

BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO

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|---------------------------------|---|------------------|
| In the Matter of the Protest of |) | |
| |) | DOCKET NO. 15330 |
| [REDACTED], |) | |
| |) | DECISION |
| Petitioner. |) | |
| |) | |
| |) | |
| |) | |

On November 7, 2000, the Income Tax Audit Bureau of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted] (the “taxpayer”), proposing additional income tax, penalty, and interest for tax years ending 12/31/93 through 12/31/98, inclusive, in the total amount of \$104,731. Due to net operating losses, the liability relates only to 1997 and 1998.

On January 8, 2001, a timely protest and petition for redetermination was filed by the taxpayer. An informal conference was requested by the taxpayer and held on June 28, 2001.

The Tax Commission has reviewed the file, is advised of its contents, and hereby issues its decision Affirming the Notice of Deficiency Determination. The issue for decision is whether the taxpayer had taxable nexus in three foreign countries to which it shipped merchandise from an Idaho location. We hold that it did not.

Facts

The taxpayer is headquartered in the state of Washington and processes and sells an agricultural commodity that is a raw material for a beverage. The taxpayer has a plant and warehouse in Idaho.

The auditors met with the taxpayer’s Director of Sales. He stated that the company has no sales representatives outside Washington; that all sales are made by telephone; and that the company’s sales representatives occasionally make goodwill visits to customers.

At the informal conference, the taxpayer’s representative stated that the taxpayer’s Vice

President of Operations provided services to customers in the form of on-site visits, where the discussion concerned the quality of the product in the particular crop year; its technical specifications; and scientific issues in the production of the beverage. The taxpayer's claim is that these on-site visits are to provide services after a sale has occurred, and that such services exceed solicitation of orders.

The taxpayer later provided a list of foreign trips by its personnel. The individual named at the informal conference as Vice President of Operations is shown in this list as Vice President of Sales. In May of 1993, three individuals from production, sales and technical services visited three customers in foreign country **A**. Topics discussed include chemical problems in the product, taste and quality issues, and general market conditions. In October of 1993, the Vice President of Sales, with a Vice President of Grain and the taxpayer's President visited the same customers in foreign country **A**. Topics included crop data, 1993 quality, pest concerns, lab analysis discrepancies, possible research collaboration, and possible provision of samples of a new type of product.

In late February to early March, and also in July of 1994, the Vice President of Sales visited a customer in foreign country **B**. He discussed product quality, shipping, and customs concerns. In November of 1994, a Sales Manager visited foreign country **C** to discuss the same topics.

In January of 1995, the President, the Chief Executive Officer, and the Vice President of Sales visited foreign countries **A** and **C** to discuss quality issues and U.S. market conditions.

The foregoing general pattern of activity continued annually through 1998. Although personnel varied from time to time, the topics discussed were the same.

In 1992 and following years, the taxpayer's Idaho returns showed zero sales in Idaho, even though there were sales to Idaho destinations from the Idaho plant.

Law and Analysis

Overview of Tax

Idaho law apportions business income using a formula with three fractions or factors, consisting of property, payroll, and sales, respectively. The sales factor is the ratio of Idaho sales to total sales. Idaho sales are the sum of sales shipped to an Idaho destination and sales shipped from an Idaho origin to a destination state or country where the taxpayer could not be subject to income tax under U.S. constitutional and statutory standards. Idaho Code § 63-3027. The class of sales with an Idaho origin and a destination in a jurisdiction where the taxpayer has no taxable contacts or “nexus” is referred to as “throwback sales.”

Constitutional Nexus

As a matter of constitutional law, a taxpayer would be taxable in the destination jurisdiction if it had a substantial physical presence there. Cf. Quill Corp. v. North Dakota, 504 U.S. 298 (1992)(use tax collection case). Here, visits of a few days’ duration two or three times a year by the taxpayer’s employees may fall short of substantial physical presence, but we need not decide this question nor its effect here.

Nexus under Public Law 86-272

Congress has required a higher threshold of activity than the constitutional standard to support application of a state’s income tax. Public Law 86-272, 15 U.S.C. § 381, provides in pertinent part:

(a) No State . . . shall have power to impose, for any taxable year . . . , 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; . . .

To avoid possibly unconstitutional discrimination between domestic and foreign commerce, Idaho applies the foregoing statute to foreign countries in the same manner as it does to states of the United States.

The issue under P.L. 86-272 is whether the taxpayer's activities in the three foreign countries exceeded the protected activities listed in paragraph (a)(1), quoted above. If they did, then sales shipped from the taxpayer's Idaho plant to those countries will not be counted as Idaho sales in the sales factor. If they did not, then such sales will be thrown back to Idaho to appear in the numerator of the sales factor. It is undisputed that the taxpayer sells tangible personal property; that orders are accepted in Washington; and the orders are shipped from domestic locations including Idaho. The disputed question is whether the taxpayer's foreign trips were or were not limited to "solicitation of orders."

The authoritative case interpreting "solicitation" is Wisconsin Dept. of Rev. v. William Wrigley, Jr., Co., 505 U.S. 214 (1992). There, the taxpayer Wrigley was held to be doing more in Wisconsin than solicitation, because the replacement of stale chewing gum, the supplying of gum through agency stock checks, and storage of gum had a business function to Wrigley separate from the requesting of orders. On the other hand, Wrigley's salesmen's activities in helping to resolve credit disputes with customers was held to fall within the scope of protected solicitation, because the purpose of such help was "to ingratiate the salesman with the customer, thereby facilitating requests for purchases." 505 U.S. at 235. The sum of the unprotected activities was not *de minimis*, so Wisconsin could subject Wrigley to income tax.

Here, periodic visits to foreign customers to discuss product quality, shipping issues, and

general markets were, as the taxpayer's Director of Sales put it, goodwill visits, with the purpose of ingratiating the taxpayer with the customer. No services were provided on the spot by the visitors beyond such goodwill generating discussion. There is no evidence that visits of this kind would perform any business function of the taxpayer apart from solicitation of orders.

The Wrigley Court expressly declined to adopt a bright line between activities before and after the sale. Although post-sale activities are "ordinarily" not entirely ancillary to solicitation, the Court wrote,

[w]e are not prepared to say that will invariably be true. Moreover, the presale/postsale distinction is hopelessly unworkable. ... [I]t [is] often impossible to determine whether a particular incidental activity was related to the sale that preceded it or the sale that followed it.

505 U.S. at 230-231. Since the customers here were regular customers, the Court's perceived difficulty is present in this case.

We hold that the taxpayer's activities in the three foreign countries did not exceed solicitation within the meaning of P.L. 86-272. Sales to such countries from Idaho are accordingly thrown back to Idaho and included in the numerator of the sales factor.

Penalties

We affirm the negligence penalty of 5% in 1997 and 1998 based on the taxpayer's omission of all Idaho sales from the sales factor in those years. I.C. § 63-3046(a). The 10% penalty for substantial understatement is mechanically applied, but does not apply to an item if the taxpayer either specially discloses the disputed item in the return or provides substantial authority for the treatment of the disputed item. Both penalties may be waived for reasonable cause. I.C. § 63-3046(e). *See generally* our decision in Docket No. 13772. There being no disclosure, no substantial authority, nor a showing of reasonable cause, we also affirm the penalty for substantial understatement in 1997 and 1998.

Conclusion

WHEREFORE, the Notice of Deficiency Determination dated November 7, 2000, is hereby APPROVED, AFFIRMED, and MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following tax, penalty, and interest (computed through 12/31/01)(interest runs at \$17.03 per day):

| <u>YEAR</u> | <u>TAX</u> | <u>PENALTY</u> | <u>INTEREST</u> | <u>TOTAL</u> |
|-------------|------------|----------------|-----------------|------------------|
| 12/31/97 | \$64,351 | \$9,653 | \$18,454 | \$ 92,458 |
| 12/31/98 | 13,356 | 2,004 | 2,800 | <u>18,160</u> |
| | | | TOTAL DUE | <u>\$110,618</u> |

DEMAND for immediate payment of the foregoing amount is hereby made and given.

An explanation of the taxpayer's right to appeal this decision is enclosed with this decision.

DATED this _____ day of _____, 2001.

IDAHO STATE TAX COMMISSION

COMMISSIONER

CERTIFICATE OF SERVICE

I hereby certify that on this ____ day of _____, 2001, a copy of the within and foregoing DECISION was served by sending the same by United States mail, postage prepaid, in an envelope addressed to:

[REDACTED]

Receipt No. [Redacted]

ADMINISTRATIVE ASSISTANT 1