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American Catalog Mailers Association

**IN THE SUPERIOR COURT OF THE STATE OF CALIFORNIA**  
**IN AND FOR THE COUNTY OF SAN FRANCISCO**

AMERICAN CATALOG  
MAILERS ASSOCIATION,

Plaintiff,

vs.

FRANCHISE TAX BOARD,

Defendant

Case No.:

COMPLAINT FOR  
DECLARATORY RELIEF

Plaintiff American Catalog Mailers Association (“ACMA”) brings this complaint for declaratory and injunctive relief against the Defendant Franchise Tax Board (“FTB”), and states as follows:

**I. INTRODUCTION**

1. This is an action by ACMA, the nation’s leading industry trade association advocating specifically for catalog, online, direct mail, and other remote-selling merchants and their suppliers,

1 to declare invalid Technical Advice Memorandum No. 2022-01 (the “TAM”), as well as the related  
2 guidance publication, FTB 1050, each published by the FTB. The TAM and FTB 1050, purport  
3 to adopt a new interpretation of a 63-year-old federal law, that directly contradicts the plain  
4 language of the federal law and in doing so violates the rights of ACMA members and other remote  
5 retailers. For more than six decades, to the best of ACMA’s information and belief, neither the  
6 FTB, nor any other state or local agency has attempted to impose net income tax obligations on  
7 out-of-state merchants whose activities within the physical boundaries of the state do not exceed  
8 the solicitation of orders in interstate commerce. The publication of the TAM and FTB 1050 is an  
9 announcement by the FTB, without following the applicable rulemaking procedures required by  
10 the California Administrative Procedure Act (“APA”), of a new standard of general application  
11 that purports to limit radically the protections of existing federal law, and expand the taxing  
12 authority of the FTB beyond the limits that have existed for decades and that are imposed by  
13 federal law and the U.S. Constitution.

## 14 **II. JURISDICTION AND VENUE**

15 2. This Court has subject matter jurisdiction over this action under California Gov. Code §  
16 11350 and California Code of Civil Procedure § 1060. This lawsuit does not seek to enjoin,  
17 suspend or restrain the assessment, levy or collection of any tax from any particular taxpayer.

18 3. Venue is proper in this Court under California Code of Civil Procedure § 401, because the  
19 Attorney General has an office in this County.

## 20 **III. PARTIES**

21 4. The Plaintiff, ACMA, is a Washington DC-based not-for-profit organization, organized  
22 under Section 501(c)(6) of the Internal Revenue Code of 1986, with business offices in Providence,  
23 Rhode Island. Founded in 2007, ACMA has members both large and small located across the  
24 country, who sell merchandise to customers in all 50 states through catalogs or over the internet.  
25 Many ACMA members have no property or payroll in California and conduct no activities within  
26 the physical boundaries of California.

27 5. The Defendant, FTB, is the California State Agency responsible for the administration and  
28 enforcement of California’s Franchise and Income Tax Laws.

#### IV. STANDING

6. ACMA has standing to bring this action on its own behalf and on behalf of affected ACMA members pursuant to the standards for association standing established by the U.S. Supreme Court in *Hunt v. Washington Apple Advertising Commission*, 432 U.S. 333 (1977), and as applied by California state courts. See, e.g., *Environmental Protection Information Center v. Department of Forestry & Fire Protection*, 43 Cal. App. 4th 1011, 1017-1018 (1996). ACMA members who conduct no activities within the physical boundaries of CA are nevertheless at risk of illegal assessment by the FTB on the basis of the legally erroneous TAM and guidance document published by the FTB.

#### V. FACTUAL BACKGROUND

7. The Interstate Income Tax Act of 1959, codified as 15 U.S.C. § 381, and commonly referred to as Public Law 86-272 (“P.L. 86-272”) was enacted by Congress in an exercise of its affirmative authority to regulate interstate commerce. The federal statute exempts out-of-state companies from state taxes on net income, so long as the company does not engage in activities within the state beyond the solicitation of orders for sales of tangible personal property, which are approved or rejected out of state and fulfilled by shipment or delivery from a point outside of the state. By defining a clear lower limit for the exercise of a state’s power to tax interstate commerce, P.L. 86-272 represents a careful balancing of local and national interests.

8. P.L. 86-272 provides, in relevant part:

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 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,

1 if approved, are filled by shipment or delivery from a point  
2 outside the State; and

3 2. the solicitation of orders by such person, or his representative,  
4 in such State in the name of or for the benefit of a prospective  
5 customer of such person, if orders by such customer to such  
6 person to enable such customer to fill orders resulting from  
7 such solicitation are orders described in paragraph (1). 15  
8 U.S.C. §381(a).

9 9. Congress has not repealed or amended in any way P.L. 86-272 since its passage in 1959.

10 10. P.L. 86-272 provides crucial predictability for remote retailers by clearly defining the lower  
11 limit of a state's power to tax. As the U.S. Supreme Court recognized in *Heublein Inc. v. South*  
12 *Carolina Tax Commission*, 409 U.S. 275, 281 (1972), Congress's passage of P.L. 86-272 was an  
13 "accommodation of local and national interests," which is "a delicate matter."

14 11. Striking the balance between local and national interests in the regulation of interstate  
15 commerce is a core function of the federal government, committed to Congress through the  
16 Commerce Clause of the U.S. Constitution.

17 12. Much of the U.S. Supreme Court's Commerce Clause jurisprudence is concerned with the  
18 so-called "dormant Commerce Clause," the doctrine that, in addition to being a positive grant of  
19 power to Congress, the Commerce Clause by itself prohibits state laws that unduly restrict  
20 interstate commerce. Prior to the U.S. Supreme Court's decision in *South Dakota v. Wayfair*, 138  
21 S. Ct. 2080 (2018), long-standing precedent under the dormant Commerce Clause had held that  
22 states could not compel out-of-state retailers to collect and remit the state's sales tax from  
23 customers located in the state, unless the retailer had a physical presence in the state. *See, e.g.*  
24 *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992); *National Bellas Hess, Inc. v. Department of*  
25 *Revenue of Ill.*, 386 U.S. 753 (1967).

26 13. The physical presence rule for sales tax collection, articulated in *Quill* and *Bellas Hess* and  
27 overruled in *Wayfair*, was a court-made rule grounded in the dormant Commerce Clause and  
28



specific to the sales tax context. In the *Wayfair* decision, the Supreme Court announced a change to a constitutional standard it had itself articulated.

14. In contrast to the sales tax nexus standard addressed in *Quill*, *Bellas Hess*, and *Wayfair*, P.L. 86-272 is a federal statute, the result of an affirmative exercise by Congress of its positive authority under the Commerce Clause. Only Congress, not the Supreme Court, can amend a federal statute.

15. As a duly-enacted federal law, P.L. 86-272 is binding on the states under the Supremacy Clause of the U.S. Constitution, U.S. Const. art. VI, c. 2.

**A. The FTB's TAM and FTB 1050**

16. On February 14, 2022, the FTB published the TAM, which is available on the FTB's website. A copy of the TAM is attached as **Exhibit A**, available at: <https://www.ftb.ca.gov/tax-pros/law/technical-advice-memorandums/2022-01.pdf>.

17. The stated subject of the TAM is "Determining whether the protections of 15 U.S.C. Section 381-384 (Public Law ["P.L."] 86-272) apply to fact patterns that are common in the current economy due to technological advancement for purposes of California income and franchise tax."

18. Posed as a question from FTB staff to FTB's legal counsel, the TAM presents 12 hypothetical scenarios and requests analysis to answer the following questions: 1) Are there business activities taking place in California; and 2) Do those activities exceed the protections of P.L. 86-272 such that the business becomes subject to California income or franchise tax?

19. The scenarios addressed in the TAM include the following:

...

(2) Business B regularly provides post-sale assistance to California customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website. For example, the business regularly advises customers on how to use products after they have been delivered.

...

(5) Business E places Internet "cookies" onto the computers or other

1 electronic devices of California customers. These “cookies” gather  
2 customer search information that will be used to adjust production  
3 schedules and inventory amounts, develop new products, or identify  
4 new items to offer for sale.

5  
6 ...

7 20. The TAM concludes that in the examples listed in paragraph 19 above (as well as in other  
8 scenarios described in the TAM) the business *is* conducting business activities in California, even  
9 though not physically present in California, and that the businesses activities go beyond  
10 solicitation, destroying the protection provided by P.L. 86-272.

11 21. Many of the 12 scenarios described in the TAM — such as having a clickable email address  
12 link on a website, or utilizing common website analytics to inform advertising or other business  
13 strategy through the use of cookies, as described in paragraph 19 above – include basic elements  
14 of 21<sup>st</sup> century business but do not involve engaging in activities within the state if the website is  
15 not hosted on servers located in California.

16 22. The enforcement policy announced in the TAM is a departure from longstanding FTB  
17 practice and policy, which looked to a company’s activities occurring within the physical  
18 boundaries of California when analyzing whether the company was protected by P.L. 86-272.

19 23. On May 26, 2022, Hamilton Davison, President and Executive Director of ACMA, sent a  
20 letter to the Chair, Executive Officer, and Chief Legal Counsel of the FTB, advising that the TAM  
21 is in direct contravention of P.L. 86-272, and requesting that it be withdrawn. A copy of the  
22 correspondence is attached as **Exhibit B** to this complaint. The letter was sent in the hopes of  
23 resolving the matter amicably without the need for costly litigation as “[t]he current status of the  
24 TAM results in substantial uncertainty and confusion as to the obligations of our members under  
25 federal law.” Mr. Davison’s letter also objected to the fact that the TAM was not issued in  
26 compliance with the California APA.

27 24. Mr. Davison’s May 26, 2022 letter requested a response within fifteen (15) calendar days.  
28

1       25. To date, ACMA has received no response from the FTB to Mr. Davison's May 26, 2022  
2 letter.

3       26. Instead, several months after the publication of the TAM, and after Mr. Davison had written  
4 to the FTB objecting to the TAM, the FTB replaced its guidance document FTB 1050, which had  
5 last been revised in 2017, with a new version of the document that incorporates much of the TAM,  
6 verbatim. A copy of the previous version of FTB 1050 is attached as **Exhibit C**, and a copy of the  
7 revised version of FTB 1050 is attached as **Exhibit D**, *available at:*  
8 *<https://www.ftb.ca.gov/forms/misc/1050.pdf>*.

9       27. The failure of the FTB to respond to Mr. Davison's May 26, 2022 letter and its subsequent  
10 issuance of a revised version of FTB 1050 doubling down on the FTB's unlawful enforcement  
11 policy made plain the futility of ACMA vindicating its rights and the rights of its members through  
12 dialog and negotiation with the FTB, thus necessitating this lawsuit.

13       28. The FTB's radical new interpretation of P.L. 86-272, as articulated in the TAM and FTB  
14 1050, rests on the erroneous conclusion that a business engages in activities within California if it  
15 maintains an internet website permitting any kind of interaction with a California resident, even if  
16 the website is hosted entirely on servers located outside of California. The development of the  
17 internet, however, has not altered the meaning of the words contained in P.L. 86-272, nor has the  
18 fact of the internet altered the nature of basic business practices. A company that provides a  
19 clickable email link on its website, and responds by email to customer service questions is not  
20 engaging in a different activity than a company that prints a customer service telephone number  
21 on a catalog, and provides customer service assistance via telephone – a practice and technology  
22 that was well-established at the time of P.L. 86-272's passage in 1959.

23       29. Through the TAM, and the revised FTB 1050, the FTB has announced a new rule of general  
24 application that expands the FTB's asserted authority and eliminates long-standing, affirmatively-  
25 enacted federal protections for interstate commerce.

26       30. The FTB did not provide public notice of its new interpretation of law prior to publishing  
27 the TAM or the revised FTB 1050.  
28

1 31. The FTB did not provide interested parties an opportunity to comment on the TAM or FTB  
2 1050 prior to publishing it, or respond in writing to public comments.

3 32. The FTB did not submit the TAM or FTB 1050, along with a file of all materials on which  
4 the FTB relied in formulating the legal interpretation announced in the TAM and described in FTB  
5 1050, to the Office of Administrative Law for review of its legality.

6 33. The FTB did not abide by any of the procedural requirements required under California's  
7 APA for the adoption of new regulation prior to publication of the TAM or FTB 1050.

8 **B. The Impact of the TAM and FTB 1050 on ACMA Members**

9 34. ACMA members are located across the country, and include companies with no property  
10 or payroll in California, and no activity by any employee or agent taking place within the physical  
11 boundaries of California.

12 35. ACMA members include businesses located outside of California, with no property,  
13 employee or agent located in California or engaged in activities on their behalf in California, but  
14 that engage in one or both of the following activities outside the state of California through  
15 websites hosted on servers located outside of California: a) utilizing internet cookies, as permitted  
16 by applicable law, to analyze website usage and performance of advertising, and adjust their  
17 business strategies as a result of that analysis; and/or b) providing post-sale assistance to customers  
18 via either electronic chat or email that customers initiate by clicking on an icon on the business's  
19 website.

20 36. Under the reasoning of the TAM and FTB 1050, an ACMA member with no employees or  
21 property in California, that undertakes no activity whatsoever within the physical boundaries of  
22 California, would nevertheless be subject to California tax on its net income from sales to  
23 California residents in interstate commerce, based solely on the fact that it operates a website  
24 outside of California with at least some elements of interactivity, such as the scenarios described  
25 in Paragraph 19.

26 37. Application of the TAM and FTB 1050 to require an out-of-state company to pay  
27 California's net income tax on business income – even if it doesn't engage in any activities  
28 physically within California, and merely maintains an internet accessible website with some

1 interactive features – directly contradicts P.L. 86-272, and violates the Supremacy Clause of the  
2 U.S. Constitution.

3 38. Representatives of the FTB have stated that the FTB intends to apply the reasoning of the  
4 TAM and FTB 1050 retroactively to any open tax periods, including periods prior to the  
5 publication of the TAM and FTB 1050.

6 39. Under California law, there is no statute of limitations for assessment of a tax if the  
7 taxpayer fails to file a required return. If, as described in the TAM, the mere maintenance of a  
8 clickable email address on an out-of-state website is considered an unprotected business activity  
9 occurring in California, ACMA members that have relied in good faith on the plain text of P.L.  
10 86-272, not to mention decades of settled law and practice, could suddenly find themselves at risk  
11 of audits by the FTB stretching back years, and ultimately imposing taxes, penalties and interest.

12 40. FTB's new enforcement policy regarding P.L. 86-272, articulated in the TAM and FTB  
13 1050, and FTB's stated intention to apply this new policy retroactively, amount to a refusal by  
14 FTB to respect federal law, and a violation of the rights of businesses, including ACMA members,  
15 to due process.

16 41. Faced with a refusal by the FTB to respect existing federal law and the Supremacy Clause  
17 of the U.S. Constitution, private enforcement is necessary in order to protect important public  
18 interests. ACMA seeks with this lawsuit to safeguard the rights of its members and other members  
19 of the public to due process and the protection of federal law, including those with insufficient  
20 resources to mount their own costly individual legal challenge to the FTB's unlawful acts.

21 **Count 1: Action for Declaratory Judgment under Gov. Code § 11350, declaring the**  
22 **TAM invalid because it contradicts P.L. 86-272 and the U.S. Constitution.**

23 42. ACMA repeats and incorporates by reference each of the allegations set forth in paragraphs  
24 1 - 41 as if fully set forth herein.

25 43. Gov. Code § 11350 provides that “any interested person may obtain a judicial declaration  
26 as to the validity of any regulation or order of repeal by bringing an action for declaratory relief.”

27 44. ACMA is an “interested person” for purposes of a declaratory judgment action under §  
28 11350.

1 45. Gov. Code § 11342.600 defines a “regulation” as “every rule, regulation, order, or standard  
2 of general application or the amendment, supplement, or revision of any rule, regulation, order, or  
3 standard adopted by any state agency to implement, interpret, or make specific the law enforced  
4 or administered by it, or to govern its procedure.”

5 46. The TAM (and the recently-revised FTB 1050), is a “regulation” because it provides an  
6 interpretation of the law enforced by the FTB (namely, California’s franchise and income tax laws,  
7 as limited by the Commerce Clause of the U.S. Constitution and P.L. 86-272, which is binding on  
8 the states under the Supremacy Clause of the U.S. Constitution).

9 47. Because it characterizes internet-based interactions processed on out-of-state servers as  
10 unprotected business activities occurring in California, in direct contravention of P.L. 86-272 and  
11 the U.S. Constitution, the TAM and FTB 1050 conflict with federal law, and the Court should  
12 declare the TAM and FTB 1050 invalid.

13 **Count 2: Action for Declaratory Judgment under Gov. Code § 11350, declaring the**  
14 **TAM invalid because it is an underground regulation, adopted without the required**  
15 **procedures under the APA.**

16 48. ACMA repeats and incorporates by reference each of the allegations set forth in paragraphs  
17 1-47 as if fully set forth herein.

18 49. Gov. Code § 11350 provides that “any interested person may obtain a judicial declaration  
19 as to the validity of any regulation or order of repeal by bringing an action for declaratory relief.”

20 50. ACMA is an “interested person” for purposes of a declaratory judgment action under §  
21 11350.

22 51. The APA provides that “[n]o state agency shall issue, utilize, enforce, or attempt to enforce  
23 any guideline, criterion, bulletin, manual, instruction, order, standard of general application, or  
24 other rule, which is a regulation as defined in § 11342.600, unless the guideline, criterion, bulletin,  
25 manual, instruction, order, standard of general application, or other rule has been adopted as a  
26 regulation and filed with the Secretary of State pursuant to this chapter.”

27 52. The TAM is a “regulation” as that term is defined as Gov. Code § 11342.600, as is the  
28 recently-revised FTB 1050, regarding the Application and Interpretation of P.L. 86-272.

53. Because the FTB did not follow the required APA rulemaking process before publishing the TAM or FTB 1050, both documents are impermissible “underground” regulations, and ACMA is entitled to a judicial declaration that the TAM and FTB 1050 are invalid.

**Count 3: Action for Declaratory Judgment Under California Code of Civil Procedure § 1060**

54. ACMA repeats and incorporates by reference each of the allegations set forth in paragraphs 1-53 as if fully set forth herein.

55. Section 1 of the Fourteenth Amendment to the United States Constitution and Article I, Section 7 of the California Constitution prohibit the FTB and the State of California from depriving any person of property without due process of law.

56. The TAM and FTB 1050 announce a new policy and legal interpretation of an existing law that is inconsistent with previous policy and practice of the FTB.

57. Application of the interpretation contained in the TAM and FTB 1050 to periods prior to its publication would deprive businesses, including ACMA members who engaged in no activities within the physical boundaries of California, of their right to due process of law.

58. This Court is empowered, pursuant to California Code of Civil Procedure § 1060, to declare the respective rights of parties to one another.

59. ACMA contends that TAM 2022-01 and the revisions to FTB 1050 should be declared invalid, under Counts 1 & 2. In the alternative, ACMA is entitled to declaratory and injunctive relief, limiting the application of TAM 2022-01 and FTB 1050 to prospective periods only.

**VI. PRAYER FOR RELIEF**

WHEREFORE, Plaintiff prays for relief and judgment as follows:

1. For a judicial declaration that each of FTB TAM 2022-1 and FTB 1050 are invalid because they directly contradict P.L. 86-272 when applied to remote retailers with no property or payroll in California;

2. For a judicial declaration that each of FTB TAM 2022-1 and FTB Publication 1050 are invalid because they are improper underground regulations, adopted without following the required procedures of the APA;

1       3. For a judicial declaration that retroactive application by each of the FTB of the TAM and  
2 FTB 1050 to periods prior to the documents' publication violates the rights of taxpayers to due  
3 process of law;

4       4. For attorney's fees, to the extent authorized by law, including pursuant to California Code  
5 of Civil Procedure § 1021.5;

6       5. For its costs of suit; and

7       For such further relief as the Court deems just and proper.

8 DATED: August 19, 2022

9 /S/ Richard Pachter

10 George S. Isaacson (application for  
11 admission *pro hac vice* to be  
12 submitted)  
13 Martin I. Eisenstein (application for  
14 admission *pro hac vice* to be  
15 submitted)  
16 Nathaniel A. Bessey (application for  
17 admission *pro hac vice* to be  
18 submitted)  
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**STATE OF CALIFORNIA  
FRANCHISE TAX BOARD**

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chair **Betty T. Yee** | member **Malia M. Cohen** | member **Keely Bosler**

**Exhibit**

**A**

Date: 02.14.2022

Technical Advice Memorandum: 2022-01

Requested By: Alfredo Ramirez  
Requested Date: 08/02/2021  
TAM Author: Laurie McElhatton  
Phone Number: 916-845-6916  
Fax Number: 916-843-0403

**SUBJECT: Determining whether the protections of 15 U.S.C. Sections 381-384 (Public Law ["PL"] 86-272) apply to fact patterns that are common in the current economy due to technological advancements for purposes of California income and franchise tax.**

**QUESTIONS PRESENTED**

General: For all fact patterns below, the business at issue makes sales to California customers, is commercially domiciled outside of California, and has no other activities in California other than those mentioned in the fact pattern. The issue in each fact pattern is whether the business has exceeded the protections of PL 86-272. The general analysis is: (1) Are there business activities taking place in California; and (2) Do those activities exceed the protection of PL 86-272 such that the business becomes subject to California income or franchise tax?

(1) Business A has an employee who telecommutes on a regular basis from within California performing business management and accounting tasks.

(2) Business B regularly provides post-sale assistance to California customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website. For example, the business regularly advises customers on how to use products after they have been delivered.

(3) Business C solicits and receives on-line applications for its branded credit card via the business's website from California customers. The issued cards will generate interest income and fees for the business.

(4) Business D has a website that invites viewers in California to apply for non-sales positions with Business D. The website enables viewers to fill out and submit an electronic application, and also to upload a cover letter and resume.

(5) Business E places Internet "cookies" onto the computers or other electronic devices of California customers. These "cookies" gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale.

(6) Business F remotely fixes or upgrades products previously purchased by California customers by transmitting code or other electronic instructions to those products via the Internet.

(7) Business G offers and sells extended warranty plans via its website to California customers who purchase the business's products.

(8) Business H contracts with a marketplace facilitator that facilitates the sale of business's products on the facilitator's on-line marketplace. The marketplace facilitator maintains inventory, including some of the business's products, at fulfillment centers in various states where the business's customers are located.

(9) Business I contracts with California customers to stream videos and music to electronic devices for a charge.

(10) Business J provides post-sale assistance to California customers by posting a list of static Frequently Asked Questions ("FAQs") with answers on the business's website.

(11) Business K places Internet "cookies" onto the computers or other devices of California customers. These cookies gather customer information that is only used for purposes entirely ancillary to the solicitation of orders for tangible personal property, such as: to remember items that customers have placed in their shopping cart during a current web session, to store personal information customers have provided to avoid the need for the customers to re-input the information when they return to the seller's website, and to remind customers what products they have considered during previous sessions. The cookies perform no other function, and these are the only types of cookies delivered by the business to its customers' computers or other electronic devices.

(12) Business L offers for sale only items of tangible personal property on its website. The website enables customers to search for items, read product descriptions, select items for purchase, choose among delivery options, and pay for items. The business does not engage in any in-state business activities that are not described here.

## **CONCLUSIONS**

(1) Unless the activities of the employee telecommuting from California on a regular basis constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to solicitation, these activities would cause Business A to lose protection of PL 86-272. These are business activities in California as an employee works from within the state, and the activities are non-sales activities, therefore the protection of PL 86-272 is lost.

(2) The activity of Business B in California disqualifies the business from PL 86-272 immunity because the activity does not constitute, and is not entirely ancillary to, the in-

state solicitation of orders for sales of tangible personal property. There is business activity in California because Business B is providing live chat and email through the website available to customers through computers or other electronic devices located in California. This post-sales activity is not solicitation or ancillary to solicitation as the sale has already taken place.

(3) The activity of Business C disqualifies the business from PL 86-272 immunity in California because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is making applications for credit cards available to California customers via the Internet through computers and other electronic devices located in California. This business activity exceeds solicitation as offering to provide credit to customers is an activity outside of seeking to make orders of tangible personal property in California. In addition, funds loaned through the credit cards would not be limited to purchases of tangible personal property and may not be limited to purchases from Business C.

(4) The activity of Business D in California disqualifies the business from PL 86-272 immunity in California because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is providing access to job applications, allowing upload of applications, cover letters and resumes through computers or other electronic devices located in California. This business activity exceeds solicitation as it involves human resource outreach to fill jobs that are not limited to sales.

(5) The activity of Business E in California disqualifies the business from PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is the inserting of cookies into computers or other electronic devices of California customers. This activity exceeds solicitation as gathering information for purposes of adjusting production schedules and inventory amounts, developing new products, or identifying new items to offer for sale are not activities related to facilitating a sale of tangible personal property.

(6) The activity of Business F disqualifies the business from PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity in California is the transmittal of code or other electronic instructions to a computer or other electronic device located in California. This business activity exceeds solicitation as providing repairs or upgrades to previously sold products are not activities related to facilitating the request for orders for sales of tangible personal property, but rather are post-sales activities.

(7) The activity of Business G constitutes selling, or offering to sell, a service that is not entirely ancillary to facilitating the request for orders for sales of tangible personal property. In addition, PL 86-272 immunity only applies to sales of tangible personal property. Sales of extended warranties are not sales of tangible personal property but rather are sales of intangible property and therefore are not activities within the protection of PL 86-272. Accordingly, Business G has business activities in California by offering extended warranties

for sale to California customers, and this activity exceeds solicitation of orders of tangible personal property and disqualifies the business from PL 86-272 immunity.

(8) The activity of Business H disqualifies the business from PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property. The business activity is the maintaining of inventory within California. This activity exceeds solicitation of orders for sales of tangible personal property as it amounts to consignment of stock of goods to another person, including an independent contractor, for purposes of sale.

(9) The activity of Business I disqualifies the business from PL 86-272 immunity because streaming does not constitute the sale of tangible personal property for purposes of PL 86-272. The immunity provided by PL 86-272 only applies to sales of tangible personal property. Sales of digital video and music streaming are not sales of tangible personal property but rather are services and thus are not activities within the protection of PL 86-272. Accordingly, Business I has business activities in California by offering streaming services for sale to California customers, but this activity exceeds solicitation of orders of tangible personal property and defeats Business I's PL 86-272 immunity.

(10) The activity of Business J does not disqualify the business from PL 86-272 immunity because it does not constitute a business activity within California. Viewing of static FAQs through the internet does not provide the requisite interaction between the California customer and Business J and is similar to reading a pamphlet on a product.

(11) The activity of Business K does not disqualify the business from PL 86-272 immunity because it is entirely ancillary to the in-state solicitation of orders for sales of tangible personal property. This business activity is in California because Business K downloads cookies onto computers or other electronic devices located in California. However, since these business activities are entirely ancillary to solicitation, Business K remains protected by PL 86-272.

(12) The activity of Business L does not disqualify the business from PL 86-272 immunity because the business engages exclusively in in-state activities that either constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to such solicitation. This business activity is in California due to the interaction between the website, including the download of "cookies," and the customer's computer or other electronic device located in California. However, this business activity does not exceed solicitation of orders for tangible personal property and therefore Business L remains protected by PL 86-272.

#### **APPLICABLE LAW:**

15 U.S.C. Sections 381-384 (PL 86-272).

#### **ANALYSIS AND DISCUSSION**

Congress adopted PL 86-272 in 1959. PL 86-272 prohibits a state from imposing a net income tax on the income of a person derived within the state from interstate commerce if the only business activities within the state conducted by or on behalf of the person consist

of the solicitation of orders for sales of tangible personal property. The protections provided by PL 86-272 only apply to orders that are sent outside of the state for acceptance or rejection. If the orders are accepted, they must be filled by shipment or delivery from a point outside the state to maintain PL 86-272 immunity.

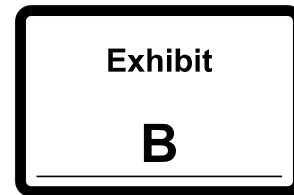
In the decades since PL 86-272 was enacted, the way in which interstate business is conducted has changed significantly. Congress, however, has neither created a federal mechanism to provide administrative guidance to taxpayers nor has it updated the statute to indicate how it applies to new business activities. (See *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.* (1992) 505 U.S. 214, 223.)

The guiding principle is that sovereign authority of states to impose tax will not be preempted unless it is the "clear and manifest purpose of Congress" to do so. (*Dept. of Revenue of Oregon v. ACF Industries, Inc.* (1994) 510 U.S. 332, 345; See also *Heublein, Inc. v. South Carolina Tax Comm'n* (1972) 409 U.S. 275, 281 [noting that Congress must convey "its purpose clearly" or "it will not be deemed to have significantly changed the Federal State Balance."])

The United States Supreme Court recently opined, in *South Dakota v. Wayfair, Inc.*, construing the Commerce Clause, that an Internet seller "may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." (138 S. Ct. 2080, 2095 (2018).) Although the United States Supreme Court was not interpreting PL 86-272 in *Wayfair*, California considers the Court's analysis as to virtual contacts to be relevant to the question of whether a seller is engaged in business activities in states where its customers are located for purposes of PL 86-272.

Finally, PL 86-272 not only affects the determination of whether a state into which tangible personal property is delivered (the "destination state") may tax the income of the seller, but it also affects the determination of whether the state from which tangible personal property is shipped (the "origin state") may subject the related receipts to that state's throwback rule. This would apply irrespective of whether the destination state is determining if it can tax the income of the seller, or whether the origin state is determining if the related receipts are subject to that state's throwback rule.

To determine whether a seller of tangible personal property via the Internet is shielded from taxation by PL 86-272 requires the same general analysis as sellers of tangible personal property by other means. Thus, an Internet seller is shielded from taxation in the customer's state if the only business activity it engages in within that state is the solicitation of orders for sales of tangible personal property, which orders are sent outside that state for approval or rejection, and if approved, are shipped from a point outside of that state.



May 26, 2022

Via Certified First-Class Mail:

Ms. Betty T. Yee  
State Controller  
Chair, California Franchise Tax Board  
PO Box 94280  
Sacramento, CA 94240-0040

Ms. Selvi Stanislaus  
Executive Officer MS-A390  
California Franchise Tax Board  
PO Box 115  
Rancho Cordova, CA 95741-0115

Ms. Jozel Brunett  
Chief Legal Counsel  
California Franchise Tax Board  
PO Box 94280  
Sacramento, CA 94240-0040

Dear Ms. Yee, Ms. Stanislaus, and Ms. Brunett,

I am President and Executive Director of the American Catalog Mailers Association (ACMA). The ACMA was founded in 2007 and is the nation's leading industry trade association advocating specifically for catalog, online, direct mail, and other remote-selling merchants, as well as their suppliers. As the primary advocate and voice for the catalog/online/direct industry, we represent our members on issues that directly concern their immediate and long-term commercial interests, including state tax laws and regulations.

I am writing in regard to the Technical Advice Memorandum (TAM) issued by the Franchise Tax Board on February 14, 2022 announcing the FTB's new interpretation of the scope of federal law P.L. 86-272, which limits the authority of states to impose income taxes on out-of-state companies.

The TAM issued by the FTB is in direct contravention of P.L. 86-272, and, under the Supremacy Clause of the U.S. Constitution (Art. VI, cl.2), the protection provided by federal law takes priority over the FTB's new rule seeking to narrow the scope of P.L. 86-272. Website activities on a website hosted outside of California do not constitute activities within California so as to preclude the protection afforded by P.L. 86-272.

On behalf of ACMA's members, our organization objects to the TAM and respectfully demands that it be withdrawn immediately. The ACMA also objects to the fact that the TAM was not issued in compliance with the California Administrative Procedures Act and, therefore, should not be enforceable as law.

Please provide a response to this demand letter within 15 calendar days. The current status of the TAM results in substantial uncertainty and confusion as to the tax obligations of our members under applicable federal law.

Thank you for your prompt attention to this issue. I look forward to your response.

Sincerely,

A handwritten signature in black ink that reads "Hamilton Davison". The signature is written in a cursive, flowing style.

Hamilton Davison  
President & Executive Director



# FTB Publication 1050

## Application and Interpretation of Public Law 86-272

Guide to Jurisdictional Standards Under the Uniform Division of Income Tax Purposes Act

### Introduction

California signed a resolution adopting the "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272." It is the policy of the State signatories to that document to impose their net income tax, subject to state and federal legislative limitations, to the fullest extent constitutionally permissible. Interpretation of the solicitation of orders standard in Public Law (PL) 86-272 requires a determination of the fair meaning of that term in the first instance. (*Wisconsin Department of Revenue v. William Wrigley, Jr., Co.* (1992) 505 U.S. 214, 112 S.Ct.2447.) The United States Supreme Court has recently established a standard for interpreting the term "solicitation" and this Statement has been revised to conform to such standard. In those cases where there may be reasonable differences of opinion as to whether the disputed activity exceeds what is protected by PL 86-272, the signatory states will apply the principle that the preemption of the state taxation that is required by PL 86-272 will be limited to those activities that fall within the "clear and manifest purpose of Congress." See *Department of Revenue of Oregon v. ACF Industries, Inc., et al.*, 510 U.S. 332, 114S.Ct. 843, 127 L. Ed.2d 165 (1994), *Cipollone v. Liggett Group, Inc.*, 505 U.S. 504, 112 S.Ct. 2608, 120 E.Ed.2d 407, 422 (1992); *Heublein Inc. v. South Carolina Tax Com.*, 409 U.S. 275, 281-282(1972).

The following information reflects the signatory states' current practices with regard to: (1) whether a particular factual circumstance is considered under PL 86-272 or permitted under this Statement as either protected or not protected from taxation by reason of PL 86-272; and (2) the jurisdictional standards that will apply to sales made in another state for purposes of applying a throwback rule (if applicable) with respect to such sales. It is the intent of the signatory states to apply this Statement uniformly to factual circumstances, irrespective of whether such application involves an analysis for jurisdictional purposes in the state into which such tangible personal property has been shipped or delivered or for throwback purposes in the state from which such property has been shipped or delivered.

### I. Nature of Property Being Sold

Only the solicitation to sell personal property is afforded immunity under PL 86-L. 86-272; therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangibles, such as franchises, patents, copyrights, trademarks, service marks and the like, or any other type of property are not protected activities under PL 86-272.

The sale or delivery and the solicitation for the sale or delivery of any type of service that is not either (1) ancillary to solicitation or (2) otherwise set forth as a protected activity under the Section IV.B. hereof is also not protected under PL 86-272 or this Statement.

### II. Solicitation of Orders and Activities Ancillary to Solicitation

For the in-state activity to be a protected activity under PL 86-272, it must be limited solely to solicitation (except for *de minimis* activities described in Article III, and those activities conducted by independent contractors described in Article V. below). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order. Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. The mere assignment of activities to sales personnel does not merely by such assignment, make such activities ancillary to solicitation of orders. Additionally, activities that seek to promote sales are not ancillary, because PL 86-272 does not protect activity that facilitates sales; it only protects ancillary activities that facilitate the request for an order. The conducting of activities not falling within the foregoing definition of solicitation will cause the company to lose its protection from a net income tax afforded by PL 86-272, unless the disqualifying activities, taken together, are either *de minimis* or are otherwise permitted under this Statement.

### III. De Minimis Activities

*De minimis* activities are those that, when taken together, establish only a trivial connection with the taxing state. An activity conducted within a taxing state on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or nontrivial connection with the state is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a nontrivial connection with the taxing state, then such activity exceeds the protection of PL 86-272. Establishing that the disqualifying activities only account for a relatively small part of the business conducted within the taxing state is not determinative of whether a *de minimis* level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing state is inconsistent with the limited protection afforded by PL 86-272.

### IV. Specific Listing of Unprotected and Protected Activities

The following two listings – IV.A. and IV.B. – set forth the in-state activities that are presently treated by the signatory state as "Unprotected Activities" or "Protected Activities." Such listings may be subject to an amendment by addition or deletion that appears on the individual signatory state's signature page attached to this Statement

The signatory state has included on the list of "Protected Activities" those in-state activities that are not either required protection under PL 86-272; or if not so required, that the signatory state, in its discretion, has permitted protection. The mere inclusion of an activity on the listing of "Protected Activities," therefore, is not a statement or admission by the signatory state that said activity is required any protection under PL 86-272.

#### **A. Unprotected Activities:**

The following in-state activities (assuming they are not of a *de minimis* level) are not considered as either solicitation of orders or ancillary thereto or otherwise protected under PL 86-272 and will cause otherwise protected sales to lose their protection under PL 86-272:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.
5. Conducting training courses, seminars, or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other instrument or process by which sales are made within this state by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the tax year.
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
16. Owning, leasing, using or maintaining any of the following facilities or property in-state:
  - a. Repair shop.
  - b. Parts department.
  - c. Any kind of office other than an in-home office as described as permitted under IV.A.18 and IV.B.2.
  - d. Warehouse.
  - e. Meeting place for directors, officers, or employees.
  - f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
  - g. Telephone answering service that is publicly attributed to the company or to employees or agents of the company in their representative status.
  - h. Mobile stores, vehicles with drivers who are sales personnel making sales from the vehicles.
  - i. Real property or fixtures to real property of any kind.
17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.

18. Maintaining, by any employee or other representative, an office or place of business of any kind (other than an in-home office located within the residence of the employee or representative that (i) is not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the company; or for such other activities that are protected under PL 86-272 or under paragraph IV.B. of this Statement).

A telephone listing or other public listing within the state for the company or for an employee or representative of the company in such capacity or other indications through advertising or business literature that the company or its employee or representative can be contacted at a specific address within the state shall normally be determined as the company maintaining within this state an office or place of business attributable to the company or to its employee or representative in a representative capacity. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, address, telephone, fax numbers and affiliation with the company shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the company or its employee or representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above shall, by itself, cause the loss of protection under this Statement.

For the purpose of this subsection it is not relevant whether the company pays directly, indirectly, or not at all for the cost of maintaining such in-home office.

19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.
20. Conducting any activity not listed in paragraph IV.B. below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases.

#### **B. Protected Activities**

The following in-state activities will not cause the loss of protection for otherwise protected sales:

1. Soliciting orders for sales by any type of advertising.
2. Soliciting of orders by an in-state resident employee or representative of the company, so long as such person does not maintain or use any office or other place of business in the state other than an "in-home" office as described in IV.A. 18 above.
3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.
4. Furnishing and setting up display racks and advising customers on the display of the company's products without charge or other consideration.
5. Providing automobiles to sales personnel for their use in conducting protected activities.
6. Passing orders, inquiries and complaints on to the home office.



7. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers would be protected if such solicitation activities are otherwise immune.
8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
9. Checking of customers' inventories without a charge therefore (for re-order, but not for other purposes such as quality control).
10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the tax year.
11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.
12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.
13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is solely limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer, and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation or permitted by this Statement under paragraph IV.B. shall not, by itself, remove the protection under this Statement.

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## **V. Independent Contractors**

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PL 86-272 provides protection to certain in-state activities if conducted by an independent contractor that would not be afforded if performed by the company or its employees or other representatives. Independent contractors may engage in the following limited activities in the state without the company's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining an office.

Sales representatives who represent a single principal are not considered to be independent contractors and are subject to the same limitations as those provided under PL 86-272 and this Statement.

Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the company, except for purposes of display and solicitation, shall remove the protection.

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## **VI. Application of Destination State Law In Case of Conflict**

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When it appears that two or more signatory states have included or will include the same receipts from a sale in their respective sales factor numerators, at the written request of the company, said states will in good faith confer with one another to determine which state should be assigned said receipts. Such conference shall identify what law, regulation or written guideline, if any, has been

adopted in the state of destination with respect to the issue. The state of destination shall be that location at which the purchaser or its designee actually receives the property, regardless of freight on board point or other conditions of sale.

In determining which state is to receive the assignment of the receipts at issue, preference shall be given to any clearly applicable law, regulation or written guideline that has been adopted in state of destination. However, except in the cases of the definition of what constitutes "tangible personal property," this state is not required by this Statement to follow any other state's law, regulation or written guideline should this state determine that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the company within this state.

Notwithstanding any provision set forth in this Statement to the contrary, as between this state and any other signatory state, this state agrees to apply the definition of "tangible personal property" that exists in the state of destination to determine the application of PL 86-272 and issues of throwback, if any. Should the state of destination not have any applicable definition of such term so that it could be reasonably determined whether the property at issue constitutes "tangible personal property," then each signatory state may treat such property in any manner that would clearly reflect the income-producing activity of the company within said state.

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## **VII. Miscellaneous Practices**

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### **A. Application of Statement to Foreign Commerce.**

PL 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. For purposes of PL 86-272, "interstate commerce" includes commerce between the 50 states and The Commonwealth of Puerto Rico.

### **B. Application to Corporation Incorporated in State or to Person Resident or Domiciled in State.**

The protection afforded by PL 86-272 and the provisions of the Statement do not apply to any corporation incorporated within this state or to any person who is a resident of or domiciled in this state.

### **C. Registration or Qualification to do Business.**

A company that registers or otherwise formally qualifies to do business within this state does not, by that fact alone, lose its protection under PL 86-272. Where, separate from or ancillary to such registration or qualification, the company receives and seeks to use or protect any additional benefit or protection from this state through activity not otherwise protected under PL 86-272 or this Statement, such protection shall be removed.

### **D. Loss of Protection for Conducting Unprotected Activity during Part of Tax Year.**

The protection afforded under PL 86-272 and the provisions of this Statement shall be determined on a tax year by tax year basis. Therefore, if at any time during a tax year the company conducts activities that are not protected under PL 86-272 or this Statement, no sales in this state or income earned by the company attributed to this state during any part of said tax year shall be protected from taxation under said PL or this Statement.

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E. Application of the **Throwback Rule**.

In the *Appeal of Finnigan Corporation*, 88-SBE-022, August 25, 1988, the State Board of Equalization (SBE) ruled that the word taxpayer, as used in Revenue & Taxation Code Section 24135(b) (2), means "all of the corporations within the unitary group." Therefore, the SBE held that when sales were shipped from California to another state by a member of a group conducting a unitary business in California, the throwback rule did not apply if **any** corporations within the unitary group are taxable in the other state. In the *Appeal of Finnigan Corporation*, Opn. On Pet. For Rehg., 88-SBE-022A, January 24, 1990, the SBE expressly overruled the apportionment rule announced in the *Appeal of Joyce, Inc.*, 66-SBE-070, November 23, 1966, that the income attributable to the California activities of a corporation exempt from taxation by this state because of PL 86-272 had to be separately computed by application of the apportionment method and then excluded from the measure of the franchise tax. In practice, the *Joyce* rule was accomplished by excluding from the numerator of the apportionment formula, but not the denominator, the California factors of the corporations, within the unitary group that were not themselves taxable by this state. Under *Finnigan*, this restriction no longer applied.

In the *Appeal of Huffy Corporation*, 99-SBE-005, April 22, 1999, the SBE ruled that the apportionment method announced in *Joyce* should be applied to tax years beginning on or after April 22, 1999, on a prospective basis. Thus, for those tax years, the income attributable to the California activities of a corporation exempt from taxation by this state because of PL 86-272 must be separately computed by application of the apportionment formula and then excluded from the measure of the franchise tax. In practice, the *Joyce* rule is accomplished by excluding from the numerator of the apportionment formula, but not the denominator, the California factors of the corporations within the unitary group that were not themselves taxable by this state.

For tax years beginning on or after January 1, 2011, California reverts back to the *Finnigan* rule. For purposes of determining which sales are included in the California sales factor numerator, sales delivered or shipped to a purchaser in California will be included in the numerator if any member of the combined reporting group is taxable in California. Sales delivered or shipped to a purchaser outside of California will be assigned to California if no member of the combined reporting group is taxable in the state of destination.

Accordingly, the Franchise Tax Board's administrative practice with respect to multi-entity apportionment formula rules is as follows:

**For Tax Years Beginning Before April 22, 1999 and for Tax Years Beginning on or After January 1, 2011.**

1. Sales of goods shipped from California to other states are to be assigned to this state under the throwback rule only when no member of the seller's unitary group is taxable within the destination state.
2. The California property, payroll, and sales of each corporation within a unitary group will be taken into account in the apportionment of business income to this state, including amounts attributable to entities exempt from taxation in this state because of PL 86-272. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state by use of the "revised method" currently authorized by Legal Ruling 234.

**For Tax Years Beginning on or After April 22, 1999 and for Tax Years Beginning Before January 1, 2011.**

1. Sales of goods shipped from California to other states are to be assigned to this state under the throwback rule only when the selling corporation is itself not taxable within the destination state.
2. The California property, payroll, and sales of those corporations within a unitary group that are taxable in this state will be taken into account in the apportionment of business income to this state. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state by use of the "revised method" currently authorized by Legal Ruling 234.

**Contact Us**

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# FTB Publication 1050

## Application and Interpretation of Public Law 86-272

Guide to Jurisdictional Standards Under the Uniform Division of Income Tax Purposes

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### Introduction

This Publication addresses the application of Public Law (PL) 86-272, 15 U.S.C. §§381-384, which Congress adopted in 1959. PL 86-272 prohibits a state from imposing a net income tax on the income of a person derived within the state from interstate commerce if the only business activities within the state conducted by or on behalf of the person consist of the solicitation of orders for sales of tangible personal property. The protections provided by PL 86-272 only apply to orders that are sent outside the state for acceptance or rejection. If the orders are accepted, they must be filled by shipment or delivery from a point outside the state to maintain PL 86-272 immunity.

In the decades since PL 86-272 was enacted, the way in which interstate business is conducted has changed significantly. Congress, however, has neither created a federal mechanism to provide administrative guidance to taxpayers nor has it updated the statute to indicate how it applies to new business activities. See *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214, 223 (1992) (finding the statute's minimum standard "to be somewhat less than entirely clear"). The contents of this Publication are intended to serve as general guidance to taxpayers and to provide notice as to how this state will apply the statute.

This Publication is guided by the principle that sovereign authority of states to impose tax will not be preempted unless it is the "clear and manifest purpose of Congress" to do so. *Department of Revenue of Oregon v. ACF*

*Industries, Inc.*, 510 U.S. 332, 345 (1994). See also *Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275, 281-82 (1972) (noting that Congress must convey "its purpose clearly" or "it will not be deemed to have significantly changed the Federal-State balance"). The Supreme Court recently opined, in *South Dakota v. Wayfair, Inc.*, construing the Commerce Clause, that an Internet seller "may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." 138 S. Ct. 2080, 2095 (2018). Although the *Wayfair* Court was not interpreting PL 86-272, this state considers the Court's analysis as to virtual contacts to be relevant to the question of whether a seller is engaged in business activities in states where its customers are located for purposes of the statute.

This Publication does not attempt to take into account limitations on the application of business income taxes other than PL 86-272, including those limitations that may be provided under state law.

Finally, PL 86-272 not only affects the determination of whether a state into which tangible personal property is delivered (the "destination state") may tax the income of the seller, but it also affects the determination of whether the state from which tangible personal property is shipped (the "origin state") may subject the related receipts to that state's throwback rule. This state intends to apply this Publication uniformly, irrespective of whether the destination state is determining if it can tax the income of the seller, or whether the origin state is determining if the related receipts are subject to that state's throwback rule.

## **Article I. Nature of Property Being Sold**

Only the solicitation to sell tangible personal property is afforded immunity under PL 86-272. Therefore, the leasing, renting, licensing or other disposition of tangible personal property, or transactions involving intangible property, such as franchises, patents, copyrights, trademarks, service marks and the like, or any other type of property are not protected activities under PL 86-272.

The sale or delivery, and the solicitation for the sale or delivery, of any type of service is not protected unless it is either: (1) entirely ancillary to solicitation of orders for sales of tangible personal property; or (2) otherwise set forth as a protected activity under Article IV, Section B, of this Publication.

## **Article II. Solicitation of Orders and Activities Ancillary to Solicitation**

For in-state activity to be a protected activity under PL 86-272, it must be limited solely to solicitation (except for *de minimis* activities described in Article III, and those activities conducted by independent contractors described in Article V). Solicitation means (1) speech or conduct that explicitly or implicitly invites an order; and (2) activities that neither explicitly nor implicitly invite an order, but are entirely ancillary to requests for an order. See *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*, 505 U.S. 214 (1992).

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation of orders. Activities that a seller would engage in apart from soliciting orders are not ancillary to the solicitation of orders. The assignment of activities to sales personnel does not, merely by such assignment, make those activities ancillary to the solicitation of orders. Additionally, activities that seek to promote sales are not ancillary, because PL 86-272 does not protect activity that facilitates sales; it only protects ancillary activities that facilitate the request for an order. The conducting of activities that are not solicitation or entirely ancillary to solicitation will cause the company to lose its PL 86-272 protection, unless the disqualifying activities, taken together, are either *de minimis* (Article III) or permissible independent contractor activity (Article V).

## **Article III. De Minimis Activities**

*De minimis* activities are those activities that, when taken together, establish only a trivial connection with the taxing state. An activity conducted within a taxing state on a regular or systematic basis or pursuant to a company policy (whether the policy is in writing or not) normally will not be considered trivial. Whether or not an activity consists of a trivial or nontrivial connection with the state is measured on both a qualitative and quantitative basis. If an activity either qualitatively or quantitatively creates a nontrivial connection with the

taxing state, and is otherwise not protected, then the activity exceeds the protection of PL 86-272.

Establishing that unprotected activities only account for a relatively small part of the business conducted within the taxing state is not determinative of whether the activities are *de minimis*. The relative economic importance of unprotected in-state activities, as compared to protected activities, does not determine whether the conduct of the unprotected activities causes the business to lose PL 86-272 protection.

## **Article IV. Specific Listing of Unprotected and Protected Activities**

The following two lists – Sections A and B – set forth in-state activities that are presently treated by this state as “Unprotected Activities” or “Protected Activities.”

### **Section A. Unprotected Activities**

The following in-state activities (assuming they are not *de minimis*) are not considered solicitation of orders for sales of tangible personal property, entirely ancillary to solicitation, or otherwise protected under PL 86-272:

1. Making repairs or providing maintenance or service to the property sold or to be sold.
2. Collecting current or delinquent accounts, whether directly or by third parties, through assignment or otherwise.
3. Investigating credit worthiness.
4. Installation or supervision of installation at or after shipment or delivery.
5. Conducting training courses, seminars, or lectures for personnel other than personnel involved only in solicitation.
6. Providing any kind of technical assistance or service including, but not limited to, engineering assistance or design service, when one of the purposes thereof is other than the facilitation of the solicitation of orders.
7. Investigating, handling, or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints when the sole purpose of such mediation is to ingratiate the sales personnel with the customer.
8. Approving or accepting orders.
9. Repossessing property.
10. Securing deposits on sales.
11. Picking up or replacing damaged or returned property.
12. Hiring, training, or supervising personnel, other than personnel involved only in solicitation.
13. Using agency stock checks or any other instrument or process by which sales are made by sales personnel.
14. Maintaining a sample or display room in excess of two weeks (14 days) at any one location within the state during the taxable year.
15. Carrying samples for sale, exchange or distribution in any manner for consideration or other value.
16. Owning, leasing, using or maintaining any of the following facilities or property in-state:

- a. Repair shop.
  - b. Parts department.
  - c. Any kind of office other than an in-home office as permitted under Article IV, Sections A, No.18 and B, No.2.
  - d. Warehouse.
  - e. Meeting place for directors, officers, or employees.
  - f. Stock of goods other than samples for sales personnel or that are used entirely ancillary to solicitation.
  - g. Telephone answering service that is publicly attributed to the business or to employees or agents of the business in their representative status.
  - h. Mobile stores, vehicles with drivers who are sales personnel making sales from the vehicles.
  - i. Real property or fixtures to real property of any kind.
17. Consigning stock of goods or other tangible personal property to any person, including an independent contractor, for sale.
18. Maintaining an office or place of business of any kind by an employee or other representative. This does not include an in-home office as explained under Protected Activities (Article IV, Section B, No. 13). An in-home office is one that is located within the residence of the employee or representative that (i) is not publicly attributed to the business or to the employee or representative of the business in an employee or representative capacity, and (ii) so long as the use of such office is limited to soliciting and receiving orders from customers; for transmitting such orders outside the state for acceptance or rejection by the business; or for such other activities that are protected under PL 86-272.

A business will be considered to be maintaining an office or place of business in this state if: 1) there is a public listing within the state for the business or for an employee or representative of the business in such capacity; 2) if there is advertising or business literature that the business or its employee or representative can be contacted at a specific address within the state. However, the normal distribution and use of business cards and stationery identifying the employee's or representative's name, street address, email address, telephone, fax numbers and affiliation with the business shall not, by itself, be considered as advertising or otherwise publicly attributing an office to the business or its employee or representative.

The maintenance of any office or other place of business in this state that does not strictly qualify as an "in-home" office as described above will, by itself, cause the loss of protection.

For the purpose of this subsection it is not relevant whether the business pays directly, indirectly, or not at all for the cost of maintaining an in-home office.

- 19. Entering into franchising or licensing agreements; selling or otherwise disposing of franchises and licenses; or selling or otherwise transferring tangible personal property pursuant to such franchise or license by the franchisor or licensor to its franchisee or licensee within the state.
- 20. Activities performed by an employee who telecommutes on a regular basis from within the state, unless the activities constitute the solicitation of orders for sales of tangible personal property or are entirely ancillary to such solicitation.
- 21. Conducting an activity not listed in Protected Activities (Article IV, Section B), which is not entirely ancillary to facilitating the request for orders, even if the activity helps to increase purchases.

### **Section B. Protected Activities**

The following in-state activities are protected:

- 1. Soliciting orders for sales of tangible personal property by any type of advertising.
- 2. Soliciting of orders for sales of tangible personal property by an in-state resident employee or representative of the business, so long as the employee or representative does not maintain or use any office or other place of business in the state other than an "in-home" office as described in Article IV, Section A, No. 18.
- 3. Carrying samples and promotional materials only for display or distribution without charge or other consideration.
- 4. Furnishing and setting up display racks and advising customers on the display of the business's products without charge or other consideration.
- 5. Providing automobiles to sales personnel for their use in conducting protected activities.
- 6. Passing orders, inquiries and complaints on to the home office.
- 7. Missionary sales activities; i.e., the solicitation of indirect customers for the business's goods. For example, a manufacturer's solicitation of retailers to buy the manufacturer's goods from the manufacturer's wholesale customers is protected if the-solicitation activity is otherwise immune.
- 8. Coordinating shipment or delivery without payment or other consideration and providing information relating thereto either prior or subsequent to the placement of an order.
- 9. Checking of customers' inventories without a charge therefore (for re-order, but not for other purposes such as quality control).
- 10. Maintaining a sample or display room for two weeks (14 days) or less at any one location within the state during the taxable year.
- 11. Recruiting, training or evaluating sales personnel, including occasionally using homes, hotels or similar places for meetings with sales personnel.
- 12. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales

personnel with the customer and facilitating requests for orders.

13. Owning, leasing, using or maintaining personal property for use in the employee or representative's "in-home" office or automobile that is limited to the conducting of protected activities. Therefore, the use of personal property such as a cellular telephone, facsimile machine, duplicating equipment, personal computer, and computer software that is limited to the carrying on of protected solicitation and activity entirely ancillary to such solicitation will not, by itself, remove the protection.

### **Section C. Activities Conducted Via the Internet**

To determine whether a seller of tangible personal property via the Internet is shielded from taxation by PL 86-272 requires the same general analysis as sellers of tangible personal property by other means. Thus, an Internet seller is shielded from taxation in the customer's state if the only business activity it engages in within that state is the solicitation of orders for sales of tangible personal property, which orders are sent outside that state for approval or rejection, and if approved, are shipped from a point outside of that state.

If the seller's activities within a state extend beyond solicitation of orders for sales of tangible personal property, and are neither entirely ancillary to solicitation nor de minimis, PL 86-272 does not shield the seller from taxation by the customer's state.

As a general rule, when a business interacts with a customer via the business's website or app, the business engages in a business activity within the customer's state. However, for purposes of this Publication, when a business presents static text or photos on its website, that presentation does not in itself constitute a business activity within those states where the business's customers are located.

Following are examples of activities conducted by a business that operates a website offering for sale only items of tangible personal property, unless otherwise indicated. In each case, customer orders are approved or rejected, and the products are shipped from a location outside of the customer's state. The business has no contacts with the customer's state other than what is indicated.

#### **(a) Unprotected Activities Conducted Via the Internet**

1. The business regularly provides post-sale assistance to in-state customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website. For example, the business regularly advises customers on how to use products after they have been delivered. This in-state business activity defeats the business's PL 86-272 immunity in states where the customers are located because it does not

constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property.

2. The business solicits and receives on-line applications for its branded credit card via the business's website. The issued cards will generate interest income and fees for the business. This in-state business activity defeats the business's PL 86-272 immunity in states where the on-line application for cards is available to customers because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property.

3. The business's website invites viewers in a customer's state to apply for non-sales positions with the business. The website enables viewers to fill out and submit an electronic application, as well as to upload a cover letter and resume. This in-state business activity defeats the business's PL 86-272 immunity in the customer's state because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property.

4. The business places Internet "cookies" onto the computers or other electronic devices of in-state customers. These cookies gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale. This in-state business activity defeats the business's PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property.

5. The business remotely fixes or upgrades products previously purchased by its in-state customers by transmitting code or other electronic instructions to those products via the Internet. This in-state business activity defeats the business's PL 86-272 immunity because it does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of tangible personal property.

6. The business offers and sells extended warranty plans via its website to in-state customers who purchase the business's products. Selling, or offering to sell, a service that is not entirely ancillary to the solicitation of orders for sales of tangible personal property, such as an extended warranty plan, defeats the business's PL 86-272 immunity—see Article I, Nature of Property Being Sold.

7. The business contracts with a marketplace facilitator that facilitates the sale of the business's products on the facilitator's on-line marketplace. The marketplace facilitator maintains inventory, including some of the business's products, at fulfillment centers in various

states where the business's customers are located. This maintenance of the business's products defeats the business's PL 86-272 immunity in those states where the fulfillment centers are located—see Article V, Independent Contractors.

8. The business contracts with in-state customers to stream videos and music to electronic devices for a charge. This in-state business activity defeats the business's PL 86-272 immunity because streaming does not constitute the sale of tangible personal property for purposes of PL 86-272—see Article I, Nature of Property Being Sold.

**(b) Protected Activities Conducted Via the Internet**

1. The business provides post-sale assistance to in-state customers by posting a list of static FAQs with answers on the business's website. This posting of the static FAQs does not defeat the business's PL 86-272 immunity because it does not constitute a business activity within the customers' state.

2. The business places Internet "cookies" onto the computers or other devices of in-state customers. These cookies gather customer information that is only used for purposes entirely ancillary to the solicitation of orders for tangible personal property, such as: to remember items that customers have placed in their shopping cart during a current web session, to store personal information customers have provided to avoid the need for the customers to re-input the information when they return to the seller's website, and to remind customers what products they have considered during previous sessions. The cookies perform no other function, and these are the only types of cookies delivered by the business to its customers' computers or other devices. This in-state business activity does not defeat the business's PL 86-272 immunity because it is entirely ancillary to the in-state solicitation of orders for sales of tangible personal property.

3. The business offers for sale only items of tangible personal property on its website. The website enables customers to search for items, read product descriptions, select items for purchase, choose among delivery options, and pay for the items. The business does not engage in any in-state business activities that are not described in this example, such as the activities described in Article IV, Section C, Unprotected Activities, examples a-h. This business activity does not defeat the business's PL 86-272 immunity because the business engages exclusively in in-state activities that either constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to solicitation.

**Article V. Independent Contractors**

PL 86-272 provides protection to certain in-state activities if conducted by an independent contractor that

would not be afforded if performed by the business or its employees or other representatives. Independent contractors may engage in the following limited activities in the state without the business's loss of immunity:

1. Soliciting sales.
2. Making sales.
3. Maintaining an office.

Sales representatives and others who represent a single principal are not considered to be independent contractors.

Maintenance of a stock of goods in the state by the independent contractor under consignment or any other type of arrangement with the business, except for purposes of display and solicitation, removes the protection.

Performance of unprotected activities by an independent contractor on behalf of a seller, such as performing warranty work or accepting returns of products, also removes the statutory protection.

**Article VI. Application of Destination State Law in Case of Conflict**

In determining which state is to receive the assignment of the receipts at issue, preference is given to any clearly applicable law, regulation or written guideline that has been adopted by the destination state. However, except in the cases of the definition of what constitutes "tangible personal property," this state is not required by this Publication to follow any other state's (including the destination state's) law, regulation or written guideline if it determines that to do so (i) would conflict with its own laws, regulations, or written guidelines and (ii) would not clearly reflect the income-producing activity of the business within its borders.

Notwithstanding any provision set forth in this Publication to the contrary, this state will apply the destination state's definition of "tangible personal property" to determine the application of PL 86-272 as it relates to the origin state's throwback rule, if any. If the destination state lacks a definition that would enable a determination of whether the sale in question is a sale of "tangible personal property," then each state may treat the sale in any manner that would clearly reflect the activity of the business within its borders.

**Article VII. Miscellaneous Practices**

**A. Application to Foreign Commerce.**

PL 86-272 specifically applies, by its terms, to "interstate commerce" and does not directly apply to foreign commerce. For purposes of PL 86-272, "interstate commerce" includes commerce between the 50 states and The Commonwealth of Puerto Rico.

**B. Application to Corporation Incorporated in State or to Person Resident or Domiciled in State.**

The protection afforded by PL 86-272 does not apply to a corporation incorporated under the

laws of the taxing state or to a person who is a resident of or domiciled in the taxing state.

C. Registration or Qualification to do Business.

If a business's only connection to this state is that it registered or qualified to do business within this state, it will not forfeit the protection that may otherwise apply under PL 86-272 in this state. Seeking to use or protect any additional benefit under state law through engaging in other activity not protected under PL 86-272 (such as protecting a trade secret or corporate name) will forfeit the protection.

D. Loss of Protection for Conducting Unprotected Activity during Part of Taxable Year.

The protection afforded by PL 86-272 is determined on a taxable year by taxable year basis. Therefore, if at any time during a taxable year a business conducts activities that are not protected under PL 86-272, the business will not be considered protected under PL 86-272 for the entirety of that year.

E. Application of the **Throwback** Rule.

The Franchise Tax Board's multi-entity apportionment formula rules are as follows:

**For taxable years beginning on or after April 22, 1999 and for taxable years beginning before January 1, 2011, California followed the administrative practice of applying the Joyce rule.**

1. For purposes of determining which sales are included in the California sales factor numerator, sales of tangible personal property delivered or shipped to a purchaser in California will be included in the numerator only if the selling corporation is taxable in California.
2. Sales of tangible personal property delivered or shipped from California to other states are to be assigned to this state under the throwback rule only when the selling corporation is itself not taxable within the destination state.
3. The California property, payroll, and sales of those corporations within a unitary group (property, payroll, and single-weighted sales for certain entities with qualified business activities, see R&TC section 25128) that are taxable in this state will be taken into account in the apportionment of business income to this state.

**For taxable years beginning on or after January 1, 2011, California applies the *Finnigan* rule (R&TC section 25135 (b).)**

1. For purposes of determining which sales are included in the California sales factor numerator, sales of tangible personal property delivered or shipped to a purchaser in California will be included in the numerator if any member of the combined reporting group is taxable in California.

2. Sales of tangible personal property delivered or shipped from California to other states are to be assigned to this state under the throwback rule only when no member of the seller's unitary group is taxable within the destination state.

3. Treatment by Taxable Years:

- a. For taxable years beginning on or after January 1, 2011 and before January 1, 2013:
  - 1) For taxpayers not electing single-sales factor, the California property, payroll, and sales of each corporation within a unitary group (property, payroll and single-weighted sales for certain entities with qualified business activities, see R&TC section 25128) will be taken into account in the apportionment of business income to this state, including amounts attributable to entities exempt from taxation in this state because of PL 86-272. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state.
  - 2) For taxpayers electing single-sales factor, the California sales of each corporation within a unitary group (property, payroll and single-weighted sales for certain entities with qualified business activities, see R&TC section 25128) will be taken into account in the apportionment of business income to this state, including amounts attributable to entities exempt from taxation in this state because of PL 86-272. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state.
- b. For taxable years beginning on or after January 1, 2013, the California sales of each corporation within a unitary group (property, payroll and single-weighted sales for certain entities with qualified business activities, see R&TC section 25128) will be taken into account in the apportionment of business income to this state, including amounts attributable to entities exempt from taxation in this state because of PL 86-272. The total business income thus apportioned to California will be assigned to the individual corporations taxable by this state.

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