesmen, without the technicians, would have gone beyond solicitation. In addition, the Clairol decision has been criticized, and other courts have stated that all of the activities engaged in by Clairol's salesmen would come within the normal connotations of "solicitation." (United States Tobacco Co. v. Commonwealth, 478 Pa. 125 [368 A.2d 471], cert. den., 439 U.S. 880 [58 L.Ed.2d 193] (1978); Olympia Brewing Company v. Department of Revenue, supra.) For these reasons, we believe appellant's reliance upon the Clairol case is misplaced.

We believe that appellant has failed to establish that the activities of its salesmen clearly exceed solicitation. The salesmen engage in no activities which have previously been found to exceed solicitation. The activities which appellant contend exceed solicitation are: (1) holding mini markets; (2) taking inventory of major customer's stock; and (3) assisting customers with the display of stock. The mini markets are held to give the salesmen the opportunity to display appellant's product, the first step towards soliciting an order. Similarly, the taking of inventory by salesmen is directly connected to the soliciting of orders. By performing this service, appellant's salesmen are able to establish the customers' reorder needs and thereby convince these customers to purchase appellant's products. Finally, assisting retailers to display Olga stock is also directly linked to solicitation since its purpose is to induce purchases of Olga stock. Appellant incorrectly equates this activity with the activity of the taxpayer in the Appeal of Riblet Tramway Co., supra. In that appeal, the taxpayer sold ski lift equipment and contractually reserved the right to inspect the equipment sold after it was installed. This board held that such activity went beyond solicitation. We believe that there is a vast difference between having the legal right to inspect and approve installation of a complex machine and helping a customer display lingerie, and we therefore conclude that the Riblet Tramway Co. appeal does not support appellant's position.

Since appellant has failed to establish that its salesmen are engaged in activities within the foreign states which clearly exceed solicitation, it has not met its burden of proof, and the action of respondent, as modified in accordance with its concession regarding the sales in Washington, must be sustained.

