**BEFORE THE TAX COMMISSION OF THE STATE OF IDAHO**

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| In the Matter of the Protest of<br><br>[Redacted] Petitioner. | )<br>)<br>)<br>)<br>)<br>) | DOCKET NO. 17948<br><br>DECISION |

On January 5, 2004, the Income Tax Audit Division of the Idaho State Tax Commission issued a Notice of Deficiency Determination to [Redacted]. asserting an Idaho income tax liability in the amount of $224,861 for the [Redacted] 1995 through [Redacted] 2000 taxable years. On March 2, 2004, the taxpayer filed a timely appeal and petition for redetermination. An informal conference was requested by the taxpayer and was held via telephone on December 7, 2004. The Tax Commission, having reviewed the file, hereby issues its decision modifying the January 5, 2004 Notice of Deficiency Determination.

**FACTS AND PROCEDURAL HISTORY**

[Redacted]is the parent of a worldwide unitary group of companies that is primarily engaged in the manufacture, marketing and distribution of a wide variety of [Redacted] [Redacted] is privately owned and, therefore, does not publish annual reports to its shareholders or otherwise disseminate financial information to the public.

[Redacted]It is uncontested that there are at least [Redacted] that operate [Redacted] in Idaho.[Redacted] However, [Redacted] has consistently taken the position that the [Redacted]s are independent from [Redacted] and are not employees, agents, or representatives [Redacted]. In addition, [Redacted] has consistently taken the position that it has no other employees or representative conducting business activities within Idaho and has no property or business facilities located within this state. Finally, [Redacted] has consistently taken the position that it is not required to file an Idaho corporate income tax return either because its activities within this state are insufficient to create "nexus" for income tax purposes or that it is immune from Idaho's income tax laws under the provisions of Public Law 86-272. In [Redacted] the Idaho State Tax Commission took a look at [Redacted] Idaho business activity for the 1978 through 1980 income tax reporting periods and determined that [Redacted] did not have sufficient nexus with this state to be required to file Idaho corporate income tax returns. *See* Tax Commission Decision, Docket No. 11042-01 (1/31/84). However, in 1990 [Redacted] issued a decision holding that [Redacted] business activity within the [Redacted] was sufficient to exceed Public Law 86-272 and to meet the nexus requirements of the Due Process and Commerce Clauses. [Redacted]. Based on the length of time that had passed since this Commission issued its decision in Docket No. 11042-01, and based on the conflicting authority set out in the [Redacted] decision, the Tax Commission determined that it was appropriate to re-evaluate whether [Redacted] has an Idaho income tax filing requirement.

In 2001 the Idaho State Tax Commission authorized the Multistate Tax Commission (MTC) to conduct a non-filer audit of [Redacted] for the 1995 through 2000 taxable years. Based on that audit, the MTC found that [Redacted] had sufficient nexus with Idaho to be required to file Idaho corporate income tax returns. The MTC audit staff provided the Tax Commission with a detailed audit report that included a proposed Idaho corporate income tax calculation. After reviewing the MTC audit narrative and supporting documents, the Idaho State Tax Commission's audit staff accepted the recommendations of the MTC audit staff regarding [Redacted] purported income tax filing requirement for the years under review but modified the Idaho corporate income tax calculation in several respects. Interest and the 25% non-filer penalty were added, and the Notice of Deficiency Determination that is the subject matter of this protest was then issued.

## ISSUES PROTESTED

[Redacted] has raised several issues in its letter of protest. Those issues can be categorized and restated as follows:

A. Filing Requirement:

1. Is [Redacted] engaged in activity within Idaho that exceeds the protection of Public Law 86-272?

2. If yes, does [Redacted] have sufficient nexus with Idaho under the Commerce Clause of the U.S. Constitution to be required to comply with Idaho's income tax laws?

3. If yes, is [Redacted] statutorily required to file an Idaho corporation income tax return in each of the years at issue?

B. Audit Adjustments:

4. Should the tax calculation be adjusted to delete income from "Elimination Co" which appears to have been double counted?

5. Should [Redacted] be excluded from the combined group calculation?

6. Should certain "income earned on capital transactions serving an investment function" be recharacterized as non-business income?

7. Assuming the Tax Commission does not agree with [Redacted] on issues 5 and 6 listed above, should the sales factor denominator used in the Idaho combined group calculation be increased to include the gross receipts from [Redacted] and the income earned on "capital transactions serving an investment function"?

8. Has [Redacted]provided sufficient substantiation to allow the elimination of intercompany dividends?

9. Should the Idaho sales factor numerator be adjusted to more accurately reflect [Redacted] Idaho sales?

10. Should the Idaho property factor numerator for the 1995 through 1997 taxable years be reduced to zero to more accurately reflect [Redacted]'s Idaho property factor in those years?

11. Should the 25% nonfiler penalty be waived?

After review of the taxpayer's letter of protest and the additional information submitted in support of its protest, the Tax Commission agrees with [Redacted] with respect to issues number 4, 8, and 10. In addition, after careful deliberation, the Commission hereby agrees to waive the 25% nonfiler penalty. With respect to issues 5 and 6, the Commission will go ahead and make the adjustments proposed by [Redacted]. While we do not necessarily agree with [Redacted] on these two issues, in an effort to narrow the focus of this protest we will go ahead and make the suggested changes.

In summary, the Commission hereby agrees to modify the January 5, 2004, Notice of Deficiency Determination to reflect the adjustments proposed by [Redacted] with respect to issues 4, 5, 6, 8, 10, and 11. Because the Commission is allowing the adjustments raised in issues 5 and 6, issue number 7 is moot. Finally, with respect to issue number 9, [Redacted] has presented no documentation from which we are able to make any adjustment to the Idaho sales factor numerator. Therefore, we have no choice but to deny issue number 9. That leaves only the "filing requirement" issues listed above that are still in dispute. Our analysis of whether [Redacted] had an Idaho income tax filing requirement for the 1995 through 2000 taxable years is set forth below.

## ANALYSIS

### A. The Idaho Activities of [Redacted] Exceed the Protection of Public Law 86-272.

The first issue raised in this protest is whether the Idaho activities of [Redacted] exceed the protection of Public Law 86-272, 73 Stat. 555 (1959) (codified at 15 U.S.C. 381 - 384). Section 101(a) of Public Law 86-272 provides as follows:

> (a) No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after the date of the enactment of this Act, 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).

Public Law 86-272 was enacted by Congress in 1959 as an express limitation on the ability of the several states to impose an income or franchise tax. The Public Law provides that a nondomicilary corporation is not subject to the income tax jurisdiction of a foreign state if that corporation's "only business activity within the State consists of 'solicitation of orders' for tangible goods, provided that the orders are sent outside the State for approval and the goods are delivered from outside the state." Wisconsin Dept. of Revenue v. William Wrigley, Jr. Co., 505 U.S. 214, 216, 112 S.Ct. 2447, 2450 (1992). Because Public Law 86-272 is an express federal preemption on the ability of the several states to impose an income or franchise tax on certain businesses, the provisions of the Public Law are narrowly construed. *C.f.* Department of Revenue of Oregon v. ACF Industries, Inc., 510 U.S. 332, 345, 114 S.Ct. 843, 851 (1994) ("We will interpret a statute to pre-empt the traditional state powers only if that result is the clear and manifest purpose of Congress.") (Internal quotations omitted). To the extent a company engages in non-*de minimis* activity within the foreign state that exceeds the minimum standard established by the Public Law, that company is not exempt from the income tax laws of the foreign state.

The term "solicitation of orders" as used in the Public Law covers three types of activities: (1) express solicitation of orders for tangible goods, (2) implied solicitation of orders for tangible goods, and (3) any activity that is "entirely ancillary" to express or implied solicitation of orders for tangible goods. Wrigley at 223, 228 - 229, 112 S.Ct. at 2453 - 2454, 2456. An activity is entirely ancillary to express or implied solicitation if it serves no legitimate business purpose outside the solicitation of orders for tangible goods. For example, "[p]roviding a car and a stock of free samples to salesmen is part of the 'solicitations of orders,' because the only reason to do it is to facilitate requests for purchases. Contrariwise, 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." *Id.* at 229, 112 S.Ct. at 2457.

In the present case, the Multistate Tax Commission has determined that [Redacted] is engaged in business activity within Idaho that exceeds the protection afforded by Public Law 86-272. The MTC audit staff relies primarily on the [Redacted] decision in [Redacted] that found that [Redacted]'s business activity in [Redacted] exceeded Public Law 86-272 during the 1978 through 1980 taxable years. According to the [Redacted], the independent [Redacted] were representatives of [Redacted] for the purpose of soliciting sales of [Redacted]. The Court also found that an [Redacted] constitutes a non-exclusive franchise. Thus, the [Redacted] representatives were found to be soliciting the sale of intangible personal property -- [Redacted] -

- within the state of [Redacted]. Because the solicitation of sales of intangible personal property goes beyond the scope of Public Law 86-272, [Redacted] was found to have a [Redacted]income tax filing requirement for the years at issue.

The MTC audit staff has asserted that the solicitation and marketing activity engaged in by the [Redacted] independent [Redacted] as set out in the [Redacted] decision are essentially identical to the solicitation and marketing activity that took place within Idaho during the 1995 through 2000 taxable years. MTC Audit Report, State of Idaho Narrative, pp. 8 - 9 and Exhibit C. Thus, according to the MTC audit staff, [Redacted] representatives are engaged in the solicitation and sale of intangible personal property within Idaho, which goes beyond the protection of Public Law 86-272. [Redacted], on the other hand, asserts that the [Redacted]case was wrongly decided or is no longer controlling and that [Redacted] is not engaged in any non-protected activity in Idaho.

It is undisputed that [Redacted] had no employees, offices, warehouses, or other business facilities within Idaho during the years at issue. Thus, the crux of this administrative protest comes down to whether the [Redacted] who operate within Idaho are representatives of [Redacted] and, if so, whether those representatives are engaged in business activity on behalf of [Redacted] that exceeds Public Law 86-272.

**1. The [Redacted] are [Redacted]Representatives.**

[Redacted] argues that the [Redacted]s that operate within Idaho are not representatives of [Redacted]. According to [Redacted]:

> The [Redacted] are [[Redacted]] customers and are not [[Redacted]] sales representatives. The contractual relationship between [[Redacted]] and the [Redacted] is not that of an employee, agent or representative. Rather, each contract defines the sales terms between [[Redacted]] and [Redacted]. In fact, the contract provides that the [Redacted]. The sale of product between [[Redacted]] and the [Redacted]is a completed sale – it is

> not dependent upon the [Redacted]' ability to resale the items to others. In no event does an [Redacted] sell products on behalf of [[Redacted]].

Letter of protest, p. 4. After reviewing the audit file and the [Redacted] contained therein, we must disagree with [Redacted]characterization of the relationship it has with [Redacted]. While these [Redacted] are not employees of [Redacted], they are far more than mere "customers." [Redacted] are bound by a contractual relationship with [Redacted] that sets out the various rights and responsibilities that govern the relationship. [Redacted] We find that this relationship allows, and even encourages, [Redacted] to act on [Redacted]'s behalf in the solicitation and sale of [Redacted]To become an [Redacted] an individual must (1) [Redacted] (2) file an application for authorization [Redacted], and (3) possess at least [Redacted]. The application form specifies that the applicant is applying to become an [Redacted] and that the applicant agrees to abide by the terms of the [Redacted] form. [Redacted] provided with letter of protest. The form specifically provides that "this authorization does not make [the applicant] an employee, agent, or legal representative of [Redacted] However, the application form also specifies that the applicant agrees to comply with the [Redacted] Taken together, the [Redacted] set out the legal rights and responsibilities between [Redacted]and its worldwide network of [Redacted].

[Redacted] The [Redacted] business model is dependent on developing and expanding [Redacted] The fact that [Redacted] characterizes this [Redacted] force as "independent businessmen [does] not negate the fact that those soliciting the sale of [Redacted] . . . were acting on behalf of and with the full authority of [Redacted]." [Redacted]

In conclusion, we find that the independent [Redacted] are representatives of [Redacted] for the purpose of [Redacted] and for the purpose of [Redacted]. We next turn to whether the in-state activity of these representatives exceeds the protection of Public Law 86-272.

### 2. The [Redacted] Representatives are Engaged in Soliciting Sales of Intangible Franchise Rights.

[Redacted]next argues that the holding in <u>[Redacted]</u> was flawed because, according to [Redacted] the evidence elicited in that case did not support the Court's finding that [Redacted] was selling [Redacted]  As set forth in the letter of protest:

> The [[Redacted]] conclusion that [Redacted] was taxable in [Redacted]was based on the erroneous premise that [Redacted]  Following is a brief description of the process of becoming [Redacted].

[Redacted]
Letter of protest, p. 6.

[Redacted]'s claim that it is selling tangible "[Redacted]" and tangible "[Redacted]" as opposed to intangible [Redacted] is belied by the express terms of its [Redacted] Application and [Redacted].  The application that a potential [Redacted] [Redacted] must sign clearly states that the application relates to the acquisition of [Redacted].  For example, the 1995 [Redacted] Application states in capital letters that

> THIS FORM AUTHORIZES YOU TO ACT AS [Redacted] FOR A PERIOD OF 30 DAYS.  BY THE END OF THAT TIME, YOU WILL HAVE RECEIVED YOUR [Redacted]CARD, WHICH AUTHORIZES YOU TO [Redacted].

[Redacted].  Likewise, the [Redacted] includes the express representation from the [Redacted] signing the renewal form that "I intend to continue [Redacted] in 1995.  Please send [Redacted]. I understand I must renew to stay in business."  [Redacted].  It is the [Redacted] that is being offered by [Redacted] and accepted by the prospective [Redacted] who signs the agreement, not the purchase of tangible [Redacted].  While [Redacted] may book the fee it receives from these agreements as the sale of a [Redacted] or [Redacted], the true object of the transaction is the sale of a [Redacted].

It is also clear that [Redacted] considers its [Redacted] to be a valuable right that is worth protecting. The [Redacted] provide that an [Redacted] "may sell his or her ownership interest" in a [Redacted] only in limited circumstances. [Redacted]. In addition, [Redacted]retains the power to suspend or terminate a [Redacted] where the [Redacted] are not followed. [Redacted]. Obtaining an [Redacted] not only authorizes the [Redacted], it also allows the [Redacted] to use the [Redacted] trade name and the various [Redacted] trademarks. [Redacted]7. While the [Redacted] does not give the [Redacted] an exclusive franchise over a particular territory, [Redacted], the [Redacted] is still a valuable intangible right. [Redacted]'s claim that it simply gives away this valuable right to anyone willing to pay for the [Redacted] is simply not realistic.

The [Redacted] characterized the [Redacted] as a "nonexclusive franchise." [Redacted]). We agree. As pointed out by the [Redacted]:

[Redacted]As pointed out above, [Redacted] takes issue with the above quoted portion of the [Redacted] decision. According to [Redacted] there was no evidence to support the Court's finding that [Redacted] sold [Redacted] because the fee charged to purchase the "[Redacted]" (which we have already determined was not the true object of the transaction) was pocketed by [Redacted]. [Redacted], in effect, treats the sale of its "[Redacted] as two separate and distinct transactions: (1) the sale of the [Redacted], and (2) the sale of that [Redacted]. [Redacted] points out that this second transaction "does not generate additional revenue for [Redacted], it generates revenue for [Redacted]." Letter of protest, p. 6. Again, we must disagree with [Redacted]'s characterization of this transaction. The [Redacted] who purchases the [Redacted] winds up with a net gain of zero. Because [Redacted] requires the pre-purchase of [Redacted] it has already received the revenue generated from the ultimate sale of [Redacted]. The [Redacted] simply recoups his out-of-pocket costs, while [Redacted] ends up with the fee. In addition, it appears that under the [Redacted] As a result, the fact that [Redacted] requires the pre-purchase of [Redacted] does not appear to materially shift the risk of non-sale of the [Redacted]. If we view the sale and resale of [Redacted] as part and parcel of one unified transaction, it is clear that [Redacted] is the party selling the [Redacted]. While [Redacted] to solicit the sale and as the conduit through which to make the sale, it is ultimately [Redacted] that is entering into [Redacted] and pocketing the fee. Therefore, we concur with the [Redacted] characterization of the transaction. The [Redacted] are a nonexclusive franchise sold for a fee by [Redacted]allowing the purchaser the right to [Redacted]In any event, we do not believe that it is essential to find as a matter of fact that [Redacted]is <u>selling</u> [Redacted]. To the extent [Redacted] is simply giving away these [Redacted] – which we have determined to be in the nature of a non-exclusive franchise – [Redacted] is still engaged in business activity that is not protected by Public Law 86-272. The granting of a non-exclusive franchise right to a third party, even where the transfer is not conditioned on the payment of an up-front fee, is not protected by the Public Law. Thus, even if we assume that [Redacted] is not selling [Redacted], the in-state solicitation of [Redacted], which [Redacted] then <u>grants</u> to an applicant free of charge, constitutes non-protected business activity.

In conclusion, the solicitation and sale/grant of [Redacted] constitutes non-protected business activity. Because [Redacted] representatives were engaged in the solicitation of [Redacted] within Idaho during the years under review, we find that [Redacted] was not protected by Public Law 86-272.

**3. The Holding in <u>Wisconsin Dept. of Revenue v. William Wrigley, Jr., Co.</u> does not Change the Result.**

[Redacted] also argues that the holding of the [Redacted] is no longer valid given the U.S. Supreme Court's 1992 decision in Wisconsin Dept. of Revenue v. William Wrigley Jr., Co., 505 U.S. 214, 112 S.Ct. 2447 (1992). In Wrigley, the U.S. Supreme Court interpreted the term "solicitation of orders" to include not only the express and implied solicitation of orders for tangible goods, but also any activity that is "*entirely ancillary* to requests for purchases" of tangible goods. *Id.* at 228, 112 S.Ct. at 2456. The Court drew a distinction "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." *Id.* at 228 - 229, 112 S.Ct. at 2456. [Redacted] takes the position that the in-state solicitation of [Redacted] is entirely ancillary to the sale of tangible personal property.

[Redacted]'s position is not totally without merit. As pointed out by the U.S. Supreme Court in Wrigley: "Wrigley's in-state recruitment, training, and evaluation of sales representatives served no purpose apart from their role in facilitating solicitation." *Id.* at 234, 112 S.Ct. at 2459. Thus, the in-state recruitment and training of the Wrigley sales force was protected activity. It could be argued that [Redacted]'s in-state recruitment and training of [Redacted] is also protected activity in that it serves no business purpose other than to facilitate the solicitation and sale of [Redacted]. However, we believe that there is a key distinction between the sales force being recruited and trained in Wrigley and the sales force being recruited and trained in the present case. Namely, the [Redacted] By contrast, Wrigley was engaged in the manufacturing, marketing and selling of chewing gum and similar products. Its business plan did not focus on the [Redacted] to sell and distribute its products. In addition, there was no sale or grant of a non-exclusive franchise right to the Wrigley salesmen. The profits earned by

Wrigley were directly attributable to selling tangible goods (gum), not the [Redacted] or the granting of non-exclusive franchise rights to sell Wrigley products.

The Public Law creates income tax immunity for a person whose only "business activity" within the state is limited to the solicitation of orders for tangible goods, provided the orders are sent outside the state for approval or rejection and provided the goods are delivered from a point outside the state. The term "business activity" connotes more than just in-state acts; it "connotes courses of conduct." Wrigley at 226, 112 at 2455. In the present case, [Redacted] is engaged in a course of conduct designed not only to facilitate the sale and distribution of its tangible products, but also to facilitate and encourage the recruitment of new IBOs and to grant non-exclusive franchise rights to [Redacted] Thus, we believe there is a valid business reason for [Redacted] to [Redacted] and to grant franchise rights to [Redacted] that goes beyond the solicitation of orders of [Redacted]. *C.f.* National Tires, Inc. v. Lindley, 426 N.E.2d 793, 798 (Ohio Ct. App. 1980) (company's activities went beyond solicitation to "functions more commonly related to maintaining an on-going business.") (Cited with approval in Wrigley at 229, 112 S.Ct. at 2457). [Redacted] Delegating the [Redacted] and training function to [Redacted] does not make the [Redacted] and granting of [Redacted] entirely ancillary to the solicitation of order for tangible personal property.

The definition of "solicitation of orders" set down by the U.S. Supreme Court in Wrigley does not convince us that the [Redacted] was wrong when it found that [Redacted] was not protected from [Redacted]'s income tax by Public Law 86-272. More importantly, application of the analysis set out in Wrigley does not convince us that [Redacted]'s activities in Idaho are entirely ancillary to the solicitation of orders for tangible goods. There is a valid business reason for [Redacted] and to grant them franchise rights that goes beyond the solicitation of orders of

[Redacted]. Therefore, we find that [Redacted] is not protected by Public Law 86-272 during the years at issue.

**B. [Redacted] has Income Tax Nexus with the State of Idaho.**

[Redacted] argues that even if it is not protected by Public Law 86-272, the company still has insufficient connection or "nexus" with Idaho to be required to comply with Idaho's income tax laws. We disagree.

Under the Due Process Clause and the Commerce Clause of the United States Constitution, a taxpayer must have certain minimum contacts or connections with a state before that taxpayer is required to obey the laws, including the tax laws, of that state. This minimum connection is often referred to as "nexus." In many cases it is relatively easy to determine if the required nexus exists. For example, a corporation that has a warehouse or a manufacturing plant within a state will undoubtedly have nexus and, as a result, will be required to comply with the corporate income tax laws of the state. There are also easy cases on the other extreme where it is clear that no nexus exists. As an example, a company that does not manufacture, market, or sell any of its products or services within a state will not have nexus and will not be required to comply with the tax laws of that state. The present administrative protest falls somewhere in between. While [Redacted] does not have employees, a business office, warehouse, or manufacturing facility within Idaho, it does sell its products to [Redacted] located in this state and uses its [Redacted]. The question presented here is whether this activity creates sufficient nexus with Idaho to require [Redacted] to file a corporate income tax return.

At the outset it should be noted that [Redacted] has not raised a due process "minimum connection" claim. Rather, [Redacted] is asserting that it lacks "substantial nexus" with Idaho under the dormant Commerce Clause. As a result, we will not address the nexus requirement of the Due Process Clause.

[Redacted] asserts that it lacks a "physical presence" in Idaho and, therefore, does not meet the Commerce Clause nexus standard set out in Quill Corp. v. North Dakota, 504 U.S. 298, 112 S.Ct. 1904 (1992). Letter of protest, p. 3 - 4. We disagree for two reasons. First, we do not read Quill as requiring a physical presence for income tax nexus. Second, even if physical presence is required for income tax nexus, [Redacted] has sufficient physical presence within Idaho through its [Redacted].

In Quill Corp. v. North Dakota the United States Supreme Court held that Quill Corporation was not required to collect North Dakota sales or use tax on products it sold to North Dakota customers because Quill had no physical presence within the state of North Dakota during the taxable periods under review. In reaching that holding the Court first determined that the minimum connection required under the Due Process Clause and the Commerce Clause were not necessarily the same. According to the Court, "although we have not always been precise in distinguishing between the two, the Due Process Clause and the Commerce Clause are analytically distinct." Quill at 305, 112 S.Ct. at 1909. "Due process centrally concerns the fundamental fairness of governmental activity. Thus, at the most general level, the due process nexus analysis requires that we ask whether an individual's connection with a State are substantial enough to legitimate the State's exercise of power over him. . . . In contrast, the Commerce Clause and its nexus requirement are informed not so much by concerns about fairness for the individual defendant as by structural concerns about the effects of state regulation on the national economy." *Id.* at 312, 112 S.Ct. at 1913. Thus, under the Due Process Clause, the focus is on whether the taxpayer has directed its activities at the taxing state so that it is reasonable and fair to require that taxpayer to comply with the state's tax laws. Physical presence of the taxpayer within the taxing state is not a requirement under the due process test. "[I]f a foreign corporation purposefully avails itself of the benefits of an economic market in the forum State, it may subject itself to the State's *in personam* jurisdiction even if it has no physical presence in the State." *Id.* at 307, 112 S.Ct. at 1910. The Court then went on to find that "there is no question that Quill has purposefully directed its activities at North Dakota residents [and] that the magnitude of those contacts are more than sufficient for due process purposes . . . ." *Id.* at 308, 112 S.Ct. at 1911.

After determining that Quill Corporation had sufficient nexus with North Dakota for due process purposes, the Court then turned its attention to the Commerce Clause nexus requirement. The Commerce Clause is an express grant of power to Congress to regulate commerce between the various states. *See* U.S. Const., Art. I, § 8, cl. 3 ("The congress shall have power . . . To regulate commerce . . . among the several states . . . ."). However, under the so-called "dormant" or "negative" Commerce Clause, the U.S. Supreme Court has determined that there are certain limits placed on state laws even when Congress has not affirmatively acted. In other words, the Commerce Clause by its own force provides certain limits on the ability of the several States to impose laws that affect interstate commerce. With respect to state tax laws, the United States Supreme Court, in Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 97 S.Ct. 1076 (1977), established a four part test that is used to determine the validity of a state tax under the dormant Commerce Clause. The first prong of the Complete Auto Transit four-part test requires that the state tax must be applied to a taxpayer or taxable activity that has a "substantial nexus" with the taxing state. The remaining three parts of the Complete Auto Transit test are that the tax must be fairly apportioned, must not discriminate against interstate commerce, and must be fairly related to the services provided by the state. *Id.* at 279, 97 S.Ct. at 1079.

While Complete Auto Transit sets out the current analysis used to determine if a state tax will be valid under the dormant Commerce Clause, it is important to note that the sweep of the Supreme Court's dormant Commerce Clause jurisprudence has changed significantly over the years. Because the history of the Supreme Court's dormant Commerce Clause jurisprudence is important in understanding the purpose (and the limits) of the Court's holding in Quill, the Court's discussion of that history is set out at length below:

> Our interpretation of the "negative" or "dormant" Commerce Clause has evolved substantially over the years, particularly as that clause concerns limitations on state taxation powers. Our early cases, beginning with *Brown v. Maryland*, 12 Wheat. 419 (1827), swept broadly, and in *Leloup v. Port of Mobile*, 127 U.S. 640, 648 (1888), we declared that "no State has the right to lay a tax on interstate commerce in any form." We later narrowed that rule and distinguished between direct burdens on interstate commerce, which were prohibited, and indirect burdens, which generally were not. *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256-258 (1938), and subsequent decisions rejected this formal, categorical analysis and adopted a "multiple-taxation doctrine" that focused not on whether a tax was "direct" or "indirect" but rather on whether a tax subjected interstate commerce to a risk of multiple taxation. However, in *Freeman v. Hewit*, 329 U.S. 249, 256 (1946), we embraced again the formal distinction between direct and indirect taxation, invalidating Indiana's imposition of a gross receipts tax on a particular transaction because that application would "impos[e] a direct tax on interstate sales." Most recently, in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 285 (1977), we renounced the *Freeman* approach as "attaching constitutional significance to a semantic difference." We expressly overruled one of *Freeman's* progeny, *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1951), which held that a tax on "the privilege of doing interstate business" was unconstitutional, while recognizing that a differently denominated tax with the same economic effect would not be unconstitutional. *Spector*, as we observed in *Railway Express Agency, Inc. v. Virginia*, 358 U.S. 434, 441 (1959), created a situation in which "magic words or labels" could "disable an otherwise constitutional levy." *Complete Auto* emphasized the importance of looking

> past "the formal language of the tax statute [to] its practical effect," and set forth a four-part test that continued to govern the validity of state taxes under the Commerce Clause.

Quill at 309 - 310, 112 S.Ct. at 1911 - 1912 (citations and footnotes omitted).

After discussing the convulsive history of the Court's dormant Commerce Clause jurisprudence, the Supreme Court then went on to determine that one of its prior cases, National Bellas Hess v. Illinois, 386 U.S. 753, 87 S.Ct. 1389 (1967), was consistent with the Court's current jurisprudence. In Bellas Hess the state of Illinois had attempted to impose a sales and use tax collection responsibility on an out-of-state mail-order seller that had no physical presence within Illinois other than the use of the postal service or common carriers to deliver its products to its Illinois customers. In striking down the Illinois law, the Supreme Court held that it was impermissible for a state to "impose the duty of use tax collection and payment upon a seller whose only connection with customers in the State is by common carrier or the United States Mail." Bellas Hess at 758, 87 S.Ct. at 1392. As a result, for purposes of imposing a sales or use tax collection responsibility on an out-of-state seller, Bellas Hess established that something more than delivery via the U.S. mail or common carrier was necessary. In effect, Bellas Hess established a safe-harbor rule for mail order sellers. So long as the seller's only connection within the taxing state was the delivery of its products by common carrier or the United States mail, that seller would not be required to collect or remit sales or use tax on those sales.

In Quill the U.S. Supreme Court recognized and revitalized the safe harbor rule established in Bellas Hess. In so doing the Court commented that "[l]ike other bright-line tests, the *Bellas Hess* rule appears artificial at its edges: Whether or not a State may compel a vendor to collect a sales or use tax may turn on the presence in the taxing State of a small sales force, plant, or office." *Id.* at 315, 112 S.Ct. at 1914. The Court then went on to hold:

> This artificiality, however, is more than offset by the benefits of a clear rule. Such a rule firmly establishes the boundaries of legitimate state authority to impose a duty to collect sales and use taxes and reduces litigation concerning those taxes. . . .
>
> Moreover, a bright-line rule in the area of sales and use taxes also encourages settled expectations and, in doing so, fosters investment by businesses and individuals. Indeed, it is not unlikely that the mail-order industry's dramatic growth over the last quarter-century is due in part to the bright-line exemption from state taxation created in *Bellas Hess.*

*Id.* at 315-316, 112 S.Ct. at 1915. After discussing the benefits of the bright-line rule established in Bellas Hess, the Court in Quill found that because "the *Bellas Hess* rule has engendered substantial reliance and has become part of the basic framework of a sizable industry," it was unwise and unnecessary to overrule that case. *Id.* at 317, 112 S.Ct. at 1915-1916. The Court also emphasized that Congress, through its affirmative Commerce Clause powers, was in a much better position to decide the continuing utility of the Bellas Hess safe harbor rule. *Id.* at 318, 112 S.Ct. at 1916. In any event, because the Bellas Hess safe harbor still applied, the opinion of the North Dakota Supreme Court (which had held that Bellas Hess was no longer good law) was overruled.

From its context, it is clear that the Supreme Court's holding in Bellas Hess and Quill are limited only to sales and use tax collection cases. Neither of those cases purport to establish a safe-harbor nexus standard for income tax or other tax types. In fact, in Quill the Court specifically stated that "concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement." Quill at 317, 112 S.Ct. at 1916. Under the Court's current dormant Commerce Clause jurisprudence, a corporation with no physical presence in a state could still be found to have substantial nexus with that state. The inquiry is not limited to just the company's physical contacts within the forum state. *See* Geoffrey, Inc. v. South Carolina Tax Commission, 437 S.E.2d 13 (S.C. 1993), *cert. denied*, 114 S.Ct. 550 (1993) (use of an intangible trademark and trade name within the state was sufficient to create substantial nexus.). All of the company's activity, to the extent it is focused on creating and maintaining a market for its products and services within the state, are to be considered. It is this idea of "in-state market exploitation" that is the touchstone in the Supreme Court's more recent non-use tax cases. *See* Standard Pressed Steel Co. v. Wash. Revenue Dept., 419 U.S. 560, 562, 95 S.Ct. 706, 708 (1975) (use of a single in-state employee "with a full-time job within the State, made possible the realization and continuance of valuable contractual relations between [the taxpayer] and Boeing."); Tyler Pipe Industries v. Dept. of Revenue, 483 U.S. 232, 250, 107 S.Ct. 2810, 2821 (1987) ("As the Washington Supreme Court determined, 'the crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state . . . .'"). *See also* State v. Quantex Mirosystems, Inc., 809 So.2d 246, 251 (La. Ct. App. 2001) ("the crucial factor governing nexus is whether the activities performed in the taxing state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in the taxing state."). *See generally*, Fatale, State Tax Jurisdiction and the Mythical "Physical Presence" Constitutional Standard, 54 Tax Lawyer 105, 109 (Fall 2000).

Fortunately, we do not have to decide today whether this administrative protest represents a case where a corporation with no physical presence in Idaho nonetheless has substantial nexus with this state for purposes of the dormant Commerce Clause. In the present case [Redacted] has a physical presence within Idaho through [Redacted]. Even though [Redacted] are independent contractors, they are engaged in solicitation and sales activity for the benefit of [Redacted] that is sufficient to establish a physical presence within this state. *See* Tyler Pipe Industries v. Dept. of Revenue, 483 U.S. 232, 250 - 251, 107 S.Ct. 2810, 2821 - 2822 (1987) (in-state activities of independent contractor was sufficient to meet nexus requirement); Scripto v. Carson, 362 U.S. 207, 211, 80 S.Ct. 619, 621 - 622 (1960) (independent "wholesalers or jobbers" conducting solicitation activity on behalf of an out-of-state seller was sufficient to meet nexus requirement).[Redacted] Taken as a whole, we find that the activities of [Redacted], including the in-state solicitation and sales activities of [Redacted], constitute a substantial nexus with this state.

**C. [Redacted] was Statutorily Required to File Idaho Corporate Income Tax Returns for Each of the Taxable Years at Issue.**

The final issue to be addressed in this administrative protest is whether [Redacted] meets the relevant statutory definition of a taxpayer required to file an Idaho corporate income tax return. The present administrative protest involves the [Redacted] 1995 through [Redacted] 2000 taxable years. The relevant statutory provisions were modified effective January 1, 1996. *See* 1995 Idaho Sess. Laws, Ch. 111. As a result, we must separately analyze the statutory income tax filing provisions as they existed for the 1995 taxable year and as they existed for the post-1995 taxable years.

**1. 1995 Taxable Year.**

As applicable for the 1995 taxable year, Idaho Code § 63-3025 imposed an income tax "on the taxable income derived from sources within this state by a corporation which transacts or is authorized to transact business in this state or which has income attributable to this state." Idaho Code § 63-3025 (1989). The Tax Commission has interpreted this section to impose an income tax filing requirement on any corporation that had income attributable to Idaho under Idaho Code § 63-3027 (Idaho's version of the Uniform Division of Income for Tax Purposes Act) and that had a "business situs" in this state as defined in Idaho Code § 63-3023. In the present case, there is no dispute that [Redacted] earned income during the 1995 taxable year that is attributable to Idaho under Idaho Code § 63-3027. Therefore, we need only address the question of "business situs."

Prior to 1996, Idaho Code § 63-3023 provided the statutory definition of the term "business situs." According to that former code section:

> (a) The term "business situs" shall include or be constituted by the owning or operating of business facilities or property or conducting business or farming operations, including soliciting business, within the state of Idaho . . . .

Idaho Code § 63-3023(a) (1989). The provision specifically lists "soliciting business" as an activity that constitutes a "business situs" in this state. In the present case, we find that [Redacted]was soliciting business within Idaho during the 1995 taxable year. Therefore, [Redacted] had a "business situs" within Idaho and was required to file an Idaho corporate income tax return for the [Redacted] 1995 taxable year.

**2. 1996 through 2000 Taxable Years.**

Effective January 1, 1996, Idaho Code § 63-3025 was modified to impose an income tax "on the Idaho taxable income of a corporation which transacts or is authorized to transact business in this state." Idaho Code § 63-3025 (1996). The term "transacting business" is broadly defined in the current version of Idaho Code § 63-3023 as follows:

> (a) Subject only to the limitations of the constitutions of the United States and of the state of Idaho, and except as expressly provided in subsection (b) of this section, the term "transacting business" shall include . . . engaging in or the transacting of any activity in this state, for the purpose of or resulting in economic or pecuniary gain or profit.

Idaho Code § 63-3023(a) (1996). Thus, any business activity taking place in this state, except as expressly limited by statute or by the federal or Idaho constitutions, is sufficient to meet the definition of transacting business. During the years at issue, [Redacted] was engaged, either directly or through its representatives, in the solicitation, marketing, distribution, and sale of

[Redacted]; along with the [Redacted], the granting of nonexclusive franchise rights [Redacted], and the renewal of franchise rights that had previously been granted. This in-state activity is sufficient to meet the definition of transacting business set out in Idaho Code § 63-3023(a). Furthermore, there is no statutory or constitutional limitation that would exempt [Redacted] from Idaho's income tax laws. Therefore, we find that [Redacted] had an Idaho corporate income tax filing requirement for each of the [Redacted] 1996 through [Redacted] 2000 taxable years.

## CONCLUSION AND ORDER

WHEREFORE, the Notice of Deficiency Determination dated January 5, 2004, is MODIFIED in accordance with the foregoing analysis, and as so Modified is hereby APPROVED, AFFIRMED AND MADE FINAL.

IT IS ORDERED and THIS DOES ORDER that the taxpayer pay the following taxes, penalty and interest:

| YEAR | TAX | PENALTY | INTEREST | TOTAL |
|---|---|---|---|---|
| 1995 | $28,449 | $-0- | $19,735 | $48,184 |
| 1996 | 17,322 | -0- | 12,384 | 29,706 |
| 1997 | 22,689 | -0- | 12,484 | 35,173 |
| 1998 | 2,384 | -0- | 1,057 | 3,441 |
| 1999 | 30 | -0- | 11 | 41 |
| 2000 | 30 | -0- | 9 | 39 |
| | | | TOTAL | $116,584 |

Interest is calculated through June 30, 2005, and will continue to accrue at the rate set forth in Idaho Code § 63-3045(6) until paid. After application of the 1999 and 2000 net operating loss carryback, the taxpayer has an Idaho net operating loss carryforward of $51,978 available for the 2001 taxable year. A more detailed computation of the tax calculation and NOL carryforward will be provided on request.

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 ____________________, 2005.

IDAHO STATE TAX COMMISSION

______________________________________
COMMISSIONER

**CERTIFICATE OF SERVICE**

I hereby certify that on this ____ day of June, 2005, 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]
[Redacted]
[Redacted]
[Redacted]
[Redacted]
[Redacted]

Receipt No.

______________________________________