

**TENNESSEE DEPARTMENT OF REVENUE
REVENUE RULING #97-15**

WARNING

Revenue rulings are not binding on the Department. This presentation of the ruling in a redacted form is information only. Rulings are made in response to particular facts presented and are not intended necessarily as statements of Departmental policy.

SUBJECT

Whether Company X is doing business in Tennessee so as to be subject to Tennessee franchise, excise taxes.

SCOPE

Revenue Rulings are statements regarding the substantive application of law and statements of procedure that affect the rights and duties of taxpayers and other members of the public. Revenue Rulings are advisory in nature and are not binding on the Department.

FACTS

Company X is a corporation organized under the laws of State Y and maintains its commercial domicile, headquarters, and only production facility in State Y. Products of Company X are sold in many states, including Tennessee. However, Company X has no property in Tennessee and maintains no office or employees in Tennessee.

Company X employs a sales staff to solicit orders from customers in Tennessee. Once an order is placed with a member of the sales staff, it is subject to approval at company headquarters in State Y. After the order is approved, Company X usually delivers the products to its customers in Tennessee in its own commercial vehicles. On some occasions, Company X will ship its products to customers by common carrier.

The sales staff also performs collection activities in Tennessee. If a Tennessee customer does not pay his account as expected, one of Company X's salespersons will visit his place of business in Tennessee and request that payment be made. Hopefully, the salesperson will obtain a check in payment of the account.

After delivering its products to Tennessee customers, Company X also uses its own commercial vehicles to pick up defective products from previous purchases that do not meet customer specifications. Any trim and scrap that a customer may have will also be

picked up by Company X's commercial vehicles while they are at the customer's Tennessee place of business. These materials are hauled to Company X's plant in State Y where they are recycled. The customers involved are given a credit for the defective products, trim and scrap picked up and hauled back to State X for recycling. Company X does not charge the customer for hauling the defective products, trim and scrap back to State Y.

QUESTION PRESENTED

Is Company X doing business in Tennessee so as to be subject to Tennessee franchise, excise taxes?

RULING

Yes.

ANALYSIS

As explained below, Company X's activities of picking up and hauling customers' defective products, trim and scrap, for which the customer is given credit on his account, out of Tennessee to be recycled in State Y and the collection of customer accounts in Tennessee subject it to Tennessee corporate franchise, excise taxes.

Applicable Statutory And Case Law

T.C.A. Sections 67-4-806(a) and 67-4-903(a) impose Tennessee corporate franchise, excise taxes on "All corporations, . . . organized for profit under the laws of this state or any other state . . . and doing business in Tennessee . . .". However, Title 15 U.S.C.A. § 381(a), better known as Public Law 86-272, prohibits imposition of a net income tax when the taxpayer's only business in the taxing state is solicitation of sales of tangible goods in interstate commerce. The federal statute reads as follows:

"(a) 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 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 or 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).”

The issue in *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 112 S.Ct. 2447 (1992) was the scope of Title 15 U.S.C.A. § 381 and the activities it protects. In *Wrigley*, the U.S. Supreme Court held that “solicitation of orders” protected includes not only any speech or conduct that explicitly or implicitly invites or proposes an order, but also covers those activities that are entirely ancillary to requests for purchases and serve no independent business function apart from their connection to soliciting orders.

Although the entire process associated with the invitation of an order is protected, the phrase “solicitation or orders” does not embrace all activities that are routinely or even closely associated with solicitation or customarily performed by salesmen. *Id.* at 2455 and 2456. Activities that a company would have reason to engage in anyway, apart from solicitation or orders, but chooses to allocate to its in-state sales force are not protected from state income taxation by federal law. *Id.* at 2456.

For example, providing a car and a stock of free samples to salesmen is part of the “solicitation of orders” because the only reason to do it is to facilitate requests for purchases. However, employing salesmen to repair or service the company’s products is not part of the “solicitation of orders” since there is good reason to get that done whether or not the company has a sales force. Some activities, such as repair and servicing of products after they are sold to the customer, may indirectly help increase future purchases, but such activities are not ancillary to requesting purchases and cannot be converted into “solicitation” by merely being assigned to a salesman. Even if engaged in exclusively to facilitate requests for purchases, the maintenance of an office within the state by a company, or on its behalf, goes beyond the “solicitation of orders” and will subject the company to taxation in the state where the office is maintained. Activities that take place after a sale will ordinarily not be entirely ancillary to requests for purchases, but there may be exceptions. *Id.* at 2457.

Collection And Hauling Of Tennessee Customers’ Defective Products, Trim And Scrap To A Point Outside Tennessee For Recycling And Credit To The Customers’ Accounts Subjects Company X To Franchise, Excise Taxes

After it delivers its products to Tennessee customers, Company X employees collect any defective products from previous purchases and any trim or scrap that the customer may have. These materials are hauled back to Company X's plant in state Y and recycled. No charge is made to the customer for this service. In fact, the customer is given a credit on his account for the defective products and scrap taken out of Tennessee for recycling.

Tennessee has never subjected a corporation to franchise, excise taxes solely due to the fact that it purchased goods from Tennessee vendors and sent a truck from outside Tennessee to pick them up and take them out of Tennessee. However, when company employees in company vehicles come into Tennessee and pick-up defective products, trim and scrap from customers, haul it out of Tennessee for recycling and give the customers credit on their accounts, such activities clearly exceed solicitation of sales activities protected by Public Law 86-272. The collection of defective products from customers for recycling and the giving of credit for such products is an activity occurring after the sale which Company X has reason to do aside from making sales. Accordingly, such an activity can not be ancillary to the solicitation of sales protected by Public Law 86-272.

In *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 112 S.Ct. 2447 (1992), the United States Supreme Court cited *Miles Laboratories, Inc. v. Department of Revenue*, 546 P.2d 1081 (Or. 1976) for the proposition that the replacement of damaged goods after a sale is not entirely ancillary to the solicitation of sales protected by Public Law 86-272. *Miles Laboratories* clearly states that "picking up returned goods within the taxing state" is an example of a "fatal, 'non-solicitous' activity" that would not be protected from state income taxation by federal law. *Id.* at 1083. In *National Tires, Inc. v. Lindley*, 426 N.E.2d 793 at 798 (Ohio App. 1980), the court stated that the removal of old and defective products and ensuring credit for them exceeded the mere solicitation of sales protected by Public Law 86-272 and thus, sufficient nexus existed for the state to exercise its taxing authority. The Multistate Tax Commission also lists the "picking up or replacing damaged or returned property" as an activity that will cause a company to lose its protection under the Public Law. W. Raabe and K. Boucher, *Multistate Corporate Tax Guide*, I-41 (1997).

Company X's activity of picking up and hauling Tennessee customers' defective products, trim and scrap, for which the customer is given credit on his account, out of Tennessee to be recycled in another state subjects the corporation to Tennessee franchise, excise taxes.

*Collection Of Customer Accounts In Tennessee
Subjects Company X To Tennessee Franchise, Excise Taxes*

When a Tennessee customer does not pay his account as expected, Company X will send one of its salespersons to the customer's place of business to request payment and obtain a check for the balance of the account.

Activities which are not ancillary to requesting purchases cannot be converted into solicitation of sales protected by Public Law 86-272 simply by merely being assigned to salespersons. *Wrigley* at 2457. In *Wrigley* at page 2457, the U.S. Supreme Court cites *Herff Jones Company v. State Tax Commission*, 430 P.2d 998 (Or. 1967) in support of the fact that Public Law 86-272 does not provide state tax immunity for sales representatives' collection activities. In *Herff Jones*, sales representatives not only solicited orders but also collected an initial deposit, and on occasion, collected the balance due on merchandise ordered. Such collections were then forwarded out-of-state to the company. Salespersons in *Herff Jones* also did occasional collection work for their company in order to prevent their own commissions from being reduced. The Oregon Supreme Court held that such collection activities went beyond the mere solicitation of orders and removed the corporation from tax exempt status. The Multistate Tax Commission also lists "collecting current or delinquent accounts" as an activity that will cause a company to lose its protection under Public Law 86-272. W. Raabe and K. Boucher, *Multistate Corporate Tax Guide*, I-41 (1997).

Company X's activity of sending salespersons to collect unpaid accounts from Tennessee customers subjects the corporation to Tennessee franchise, excise taxes.

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APPROVED: _____
Ruth E. Johnson, Commissioner

DATE: 6-2-97