Vanderbilt Law Review

Volume 27
Issue 2 *Issue 2 - March 1974*

Article 4

3-1974

Public Law 86-272: Legislative Ambiguities and Judicial Difficulties

John S. Bryant

NOTES

Public Law 86-272: Legislative Ambiguities and Judicial Difficulties

I. Background

Expanding concepts of the services that state governments should perform for their citizens have prompted within recent years entry by the states into fields of endeavor formerly left to private enterprise. Coupled with the upward spiral of the cost of goods and services, expanded responsibilities undertaken by the states have increased greatly the pressure on state taxing authorities to produce revenues sufficient to cover expenses of government. Beset by fiscal problems, the states have attempted to take maximum advantage of existing revenue sources and to tap new ones.

Although sales and use taxes have been the primary source of state tax revenue in recent years,[1] the corporate income tax imposed by the majority of states[2] is supplying an increasingly significant annual contribution to governmental coffers.[3] Characteristically, a state corporate income tax is a direct levy on net income derived from activities of the corporation within the taxing state. A state's right to impose such a tax on a domestic corporation traditionally has been based upon the rationale that the state has provided the corporate entity rights and privileges for which it rightfully may ask compensation. Problems have arisen, however, when states have attempted to extend their taxing jurisdictions beyond their physical boundaries, and a "tangled underbrush"[4] of case law has addressed the question whether a state may impose a tax upon a foreign corpo-

1. *See* TAX FOUNDATION, INC., FACTS AND FIGURES ON GOVERNMENT FINANCE 19 (17th hiennial ed. 1973).

2. Forty-five states and the District of Columhia currently employ some type of corporate income tax. CCH STATE TAX GUIDE 1042 (1973).

3. The Commerce Department has reported that income taxes surpassed sales taxes as the primary source of state revenue in 1973. Wall Street J., Jan. 9, 1974, at 1, col. 9. Individual income tax collections totaled 19.6 hillion dollars; corporate income tax collections accounted for 5.4 billion dollars. *Id.*, Jan. 2, 1974, at 1, col. 5. For a tahle revealing trends in percentage distributions of state tax collections by source since 1902 see FACTS AND FIGURES ON GOVERNMENT FINANCE, *supra* note 1, at 151.

4. Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457 (1959). Mr. Justice Clark noted that the Court had decided over 300 of these cases in slightly more than that number of volumes of the reports. *Id.* at 457-58.

ration engaged solely in interstate commerce within the taxing state.[5]

The right of a state to impose a tax on income generated exclusively in interstate commerce accentuates a conflict fundamental in a federal system—the states' need to secure tax revenue is juxtaposed to the national interest in free trade and the absence of commercial barriers between the states.[6] Although taxing power is inherent in sovereign bodies, the states of the United States have divided their taxing power between the federal government and themselves. They delegated to the federal government the exclusive power to control interstate commerce when they gave Congress the right "[t]o regulate Commerce with foreign Nations, and among the several States . . . ."[7]

A. The Northwestern States Decision

Prior to 1959 it generally was accepted that the commerce clause precluded the imposition of a state corporate income tax upon a foreign corporation whose only activities within the taxing state consisted of the furtherance of interstate commerce.[8] In 1951 the Supreme Court in *Spector Motor Service, Inc. v. O'Connor*[9] had invalidated a Connecticut tax imposed on foreign corporations for the privilege of engaging in exclusively interstate commerce, holding that the tax represented an unconstitutional burden on interstate commerce. This decision undoubtedly afforded substance to the widespread assumption that any attempt by a state to impose a tax on income generated in interstate commerce would be invalid under the commerce clause.

In the 1959 decision of *Northwestern States Portland Cement Co. v. Minnesota,*[10] however, the Supreme Court dropped a bomb-

5. For a comprehensive review of the case law in this area see *Developments in the Law—Federal Limitations on State Taxation of Interstate Business,* 75 HARV. L. REV. 953 (1962).

6. *See* THE FEDERALIST nos. 7, 11, 22 (A. Hamilton); No. 42 (J. Madison).

7. U.S. CONST. art. I, § 8, cl. 3. *See* Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1 (1824).

8. *See* H.R. REP. No. 1480, 88th Cong., 2d Sess. 7 (1964).

9. 340 U.S. 602 (1951).

10. 358 U.S. 450 (1959). Consolidated for decision with the *Northwestern States* case was the case of *Williams v. Stockham Valves & Fittings, Inc.* In *Stockham Valves,* taxpayer was a Delaware corporation with principal office and plant located in Birmingham, Alabama. It manufactured and sold valves and pipe fittings through established local wholesalers in several states. Taxpayer maintained no warehouse or storage facilities in Georgia, but it did operate a sales-service office in Atlanta, manned by one salesman who spent about a third of his time soliciting orders for taxpayer's product in Georgia. All orders taken by the salesman were sent to Birmingham for approval and filling. A full-time secretary also worked in this

shell on the world of multistate business. In *Northwestern States,* taxpayer was an Iowa corporation engaged in the manufacture and sale of cement at its plant in Mason City, Iowa. Taxpayer owned no real estate in Minnesota, maintained no bank accounts there, and warehoused no merchandise within the state; however, it employed four salesmen who maintained a regular and systematic course of solicitation of orders for sales of taxpayer's cement among customers in Minnesota. All orders were sent back to Iowa for acceptance or rejection, and delivery was made from taxpayer's plant in Mason City. The salesmen used a leased sales office in Minneapolis, which was manned by a district manager and a secretary, as a clearinghouse for their orders. Through this system of solicitation in Minnesota, taxpayer generated 48 percent of its total sales. Minnesota levied its state net income tax on the amount of taxpayer's income attributable to its activities in Minnesota, as determined by a three-factor apportionment formula.[11] Taxpayer contended that the imposition of this tax violated both the due process and commerce clauses of the federal constitution and therefore was invalid. The Court sustained the tax, however, and concluded that a state may impose a tax on net income derived from the interstate operations of a foreign corporation "provided the levy is not discriminatory and is properly apportioned to local activities within the taxing state forming sufficient nexus to support the same."[12]

In addressing the due process challenge, the Court observed that "the 'controlling question is whether the state has given anything for which it can ask return.' "[13] The Court answered this question affirmatively in *Northwestern States* by noting that taxpayer had generated 48 percent of its total sales from markets within the taxing state. The Court, further observing that the apportionment provided for by the Minnesota legislature properly insured that the taxes imposed were levied only on that portion of net income arising from taxpayer's activities within the taxing state, concluded that these activities form a "sufficient nexus between such a tax and transactions within a state for which the tax is an exaction."[14]

office. Georgia levied its corporate income tax on the portion of taxpayer's income attributable to its activities in Georgia. The Supreme Court rejected taxpayer's contentions that this tax violated the due process and commerce clauses of the federal constitution.

11. MINN. STAT. ANN. § 290.19 (1945), *as amended,* (Supp. 1973). This formula, which utilizes the 3 factors of sales, property, and payroll, is popularly known as the "Massachusetts formula."

12. 358 U.S. at 452.

13. *Id.* at 465, *quoting* Wisconsin v. J.C. Penney Co., 311 U.S. 435, 444 (1940).

14. 358 U.S. at 464, *quoting* Wisconsin v. J.C. Penney Co., 311 U.S. 435, 445 (1940).

Justice Clark, writing for the majority, also recognized the need to clarify the controversy and confusion surrounding state taxation of interstate commerce. From the "quagmire" of case law in the area, the Court distilled the principle that states may not constitutionally impose taxes that burden or interfere with the free flow of commerce.[15] On the other hand, on the authority of *West Publishing Co. v. McColgan,*[16] the Court held that a net income tax on revenues derived from interstate commerce does not in itself offend constitutional limitations upon state interference with such commerce. Noting further that no "multiple burden" on interstate commerce resulting from the imposition of the tax in question had been shown, the Court refused to "deal in abstractions" regarding the effectiveness of Minnesota's apportionment formula.[17] The Court carefully distinguished between a tax on the privilege of engaging in interstate commerce, which had been invalidated in *Spector Motor Service, Inc. v. O'Connor,*[18] and the direct tax on net income derived from interstate commerce challenged in the instant case.[19] Noting that it is not repugnant to the commerce clause to "make interstate commerce pay its way," the Court concluded that " 'taxes may be imposed although their payment may come out of the funds derived from petitioner's interstate business, provided the taxes are so imposed that their burden will be reasonably related to the powers of the State and [are] non-discriminatory.' "[20] The Court found that the taxing statutes enacted by Minnesota met these tests.[21]

Justice Frankfurter, in dissent, argued that the majority's opinion was not dictated by precedent, but rather that it "broke new ground." He pointed out that in no previous case had the Court

15. 358 U.S. at 458.

16. 328 U.S. 823 (1946), *aff'g per curiam* 27 Cal. 2d 705, 166 P.2d 861 (1946).

17. 358 U.S. at 463.

18. 340 U.S. 602 (1951).

19. For a thorough discussion of this distinction see W. BEAMAN, PAYING TAXES TO OTHER STATES 8-1 to 8-8 (1963).

20. 358 U.S. at 464, *quoting* Spector Motor Serv., Inc. v. O'Connor, 340 U.S. 602, 609 (1951).

21. In a concurring opinion, Justice Harlan agreed that prior decisions governed the outcome of the instant case and supported the constitutionality of Minnesota's tax. He emphasized that the questioned tax was part of a general scheme of state income taxation reaching all individual and corporate net income, and that the tax was "not sought to he applied to portions of the net income of Northwestern . . . *because* of the source of that income—interstate commerce—but rather *despite* that source." 354 U.S at 469 (Harlan, J., concurring). Justice Harlan observed that the Court consistently had upheld state income taxes of general application when these taxes were applied to reach only that portion of income fairly allocable to taxpayer's activities within the taxing state, and he concluded that the Court in the instant case did no more.

upheld a state tax imposed on activities that are *exclusively* a part of interstate commerce; rather, each prior case involved some element of intrastate activity sufficient to justify the tax. Predicting that the majority opinion would evoke a flurry of tax legislation by the states, Justice Frankfurter feared that the decision would produce a burden on interstate commerce for two reasons. First, he reasoned that small or moderate-sized businesses engaged in multistate operations would be compelled to expand their legal and accounting capabilities in order to comply with the varied and ever-changing taxing statutes of the several states. For many small businesses engaged in marginal interstate operations, the increased legal and accounting costs might prove prohibitive, forcing them to curtail their interstate activities or to go out of business entirely. Secondly, litigation challenging the validity of various state apportionment formulas would be increased significantly when these formulas were applied to the large number of businesses engaged in exclusively interstate commerce. Recognizing the complexity of federal-state fiscal conflicts, Justice Frankfurter contended that the adjudicatory process is ill suited to provide resolution for these problems:

> At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.[22]

In conclusion, Justice Frankfurter argued that Congress alone possesses the resources and research machinery necessary to develop a standard limiting state taxing power and urged that this task be left to the legislative branch.[23]

An immediate outcry arose from members of the business community in response to the *Northwestern States* decision. Taxpayers complained that the Court had failed to define adequately the nexus sufficient to sustain such a tax and that the states undoubtedly would press for a standard permitting taxation of foreign corporations engaged solely in interstate commerce on the basis of minimal

22. *Id.* at 476 (Frankfurter, J., dissenting).

23. Justice Whittaker, joined by Justices Frankfurter and Stewart, filed a lengthy dissent in which he argued that prior case law failed to support the majority opinion in the instant case and that the tax in question indeed imposed an unconstitutional burden on interstate commerce. *Id.* at 477.

in-state operations. They contended that a nexus standard requiring only minimal contact with the taxing state would render haphazard and unequal enforcement; taxpayers who drew the attention of the state taxing authorities would be assessed and taxed, but those who remained inconspicuous would avoid taxation. Echoing Justice Frankfurter, small and medium-sized multistate businesses also argued that their legal and accounting staffs were inadequate to keep abreast of the developments in the diverse tax statutes of the states. For many of these taxpayers, compliance costs often would exceed the tax liability itself, and the increased burden would compel the curtailment or discontinuance of marginal operations and geographical consolidation of their businesses. Furthermore, the marked differences in the income apportionment formulas of the various states created a real possibility that a company might be assessed on a tax base exceeding 100 percent of net income.[24] Finally, many taxpayers recognized that the *Northwestern States* decision exposed many small companies to substantial retroactive liability for assessments that went unpaid in previous years when the constitutionality of the taxes was in doubt.[25] Recognizing these potentially adverse effects of the *Northwestern States* decision, the business community denounced the Court's ruling as erroneous and unfair.

B. Enactment of Public Law 86-272

Meanwhile, the states lost no time in enacting taxing statutes or modifying their enforcement policies to take advantage of the newly sanctioned source of revenue.[26] Therefore, when the Supreme Court in the three months following the *Northwestern States* decision refused two opportunities to restrict or sharpen its ruling in that case,[27] multistate business interests petitioned Congress for

24. For a discussion of these problems see W. BEAMAN, *supra* note 21, at 6-7 to 6-9. *See also* Dane, *Small Business Looks at Public Law 86-272 in the Perspective of Its Alternatives*, 46 VA. L. REV. 1190 (1960).

25. For example, at stake in the *Northwestern States* case were assessments covering a period of 15 years from 1933 to 1948 and totalling $102,000. 358 U.S. at 453, 455.

26. Almost immediately following the *Northwestern States* decision, Idaho, Tennessee, and Utah enacted new taxing statutes, and Kansas changed its enforcement policy to reach income derived from exclusively interstate commerce. Note, *State Taxation of Interstate Commerce: Public Law 86-272*, 46 VA. L. REV. 297 n.3 (1960).

27. *See* International Shoe Co. v. Fontenot, 236 La. 279, 107 So. 2d 640 (1958), *cert. denied*, 359 U.S. 984 (1959); Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 So. 2d 70 (1958), *appeal dismissed and cert. denied*, 359 U.S. 28 (1959). *See also* ET & WNC Transp. Co. v. Currie, 248 N.C. 560, 104 S.E.2d 403 (1958), *aff'd mem.*, 358 U.S. 28 (1959).

a legislative abrogation of the broad taxing powers ostensibly granted to the states by the decision. Following extensive committee hearings at which businessmen and state tax administrators presented their conflicting views and suggestions,[28] in September 1959, within seven months after the decision in *Northwestern States,* Congress passed a hastily drafted bill that was signed into law as Public Law 86-272.[29] The sense of urgency with which the statute

---

28. *See* S. REP. No. 453, 86th Cong., 1st Sess. (1959); H.R. REP. No. 936, 86th Cong., 1st Sess. (1959); S. REP. No. 658, 86th Cong., 1st Sess. (1959); *Hearings on State Taxation of Interstate Commerce Before the Senate Select Comm. on Small Business,* 86th Cong., 1st Sess. (1959). For a detailed account of the legislative history of Pub. L. No. 86-272 see Note, *supra* note 26, at 300-13. For an analysis of Pub. L. No. 86-272 see Hartman, *State Taxation of Corporate Income from a Multistate Business,* 13 VAND. L. REV. 21 (1959).

29. Act of Sept. 14, 1959, Pub. L. No. 86-272, 73 Stat. 555 (codified at 15 U.S.C. §§ 381-84 (1970)):

§ 381. Imposition of net income tax.

(a) *Minimum standards.*—No State, or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, 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 sucb 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, wbich orders are sent outside the State for approval or rejection, and, if approved, are filled by sbipment 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 henefit 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).

(b) *Domestic corporations; persons domiciled in or residents of a State.*—The provisions of subsection (a) of tbis section shall not apply to the imposition of a net income tax by any State, or political subdivision thereof, with respect to—

(1) any corporation which is incorporated under the laws of such State; or

(2) any individual wbo, under the laws of such State, is domiciled in, or a resident of, such State.

(c) *Sales or solicitation of orders for sales by independent contractors.*—For purposes of subsection (a) of this section, a person shall not be considered to have engaged in business activities within a State during any taxable year merely by reason of sales in such State, or the solicitation of orders for sales in such State, of tangible personal property on behalf of such person by one or more independent contractors, or by reason of the maintenance, of an office in such State by one or more independent contractors whose activities on behalf of such person in such State consist solely of making sales, or soliciting orders for sales, of tangible personal property.

(d) *Definitions.*—For purposes of this section—

(1) the term "independent contractor" means a commission agent, broker, or other independent contractor who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regular course of his business activities; and

(2) the term "representative" does not include an independent contractor.

§ 382. Assessment of net income taxes; limitations; collection.

(a) No State, or political subdivision thereof, shall have power to assess, after Septemwas drafted and enacted into law prompted one commentator to describe Public Law 86-272 as "a piece of hasty, hysteria legislation . . . pressured through the Federal Congress by a highly organized and certainly skillfully handled group of trade organizations."[30]

II. OPERATION OF PUBLIC LAW 86-272

Relying on powers granted to it by the due process and commerce clauses, Congress had enacted Public Law 86-272 to curb the broad state taxing power apparently sanctioned by the *Northwestern States* decision. It viewed the statute as a temporary, stop-gap measure[31] affording an exemption only to those foreign corporations satisfying its conditions, and inapplicable to companies incorporated in the taxing state or corporations domiciled there.[32] In an attempt to define the minimum nexus necessary to support a state's right to tax, the statute imposes a "minimum activities" standard which purports to limit state taxing jurisdiction. It should be noted, however, that the limitations on state taxing power apply only to taxes imposed on or measured by net income from sales of tangible personal property.[33]

Public Law 86-272 provides an umbrella of immunity from

---

ber 14, 1959, any net income tax which was imposed by such State or political subdivision, as the case may be, for any taxable year ending on or before such date, on the income derived within such State by any person from interstate commerce, if the imposition of such tax for a taxable year ending after such date is prohibited by section 381 of this title.

(b) The provisions of subsection (a) of this section shall not be construed—

(1) to invalidate the collection, on or before September 14, 1959, of any net income tax imposed for a taxable year ending on or before such date, or

(2) to prohibit the collection, after September 14, 1959, of any net income tax which was assessed on or before such date for a taxable year ending on or before such date.

§ 383. Definition.

For purposes of tbis chapter, the term "net income tax" means any tax imposed on, or measured by, net income.

§ 384. Separability of provisions.

lf any provision of this chapter or the application of such provision to any person or circumstance is held invalid, the remainder of this cbapter or tbe application of such provision to persons or circumstances other than those to which it is held invalid, shall not be affected thereby.

30. Roland, *State Taxation of Interstate Income: A State Tax Administrator's Viewpoint*, 12 TAX EXECUTIVE 35 (1959).

31. During the Senate floor dehate Senator Saltonstall stated: "What the bill does, in substance, is to put the matter in status quo until the Finance Committee, which, as I understand it, is going to study the subject, will know whether there should be further changes in the law or not." 105 CONG. REC. 16354 (1959).

32. 15 U.S.C. § 381(b) (1970).

33. *Id.* §§ 381, 383.

state taxing jurisdiction if the activities of the taxpayer within the taxing state fall within either of two categories. First, a foreign corporation enjoys the protection of the statute if its *only* business activities within the taxing state consist of the solicitation of orders for the sale 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.[34] The tax exemption of solicitation also applies to the activities of "missionary men" who seek orders in the name of or for the benefit of a customer of the taxpayer.[35] The legislative history of the statute, however, indicates that the tax exemption does not extend to the maintenance by the taxpayer of a sales office within the taxing state.[36]

Secondly, the statute provides that a taxpayer will not be considered to have exceeded the minimum activities standard merely because sales, or solicitations of orders for sales, of tangible personal property are made within the taxing state through an independent contractor.[37] In contrast to the permitted activities of the taxpayer itself, the independent contractor may complete a sale within the taxing state and maintain an office there without subjecting the taxpayer to liability, as long as its activities on behalf of the taxpayer consist solely of making sales or soliciting orders for sales of tangible personal property.

In addition, Congress addressed the problem of retroactive tax burdens by prohibiting the assessment of taxes for prior years if these taxes would be prohibited for taxable years after the effective date. It did not, however, prohibit the collection of taxes already assessed prior to the effective date of the statute.[38] Finally, in recognition of the stop-gap character of the statute, Congress coterminously provided for the establishment of a study committee to examine the problem thoroughly and to offer suggestions for further legislation in the area.[39]

34. *Id.* § 381(a).

35. *Id.* § 381(a)(2). An example of this situation arose in the case of Brown-Forman Distillers Corp. v. Collector of Revenue, 234 La. 651, 101 S. 2d 70 (1958), *cert. denied,* 359 U.S. 28 (1959), when Brown-Forman's representatives urged retailers to buy Brown-Forman products, not directly from the company, but from wholesalers in the taxing state.

36. The original Senate bill contained a provision expressly permitting the maintenance of "an office the primary purpose and use of which is to serve the representatives of such persons who are engaged in the solicitation of orders [for the sale of tangible personal property] . . . and to receive, process and forward such orders." 105 CONG. REC. 16470 (1959). This provision was stricken hy an amendment on the floor of the Senate. *Id.* at 16477.

37. 15 U.S.C. § 381(c) (1970).

38. *Id.* § 382. *See* note 27 *supra* and accompanying text.

39. Act of Sept. 14, 1959, Pub. L. No. 86-272, tit. II, 73 Stat. 556.

The reaction to the enactment of Public Law 86-272 paralleled the interest expressed following the *Northwestern States* ruling. Multistate business interests praised the congressional action but complained that it did not go far enough.[40] State tax administrators contended that Congress had overstepped its regulatory authority and had invaded the states' inherent power to tax.[41] The constitutionality of the statute was challenged before the Louisiana Supreme Court in *International Shoe Co. v. Cocreham*[42] on grounds that Congress lacked the specific authority to prohibit the states from levying taxes for their support under the guise of regulating interstate commerce. In the absence of this specific authority, the state of Louisiana argued that Congress' action infringed upon rights reserved to the states under the tenth amendment. Taxpayer argued, and the court accordingly held, however, that Congress has plenary power to regulate interstate commerce, and that as long as congressional action is within the scope of its power, "fairly debatable questions as to the reasonableness, wisdom and propriety of the legislation is not for the determination of the courts but for the legislative body on which rests the duty and responsibility of these decisions."[43] The court concluded that the statute represents a proper exercise of congressional authority and does not violate the tenth amendment.

III. Judicial Interpretations of Public Law 86-272

Public Law 86-272 provides that a foreign corporation will not be subject to state taxation merely because of "solicitation of orders . . . for sales of tangible personal property"[44] if they are only processed[45] within the state, or merely because of sales, or solicitations of orders for sales, made on its behalf by an independent contractor within the taxing state.[46] The operation of the statute therefore depends on the definitions of "solicitation of orders" and "indepen-

40. *See* Dane, note 24 *supra.*

41. *See* Cox, *Federal Limit on States Taxes Is Unfair to Consuming States and to Local Firms,* 11 J. Taxation 354 (1959). *See also* Roland, *Public Law 86-272: Regulation or Raid,* 46 Va. L. Rev. 1172 (1960).

42. 246 La. 244, 164 So. 2d 314, *cert. denied,* 379 U.S. 902 (1964). *See also* Smith Kline & French Laboratories v. State Tax Comm'n, 241 Ore. 50, 403 P.2d 375 (1965); State *ex rel.* Ciba Pharmaceutical Prod., Inc. v. State Tax Comm'n, 382 S.W.2d 645 (Mo. 1964).

43. 246 La. at 265-66, 164 So. 2d at 322.

44. 15 U.S.C. § 381(a)(1) (1970).

45. The exemption is granted only if orders received within the taxing state are sent out of state for approval or rejection and if approved are filled from a point outside the state. *See id.*

46. *Id.* § 381(c) (1970).

dent contractor." The interpretation of these terms determines the circumference of the umbrella sheltering out-of-state business from taxation.

A. *Definition of Solicitation*

By failing to define "solicitation" in the statute, Congress has compelled the courts to adopt their own definitions. A liberal construction of solicitation permits a foreign corporation to conduct many activities commonly regarded as incidental to solicitation without sacrificing the protection of the statute. These related activities include collecting a deposit from the customer, handling complaints, checking on credit, installation, and other similar functions. On the other hand, a narrow interpretation of solicitation imposes a rigorous standard affording tax exemption only to companies whose sole activity within the taxing state is the actual solicitation of orders from potential customers.

In practice the protection of Public Law 86-272 usually is invoked in one of two circumstances. A foreign corporation may contend that its activities within the taxing state do not exceed "solicitation," and that it is exempt from taxation.[47] On the other hand, a domestic corporation may argue that because its activities in a foreign state exceed solicitation and render it subject to taxation there, it should be allowed to allocate a portion of its income to the foreign state and thereby reduce the amount of income subject to taxation in its home state.[48] In either circumstance, the breadth of the interpretation of solicitation often is determinative of the outcome of the case.

1. *Invocation of Public Law 86-272 by Foreign Corporations.*—The state courts of Oregon have interpreted Public Law 86-272 on several occasions, and an examination of their decisions illustrates the judicial uncertainty in the area. In the early case of *Smith Kline & French Laboratores v. State Tax Commission,*[49] the Supreme Court of Oregon held that the activities of taxpayer corporation in the state were within the protective solicitation provision and that the corporation therefore was exempt from

47. *See, e.g.,* State *ex rel.* Ciba Pharmaceutical Prods., Inc., v. State Tax Comm'n, 247 Ore. 404, 430 P.2d 998 (1967); Smith Kline & French Laboratories v. State Tax Comm'n, 241 Ore. 50, 403 P.2d 375 (1965).

48. *See, e.g.,* Tonka Corp. v. Commissioner of Taxation, 284 Minn. 185, 169 N.W.2d 589 (1969); Cal-Roof Wholesale, Inc., v. State Tax Comm'n, 242 Ore. 435, 410 P.2d 233 (1966); John Ownbey Co. v. Butler, 211 Tenn. 366, 365 S.W.2d 38 (1963).

49. 241 Ore. 50, 403 P.2d 375 (1965).

taxation under the federal statute. Plaintiff taxpayer, a Pennsylvania corporation engaged in the manufacture and sale of pharmaceutical products in interstate commerce, maintained no office, office equipment, stock of goods, telephone listing, mailing address, or automobile within the state of Oregon; however, it did employ six resident representatives, paid their expenses, and provided them with samples and sales material. The primary function of these representatives was sales promotion;[50] they solicited orders only on rare occasions. Oregon customers placed orders with taxpayer at its home office in Philadelphia where they were accepted and filled. The Oregon Tax Commission having assessed a deficiency against taxpayer under the state corporate income tax, taxpayer claimed exemption under Public Law 86-272.

The Tax Commission contended that the federal statute creates an "island of immunity" around the solicitation activity; that solicitation requires that an actual order be sought by an individual calling on a potential customer; and that the activities of taxpayer's representatives, who merely encouraged the placing of orders with the wholesale drug firms selling taxpayer's products, did not qualify taxpayer for exemption.[51] Taxpayer argued, however, that its employees in Oregon did solicit orders within the meaning of Public Law 86-272 and that the statute does not require the receipt of an order by taxpayer's representatives so long as they were soliciting and encouraging the purchase of taxpayer's product.[52] The court upheld the constitutionality of the statute[53] and found that the activities of taxpayer's employees did not exceed the intended scope of the solicitation provision. The court, citing legislative history, concluded that "Congress intended to exempt not only the specifically described phase of interstate sales efforts but also *all lesser, included phases.*"[54] Furthermore, the court considered the nature of taxpayer's business and concluded that by encouraging the use and sale of its products, these representatives perform the same sales function in the pharmaceutical field that salesmen soliciting actual

50. These "detail men" visited hospitals and other institutions, doctors, and retail and wholesale druggists for the purpose of explaining the usefulness of taxpayer's products and encouraging their use and sale.

51. 241 Ore. 50, 54-55, 403 P.2d 375, 377 (1965).

52. *Id.* at 55, 403 P.2d at 377.

53. The constitutionality of the statute was challenged on both due process and commerce clause grounds. The court rejected both of these arguments. *Id.* at 56-59, 403 P.2d at 378-79.

54. *Id.* at 55, 403 P.2d at 377 (emphasis added), *quoting* 1 Ore. T.R. 532, 541 (1964).

orders from the ultimate user perform in other businesses.[55] The court thus adopted a rather liberal interpretation of solicitation, including "all lesser, including phases" under the protective provisions of Public Law 86-272.

The liberal construction of solicitation proved short-lived in Oregon, however, as the validity of the *Smith Kline* standard was eroded significantly by the 1967 decision of *Herff Jones Co. v. State Tax Commissioner.*[56] In *Herff Jones*, taxpayer was a foreign corporation engaged in the manufacture of school class rings, which it sold in interstate commerce. Taxpayer entered a contract with Master Engravers, Inc. (Masters), making the latter the franchise agent for taxpayer in Oregon and other western states. Four resident Oregon salesmen handled taxpayer's product and also sold merchandise for Masters and other companies. These salesmen regularly called on schools to solicit orders for taxpayer's products and secured a five-dollar deposit on each ring sold. Orders were sent by the salesmen to Indianapolis where they were accepted and filled. In addition to the collection of the initial deposit, the salesmen occasionally collected the balance and forwarded it to taxpayer or to Masters. Taxpayer maintained no office, place of business, or telephone listing in Oregon, and owned no property there except the salesmen's samples. When Oregon levied its corporate income tax on the net income generated by taxpayer's activities within the state, taxpayer claimed the exemption of Public Law 86-272.

Having initially decided that taxpayer's salesmen were not independent contractors,[57] the Supreme Court of Oregon addressed the issue whether the activity of the salesmen in Oregon fell within the definition of solicitation. The court repudiated the broad construction of solicitation employed by the *Smith Kline* court and stated that in order to be protected by the statute, the *only* business activity that taxpayer's sales representatives could engage in is the solicitation of orders. It found, however, that the representatives' activities were not so limited.[58] Noting that the salesmen customarily secured an initial deposit on rings sold and occasionally collected the balance due, the court held that taxpayer's activities in Oregon exceeded solicitation and failed to qualify for the exemption afforded by Public Law 86-272. The court thus rejected the broad "all

55. *Id.* at 56, 403 P.2d at 378.

56. 247 Ore. 404, 430 P.2d 998 (1967).

57. *Id.* at 410, 430 P.2d at 1000-01. For a discussion of the independent contractor question see text accompanying notes 89-91 *infra.*

58. 247 Ore. at 412, 430 P.2d at 1002.

lesser, included activities" standard of *Smith Kline* and in its place adopted a narrow, restrictive view of solicitation. Although the court declined to supply a definition of solicitation, it found that the salesmen's activities exceeded the scope of activities intended for protection under the federal statute. The judicial interpretation of solicitation by the Oregon Supreme Court thus appears to have come full circle since the *Smith Kline* decision.

The Oregon Tax Court reiterated the narrow construction of solicitation in the 1968 decision of *Briggs & Stratton Corp. v. Commissioner.*[59] Taxpayer, a Delaware corporation with its principal office in Milwaukee, Wisconsin, was engaged in the manufacture and sale of gasoline engines. It sold its engines to ten customers in Oregon, nine of whom were equipment manufacturers who used taxpayer's engines to provide motive power for their products. The other customer, Tracey & Co., was a central warehouse distributor who acted as an independent contractor handling taxpayer's products as well as products of other manufacturers. Taxpayer's only representative in Oregon was a salaried sales and service supervisor who lived in Washington and spent approximately one of every eight weeks in Oregon. This supervisor contacted the nine equipment manufacturers, offered them engineering advice, and encouraged them to buy Briggs & Stratton engines. He also maintained a close liaison with Tracey & Co., assisting it with any problems and insuring that its inventory was adequate. In addition, the supervisor conducted three or four service schools each year for the benefit of Tracey personnel and other distributors and dealers. Two other members of taxpayer's organization traveled to Oregon from Milwaukee to participate in these schools. Aside from these activities, taxpayer maintained no office and owned no property in Oregon, and all Oregon orders were accepted in Wisconsin and filled by shipment from its plant in Milwaukee.

Faced with a claim of exemption under Public Law 86-272, the Oregon Tax Court examined the activities of taxpayer's supervisor in light of the strict solicitation standard set forth in *Herff Jones.* Deeming it unnecessary to decide whether Tracey & Co. satisfied the independent contractor exemption because of its finding that taxpayer's sales and service supervisor does more than solicit orders in Oregon,[60] the court concluded that taxpayer failed to qualify for the exemption and sustained the tax. Although the activities of

59. 3 Ore. T.R. 174 (1968).
60. *Id.* at 180.

taxpayer's supervisor in *Briggs & Stratton* appeared to exceed even the most generous definition of solicitation, the language of the Oregon Tax Court confirmed its adherence to the strict standard of *Herff Jones*.

Several other states also have attempted to clarify the ambiguities of Public Law 86-272. An examination of their efforts will highlight the difficulties generated by faulty statutory draftsmanship by Congress. In *State ex rel. Ciba Pharmaceutical Products, Inc. v. State Tax Commission,*[61] the Missouri Supreme Court grappled with the definition of solicitation in a factual situation reminiscent of *Smith Kline*. Taxpayer corporation, a New Jersey pharmaceutical house with its main office in Summit, New Jersey, was engaged in the manufacture and sale of drugs. It employed about twelve "professional service representatives" to solicit orders from Missouri druggists and hospital pharmacists. These orders were sent to taxpayer's home office in New Jersey for approval and were filled by shipment from taxpayer's warehouse in Chicago. While soliciting orders from retail druggists, the representatives frequently distributed promotional brochures and assisted the pharmacist in taking inventory. In addition, they visited or "detailed" doctors in their territories, explaining the therapeutic value of taxpayer's products when prescribing medicine for their patients.

When the Missouri State Revenue Department assessed its corporate income tax on the income generated by its activities in Missouri, taxpayer invoked Public Law 86-272. The State Tax Commission contended, however, that taxpayer's activities in Missouri exceeded solicitation and that the exemption was unavailable. The court, recognizing the paucity of precedent interpreting the statute, stated that no court cases or legal authorities were available which could be of any substantial assistance in determining the scope of the statute's protection, and observed that "about the most that can be said in describing this statute is that it was hastily enacted, not very clear, and is considerably restricted in its scope . . . ."[62] The court noted that no business or financial transactions occurred as a part of the representatives' promotional activities and that no taxable income was produced or any intrastate commerce conducted. Apparently disregarding any promotional activity by the taxpayer that did not result directly in the transfer of money or product, the court concluded that the only financial transactions consisted of interstate commerce within the minimum standard protected by

61. 382 S.W.2d 645 (Mo. 1964).
62. *Id.* at 652.

the statute. The court also rejected a challenge to the constitutionality of Public Law 86-272[63] and upheld taxpayer's exemption.

The Missouri court's approach to the problem of defining solicitation parallels the "all lesser, included phases" standard of *Smith Kline* but presents a sharp contrast to the strict standard of *Herff Jones*. There seems to be little doubt that the activities held to be exempt by the *Ciba Pharmaceuticals* court would have exceeded solicitation under the standard now prevailing in Oregon. The interpretive dichotomy between these two states exemplifies the shortcoming of Public Law 86-272 and amplifies the need for a uniform legislative or judicial definition of solicitation.

The seeming disregard by the *Ciba Pharmaceuticals* court of the promotional activities carried on by taxpayer's representatives may be contrasted to the later decision of the Superior Court of New Jersey in the case of *Clairol, Inc. v. Kingsley*.[64] In *Clairol*, taxpayer was a Delaware corporation engaged in the manufacture and sale of cosmetics and beauty aids. Taxpayer employed a number of "detail men" who visited retail druggists and arranged promotional displays of taxpayer's products. They also carried promotional brochures and free samples, which were distributed to taxpayer's customers. In addition, the detail men occasionally took inventory of the druggist's stock of Clairol products and from this inventory wrote up a suggested order. Furthermore, taxpayer employed other representatives who called on beauty salons that purchased Clairol products from wholesalers to whom it sold. Although these representatives rarely solicited orders, they possessed technical backgrounds and taught the beauty salon operators new techniques for the use of these products.

New Jersey assessed its corporation business tax against taxpayer, the measure of which was the total of the tax computed on the basis of allocated net worth and that computed on the basis of allocated net income. Contending that its activities within New Jersey did not exceed the definition of solicitation, taxpayer argued that Public Law 86-272 specifically invalidated that portion of the tax measured by allocated net income and inferentially invalidated the portion measured by allocated net worth. The Superior Court of New Jersey, noting that the statute applies only to taxes on or measured by net income, summarily rejected the contention that it inferentially prohibited the portion of the tax measured by allocated

63. *Id.* at 654-57.

64. 109 N.J. Super. 22, 262 A.2d 213 (Super Ct.), *aff'd*, 57 N.J. 199, 270 A.2d 702 (1970), *appeal dismissed*, 402 U.S. 902 (1971).

net worth. The court proceeded to examine the various duties performed by taxpayer's detail men and representatives in the course of their jobs and concluded that Clairol's business activities in the state extend beyond the mere solicitation of orders either on its own behalf or on behalf of its wholesalers.[65] In contrast to the court in *Ciba Pharmaceuticals,* the New Jersey court examined the promotional activities of taxpayer's representatives and stated:

> That increased public favor of Clairol's products will eventually result in increased orders from retail druggists to wholesalers and from wholesalers to Clairol, or as in the case of its hair products from beauty salons to "beauty jobbers" and from the latter to Clairol, does not blanket all Clairol's activities with the protection afforded by the federal act to cases where the only business of the taxpayer is the solicitation of orders.[66]

The court, expressly rejecting the broad interpretation of solicitation set forth in *Smith Kline* and *Ciba Pharmaceuticals* and adopting the narrow *Herff Jones* interpretation, concluded that taxpayer's activities in New Jersey exceeded solicitation and were subject to taxation.

Following the examples of the *Herff Jones* decision in Oregon and the *Clairol* decision in New Jersey, the Supreme Court of Arkansas adopted a restrictive construction of solicitation when it interpreted Public Law 86-272 in *Hervey v. AMF Beaird, Inc.*[67] In *Hervey*, taxpayer, a Delaware corporation with its principal office in Shreveport, Louisiana, was engaged in the manufacture and sale of propane gas storage tanks. The retailers to whom taxpayer sold maintained on consignment an inventory in taxpayer's products. Taxpayer employed a salesman who made monthly calls on retail dealers in Arkansas, checked the retailers' inventory, solicited orders, billed the retailers as he sold taxpayer's products to the public, and occasionally accepted payment on behalf of taxpayer. The orders were sent to the home office in Louisiana for acceptance or rejection.

When the Arkansas Commissioner of Revenues assessed the state's corporate income tax against the amount of income generated by its activities in Arkansas, taxpayer claimed exemption under Public Law 86-272. The trial court granted taxpayer's motion for summary judgment on the ground that the tax was barred by the federal statute. On appeal the Supreme Court of Arkansas observed that legislative history and prior court decisions in other states[68]

65. 109 N.J. Super. at 30, 262 A.2d at 217-18.
66. *Id.* at 30, 262 A.2d at 218.
67. 250 Ark. 147, 464 S.W.2d 557 (1971).
68. The Arkansas court cited the following decisions: Clairol, Inc. v. Kingsley, 109 N.J.

indicated that solicitation was to be narrowly interpreted. Thus, utilizing a strict standard, the court found that the salesman exceeded solicitation when he regularly checked inventories of retailers selling taxpayer's products. In addition, the court noted that taxpayer had failed to show that under its consignment agreement with the retailers its activities were restricted to solicitations of orders for *sales* of tangible personal property. Rather than rendering a definitive decision, the court reversed the trial court's summary judgment and remanded the case for further proceedings.

These cases exemplify the difficulty that courts have experienced in interpreting Public Law 86-272. The congressional failure to provide a definition of solicitation has created uncertainty for taxpayer and tax administrator alike, and it is likely that many taxpayers in doubt about their tax liability fail to file returns at all.[69]

2. *Invocation of Public Law 86-272 by Domestic Corporations.*—Although Public Law 86-272 is most commonly invoked by a foreign corporation attempting to avoid taxation of income generated by its activities in the taxing state, domestic corporations have claimed the exemption as well to avoid taxation through apportionment of net income from a multistate business. The difficulties with the interpretation of solicitation have been no less, however, when domestic corporations have relied on the statute to apportion part of their income to other states. Characteristically, the domestic corporation contends that its activities in a foreign state exceed solicitation and render it taxable there; therefore, in order to avoid multiple taxation on the same income,[70] the taxpayer should be able to apportion part of its income to the foreign state and thereby reduce the amount subject to taxation in its home state.

The Supreme Court of Oregon encountered this argnment in the 1966 decision of *Cal-Roof Wholesale, Inc. v. State Tax Commission.*[71] Taxpayer, an Oregon corporation, was a distributor of building materials in Oregon and Washington. It conducted operations in Washington through a salesman living in that state whose chief activity was the solicitation of orders that were approved at the Oregon home office. The salesman on numerous occasions collected delinquent accounts, made pickups of returned merchandise,

Super. 22, 262 A.2d 213 (1970); Herff Jones Co. v. State Tax Comm'n, 247 Ore. 404, 430 P.2d 998 (1967); Cal-Roof Wholesale, Inc. v. State Tax Comm'n, 242 Ore. 435, 410 P.2d 233 (1966).

69. See note 101 *infra*.

70. For a general discussion of apportionment formulas and how they operate see W. BEAMAN, *supra* note 19, at 3-1 to 3-21.

71. 242 Ore. 435, 410 P.2d 233 (1966).

and customarily carried with him a supply of small items that he sold and delivered in Washington. In addition, he occasionally extended spot credit and accepted orders rather than submitting them for acceptance at the home office in Oregon. Taxpayer also regularly entered into cooperative advertising agreements in Washington with its Washington customers. When the Oregon Tax Commission assessed its corporate excise tax on its total unapportioned net income, taxpayer argued that it should be able to deduct from its net income subject to taxation in Oregon that portion attributable to its operations in Washington. The Tax Commission, relying on the broad interpretation of the Public Law 86-272 solicitation exemption as it had been set forth in the prior *Smith Kline* decision, contended that the activities of taxpayer's salesman in Washington were within the definition of solicitation and that taxpayer therefore was immune from taxation in that state and its income was not subject to apportionment. Consequently, the Commission argued that *all* of taxpayer's income should be taxable in Oregon.

The court expressly repudiated the Tax Commission's analysis of the *Smith Kline* decision, however, as a broad interpretation of solicitation for purposes of Public Law 86-272. Emphasizing the statutory language that requires that solicitation be the "*only* business activities" within the state, the court stated: "While we need not and do not here decide whether plaintiff's activities in Washington were wholly inter-state or at least in significant part intra-state, its Washington activities clearly encompassed more than 'solicitation' only."[72] As a result, taxpayer was found to be subject to a potential tax in Washington (although Washington at that time had no such tax),[73] and a tax by Oregon on taxpayer's total net income would subject it to a risk of multiple taxation. The court therefore invalidated the Oregon tax on the portion of taxpayer's income attributable to its activities in Washington.

The facts of a more recent apportionment case before the Oregon Supreme Court again indicate the measure of uncertainty with which taxing authorities regard Public Law 86-272. In *Iron Fireman Manufacturing Co. v. State Tax Commission,*[74] taxpayer was an Oregon corporation engaged in the manufacture of airplane parts which it sold to the Boeing Aircraft company in Seattle, Washington. Orders for taxpayer's products were not solicited in the normal

72. *Id.* at 448, 410 P.2d at 239.

73. The court observed that "the test of constitutionality is not based on tax laws the state of Washington has actually enacted." *Id.* at 447, 410 P.2d at 239.

74. 251 Ore. 227, 445 P.2d 126 (1968).

business fashion because of their specialized character and because of the long history of dealings between the Iron Fireman and Boeing companies. The extremely technical nature of the work required taxpayer's manager and specialists for both companies to maintain close contact. As a result, taxpayer's production engineers, metallurgists, quality control managers, and assembly supervisors spent several weeks of the year working closely with Boeing in Seattle. The contractual agreement with Boeing required taxpayer to retain a skilled metallurgist who had been trained by Boeing to be familiar with Boeing's needs and requirements. In addition, taxpayer furnished parts pursuant to contracts that had been negotiated and executed in Seattle rather than being sent back to Oregon for approval or rejection. When the Oregon State Tax Commission assessed its corporate income tax against taxpayer's total net income, taxpayer conceded tax liability on income attributable to its Oregon operations but maintained that it was entitled to exclude from income taxable in Oregon that portion generated by its activities in Washington. The Oregon Tax Commission opposed this apportionment of income on the ostensibly untenable ground that taxpayer's activities in Washington did not exceed solicitation and that Public Law 86-272 therefore rendered taxpayer immune from taxation in that state.

The Oregon Supreme Court initially noted that prior case law and legislative history indicated that solicitation as provided for in Public Law 86-272 was intended to have a narrow construction. In summary fashion the court held that taxpayer's "mutual endeavor" with Boeing in Washington greatly exceeded the mere solicitation of orders and concluded that taxpayer was entitled to apportion its income to Washington.[75] The court further noted that the execution of contracts in Washington failed to satisfy the statutory requirement that all orders be accepted or rejected outside the taxing state; however, the court declined to rest its decision on this ground but preferred instead to rely on a finding that taxpayer's activities in Washington exceeded solicitation.[76] Although the court in this case nominally subscribed to the narrow *Herff Jones* interpretation of solicitation, taxpayer's activities in Washington appear to have exceeded even the most generous interpretation of that term. Perhaps the most amazing facet of this case is that the Oregon Tax Commission advanced the Public Law 86-272 argument at all.

75. *Id.* at 232, 445 P.2d at 128.
76. *Id.* at 233, 445 P.2d at 129.

A Georgia corporation also has employed Public Law 86-272 as justification for apportioning its income to states outside Georgia. In *Hawes v. William L. Bonnell Co.*,[77] taxpayer, a Georgia corporation, attempted to apportion its income under a state statute[78] permitting apportionment if the taxpayer was "doing business" in another state. Taxpayer made 92 percent of its gross sales to customers outside Georgia. It maintained corporate sales agencies in New York and Florida, employed sales representatives who operated from offices in their homes in five different states, and shipped inventory to several out-of-state retailers who held taxpayer's product on consignment until it was sold. The State Revenue Commissioner contended that taxpayer's activities in other states did not constitute "doing business" and that taxpayer therefore was not eligible to apportion its income. Taxpayer argned first that its activities in states outside Georgia constituted doing business under the Georgia apportionment statute as interpreted by prior case law. Secondly, taxpayer maintained that its out-of-state activities exceeded solicitation under Public Law 86-272 and rendered it liable for taxation in other states; therefore, it should be permitted to apportion its income to states outside Georgia.

The Court of Appeals of Georgia held, based on prior case law interpreting the state income apportionment statute, that these activities constituted "doing business" outside Georgia and entitled taxpayer to apportion its income. Addressing taxpayer's Public Law 86-272 argument, however, the court implied in dicta that the federal statute is not applicable to a domestic corporation attempting to apportion its income to a foreign state:

> The federal Act at best only impliedly modified the [Georgia income apportionment statute] insofar as a foreign corporation's activities within the state are concerned. The fact that attempting to tax a foreign corporation under that provision might now run afoul of the federal statute would not affect the provision as to Georgia corporations with described activities in other states. The federal law does not endeavor to preempt that area. It did not in any manner relate to the Act's provisions insofar as a domestic corporation was concerned.[79]

Although the court in this case did permit taxpayer to apportion taxable income to its out-of-state operations, the court indicated that Public Law 86-272 had no application whatsoever to domestic corporations seeking to apportion income.

In 1963, the Tennessee Supreme Court examined the Public

77. 116 Ga. App. 184, 156 S.E.2d 536 (1967).
78. GA. CODE ANN. § 923113 (1961), *as amended,* (Supp. 1973).
79. 116 Ga. App. at 191, 156 S.E.2d at 541.

Law 86-272 exemption in the case of *John Ownbey Co. v. Butler*[80] and rendered what appears to be a clearly erroneous decision. The case consolidated actions by four separate companies, each of which was seeking a refund on its state excise tax. The tax in question was computed according to a three-factor apportionment formula, one of the factors being sales. Gray & Dudley, taxpayer in one of the consolidated actions, was a Tennessee corporation engaged in manufacturing and marketing appliances. Approximately 95 percent of its sales were made to customers in other states. Most of these out-of-state sales were made through the solicitation of orders, which were accepted in Tennessee, and by delivery through channels of interstate commerce. Some sales were made through independent warehouses located in Massachusetts, Connecticut, New York, Louisiana, and California. In addition, taxpayer made a few of its out-of-state sales through its agents located in Louisiana and New York. Taxpayer's product was shipped to warehouses owned by its agents in these two states, and the agents made sales and deliveries from their warehouse inventory. The agents accepted payment for these sales and made monthly payments and inventory reports to taxpayer. Relying on these facts, taxpayer contended that its activities in foreign states exceeded solicitation as used in Public Law 86-272, rendering it subject to taxation in those states; therefore, taxpayer argued, it should be entitled to apportion its taxable income to its operations in the foreign states.

Dealing with the applicability of Public Law 86-272, the Tennessee Supreme Court observed that prior to the statute's adoption in 1959, the state had not attempted to tax the portion of income that a taxpayer could attribute to its activity in other states. The court noted, however, that the federal statute denies to states the right to impose a net income tax on income derived from interstate commerce if the business activity within the taxing state consists only of solicitation of orders for the sale of tangible personal property. The court concluded in cursory fashion that taxpayer's activities outside Tennessee fell within the definition of solicitation and that they therefore were exempt from taxation in the foreign states. As a result, the court held that taxpayer's total earnings should be apportioned to Tennessee.

It seems apparent that ownership of warehouses and maintenance of inventories in Louisiana and New York clearly exceeded the scope of solicitation exempted by Public Law 86-272. The court,

80. 211 Tenn. 366, 365 S.W.2d 33 (1963).

however, chose to ignore these operations in its effort to label taxpayer's out-of-state activities as mere solicitation:

> Gray & Dudley shows that a very small portion of its business is conducted from out-of-state locations. The portion of the business which might be considered as being done there is so small that it really does not make any difference or show that the apportionment formula should follow.[81]

This de minimis approach to the solicitation question appears unique and is unsupported in legislative history and other judicial interpretations of the statute. Moreover, it appears certain that the drafters did not intend to include ownership of warehouses and storage of inventory within the definition of solicitation for the purpose of the exemption.[82]

These judicial opinions offer examples of the difficulty that courts have experienced in dealing with the meaning of solicitation. Moreover, the inconsistent results reached by these courts highlight the need for a standard definition of this crucial statutory concept.

B. *Definition of "Independent Contractor"*

Public Law 86-272 provides that a foreign corporation will not be subject to taxation because of sales, or solicitations of orders for sales, made on its behalf by an independent contractor within the taxing state.[83] In addition, the statute expressly allows the independent contractor to maintain an office in the taxing state without subjecting the foreign corporation to taxation.[84] It should be noted, however, that although the making of sales and maintenance of an office by the independent contractor within the taxing state will not violate the terms of the exemption, his efforts on behalf of the foreign taxpayer otherwise are limited to solicitation.[85] Unlike the term "solicitation," the statute does define the term "independent contractor." For purposes of the statute an independent contractor is defined as "a commission agent, broker, *or other independent contractor* who is engaged in selling, or soliciting orders for the sale of, tangible personal property for more than one principal and who holds himself out as such in the regnlar course of his business activities . . . ."[86] Since this definition embodies the very word it at-

81. *Id.* at 381, 365 S.W.2d at 39.

82. "It [the statute] does not prohibit taxation if the company has a warehouse in the State or other physical facilities . . . for the purpose of implementing the sale of goods." 105 CONG. REC. 16355 (1959) (remarks of Senator Byrd).

83. 15 U.S.C. § 381(c) (1970).

84. *Id.*

85. *Id.*

86. *Id.* § 381(d)(1) (emphasis added).

tempts to define, it has been criticized by commentators as limited in value.[87]

The Supreme Court of Oregon confronted the problem of defining the term independent contractor as employed in Public Law 86-272 in the decision of *Herff Jones Co. v. State Tax Commission.*[88] Taxpayer was a foreign corporation engaged in the sale of school class rings in Oregon through a contractual agreement with Master Engravers, Inc., an Oregon corporation. The representatives of Masters sold taxpayer's products as well as products of other companies. Under the terms of its contract with Masters, taxpayer required the representatives to post fidelity bonds, to carry automobile insurance for its benefit, and to agree not to compete with it if the contract were terminated. Taxpayer also had the right to control the representatives' sales territories and to approve hiring and firing of the sales representatives and the sales manager. Finally, taxpayer furnished order blanks, samples, and sample cases to the representatives. Claiming a tax exemption in Oregon under the federal statute, taxpayer contended that the sales representatives of Masters were independent contractors under the meaning of that statute.

The Supreme Court of Oregon noted that because of the circularity of the statutory definition, it was necessary to look to its own case law for assistance in defining the term "independent contractor."[89] The court observed that the single most important factor distinguishing between an independent contractor and an employee is the right to control or interfere with the manner and method of accomplishing the result—not the actual exercise of control. Under this test, the court concluded that it was apparent that taxpayer's representatives were not independent contractors.[90]

Adopting a similar approach to define independent contractor, the Supreme Court of Minnesota addressed the problem in the 1969 decision of *Tonka Corp. v. Commissioner of Taxation.*[91] Taxpayer, a Minnesota corporation engaged in the manufacture of toy metal vehicles, sold its products throughout the country, primarily to wholesalers and large retailers, through sales representatives oper-

87. *See, e.g.,* Note, *supra* note 26, at 318.

88. 247 Ore. 404, 430 P.2d 998 (1967). For a previous discussion of this case regarding the definition of solicitation see notes 56-58 *supra.*

89. 247 Ore. at 409, 430 P.2d at 1000.

90. *Id.* The court, having held that taxpayer's representatives were not independent contractors, also found that their activities went beyond mere solicitation. Taxpayer, therefore, was without the protection from taxation afforded by Public Law 86-272. 247 Ore. at 412, 420 P.2d at 1002.

91. 284 Minn. 185, 169 N.W.2d 589 (1969).

ating out of rented offices located in eight major cities. Each representative was compensated by taxpayer on a commission basis and was assigned to an exclusive sales territory. Although the representatives were forbidden by contract with taxpayer from handling competing product lines, they did sell noncompeting products of other manufacturers. The representatives solicited and negotiated orders, which, with the exception of some orders approved in New York by taxpayer's credit manager, were all sent to taxpayer's home office in Minnesota for approval. In addition, the representatives assisted in collection matters, arranged whole-car shipments to reduce shipping costs for customers, worked out adjustments for defective merchandise claims by customers, and maintained permanent displays of taxpayer's products in their offices. They also assisted taxpayer's advertising agency in allocating television advertising time for its products. Taxpayer maintained a special leased sales office in New York at the site of an annual toy fair. About fifteen percent of taxpayer's annual sales orders were placed during the toy fair and half of these were approved and accepted in New York by its credit manager.

When Minnesota computed income tax liability on taxpayer's total income, taxpayer filed for refunds contending that it was a corporation whose "trade or business [is] carried on partly within and partly without this state," entitling it to apportion its income according to the state income apportionment statute.[92] The Commissioner of Taxation contended, however, that taxpayer's representatives in foreign states were independent contractors and that taxpayer therefore was ineligible to apportion its income. The state further argued that all contractual agreements referred to the representatives as independent contractors and that sales by and through them did not constitute taxable business activities under Public Law 86-272; therefore, the state contended, the making of those sales could not be categorized as carrying on a trade or business outside of Minnesota.

The Minnesota Supreme Court initially recognized that the distinction between an agent and an independent contractor is a question of fact. The court looked to the *Restatement (Second) of Agency*[93] and noted that the right to exercise control is the fundamental element of the agency relationship. The court then observed that although taxpayer's New York representative possessed many of the characteristics of an independent contractor,

---

92. MINN. STAT. ANN. § 290.19 (1962), *as amended*, (Supp. 1973).
93. RESTATEMENT (SECOND) OF AGENCY § 1 (1958).

> he could not deal in competing products; he performed a great many customer services; he aided [taxpayer] in setting up its advertising program; [taxpayer], in effect, paid a large portion of his rental expense for office space; and his offices were used by [taxpayer] as its New York sales headquarters during the annual toy fair. This evidence indicates that the Tax Court was not unreasonable in concluding that [taxpayer's] relationship with its New York representative was such that he could be fairly characterized as [taxpayer's] agent or employee, [and not an independent contractor] and that sales made through him amounted to business carried on without this state.[94]

Addressing the state's argument based on Public Law 86-272, the court stated that "the evidence amply supports a finding that at least [taxpayer's] New York sales representative was more like an employee than an independent contractor. Therefore, subsections (c) and (d) of section 381 would be inapplicable."[95] Having found that the New York sales representative was an employee and not an independent contractor, the court concluded that Public Law 86-272 would not exempt taxpayer from taxation in New York, and to avoid multiple taxation, taxpayer was entitled to apportion its income to its business activities outside Minnesota.[96]

Although the statutory definition of independent contractor found in Public Law 86-272 could have been improved by more skillful legislative drafting, it does not appear that courts have experienced unreasonable difficulty in applying the term. Unlike the term "solicitation," the relevant definition of "independent contractor" may be inferred from other legal contexts.[97] In addition, the terms "commission agent" and "broker," included in the statutory definition,[98] generally are well understood and afford a workable standard by which the relationship between a taxpayer and his representative may be measured.[99]

---

94. 284 Minn. at 191, 169 N.W.2d at 594.

95. *Id.* at 193, 169 N.W.2d at 594.

96. The court stated that although the evidence supporting the employee status of taxpayer's other sales representatives was much weaker, the parties had stipulated that if taxpayer was found to be entitled to apportion its income resulting from one of its out-of-state representatives, it would be permitted to apportion *all* its income resulting from sales by these representatives. *Id.* at 193, 169 N.W.2d at 595.

97. *See, e.g.*, A. LARSON, WORKMEN'S COMPENSATION §§ 43.00-.52 (1967); RESTATEMENT (SECOND) OF AGENCY §§ 2, 220 (1958). In the decision of NLRB v. United Ins. Co. of America, 390 U.S. 254 (1968), the Supreme Court applied common-law agency principles to distinguish between an employee and an independent contractor in the absence of a statutory definition:

> In such a situation as this there is no shorthand formula or magic phrase that can be applied to find the answer, but all the incidents of the relationship must be assessed and weighed with no one factor being decisive. What is important is that the total factual context is assessed in light of the pertinent common-law agency principles.

390 U.S. at 258.

98. 15 U.S.C. § 381(d)(1) (1970).

99. *See* Note, *supra* note 26, at 318.

IV. Conclusion

Following the *Northwestern States* decision, Congress enacted Public Law 86-272 in an effort to eliminate the uncertainty and concern among multistate businessmen. The statute imposed a minimum activity standard precluding state taxation of foreign corporations engaged solely in the solicitation of orders for the sale of tangible personal property within the taxing state. The failure of the statute to define solicitation, however, has created additional uncertainty among courts, tax administrators, and taxpayers alike. Judicial interpretations of solicitation have differed among the states, creating a real risk of multiple taxation on the same income.[100] In addition, confusion regarding tax liability has caused many marginal taxpayers to fail to file returns at all.[101] Certainly a clarification of the solicitation concept is needed.

As Justice Frankfurter observed in the *Northwestern States* decision, the legislative branch of the government is better suited to afford this clarification than are the courts.[102] The accommodation of the states' right to tax and the national interest in unobstructed commerce is a delicate matter, requiring the research and statistical resources peculiarly available to Congress. The legislators accordingly should afford a statutory definition of solicitation that would eliminate the uncertainty and disparity of interpretation that now exists. For maximum effectiveness, this jurisdictional standard should be coupled with a uniform income allocation formula that would eliminate the possibility of multiple taxation.[103]

If Congress fails to act, however, a decision by the United States Supreme Court interpreting solicitation would be helpful in bringing uniformity to the area. In the recent decision of *Heublein, Inc. v. South Carolina Tax Commission,*[104] the Court peripherally addressed the solicitation question but offered no definition of the

---

100. For example, Missouri has adopted a broad interpretation of solicitation in the *Ciba Pharmaceuticals* decision while Oregon, in the *Herff Jones* case, has developed a very restricted construction of the term. Suppose, therefore, that a Missouri corporation is engaged in interstate commerce in Oregon. It is very possible that Oregon courts would find that taxpayer's activities in that state exceed solicitation, disqualifying taxpayer for the exemption. At the same time, Missouri may find that taxpayer's activities in Oregon are within the definition of solicitation and exempt from taxation in Oregon; therefore, Missouri would refuse to permit taxpayer to apportion its income to Oregon. In this manner, taxpayer's income generated from its operations in Oregon would be taxed twice—once by Oregon and again by Missouri.

101. *See* H.R. Rep. No. 1480, 88th Cong., 2d Sess. 597 (1964).

102. 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting).

103. H.R. Rep. No. 1480, 88th Cong., 2d Sess. 481-516 (1964).

104. 409 U.S. 275 (1972).

term.[105] Resting its decision on the twenty-first amendment, the Court held that a state constitutionally may require foreign corporations engaged in the sale of liquor to perform certain acts that exceed solicitation within the taxing state and necessarily to forfeit the protection of Public Law 86-272.

If the Supreme Court decides to give its sanction either to the broad interpretation of *Ciba Pharmaceuticals* or to the narrow definition of *Herff Jones* in defining solicitation, the Court should adopt the narrow standard. First, the narrow interpretation is in consonance with a literal reading of the statutory language, which requires that solicitation be the *only* activity conducted by the taxpayer within the taxing state. Secondly, the narrow definition of solicitation is supported by the weight of authority among state courts that have addressed the issue. Thirdly, the narrow definition gives the courts a more efficient standard with which to work. Employing the narrow definition of solicitation, courts must decide merely whether the activities in question exceed solicitation; if they do, the tax exemption is unavailable. On the other hand, under the broad definition of solicitation the court would be required to decide not only whether taxpayer's activities exceeded solicitation per se, but also whether the activities were "lesser, included phases" of solicitation. For administrative simplicity, therefore, the narrow definition of solicitation seems a much more workable standard. Admittedly, the adoption of a restricted interpretation of solicitation reduces the availability of an already limited tax exemption. Multistate business interests undoubtedly would prefer the adoption of the more generous broad interpreatation of solicitation. Perhaps their displeasure resulting from a judicial adoption of the narrow definition of solicitation would spur Congress into action.

Alternative jurisdictional rules that depart completely from the solicitation standard have been suggested, but no solution has been found that fails to involve a balancing of interests. In order to guide both taxpayers and state tax administrators in tax planning, Congress should weigh these interests and provide a more workable jurisdictional standard regulating state jurisdiction to tax interstate commerce, since the present guidelines provided by Public Law 86-272 have failed to enunciate clear and workable criteria for exempt-

105. The court cited both the *Smith Kline* decision, which afforded a broad interpretation of solicitation, and the *Clairol* decision, which adopted a narrow interpretation. The Supreme Court, however, failed to express its approval of either interpretation of the term. *Id.* at 278.

ing certain multistate businesses from unduly burdensome state income taxes.

JOHN SHANNON BRYANT