

BEFORE THE STATE BOARD OF EQUALIZATION
OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
AQUA AEROBIC SYSTEMS, INC.) No. 81A-790

For Appellant: Allen W. Johnson
Vice President

For Respondent: **Terry Collins**
Counsel

O P I N I O N

This appeal is made pursuant to section 25666 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protest of Aqua Aerobic Systems, Inc., against proposed assessments of additional franchise tax in the amounts of \$400, \$200, \$200, and \$200 for the income years ended August 31, 1977, August 31, 1978, August 31, 1979, and August 31, 1980, respectively.

1/ Unless otherwise specified, all section references are to sections of the Revenue and Taxation Code as in effect for the income years in issue.

A p p e a l

The issue presented is whether appellant was subject to the California franchise tax during the years at issue.

Appellant is an Illinois corporation engaged in the manufacture of water and wastewater equipment. **Its** sole facility is an assembly plant located in Rockford, Illinois. Appellant's products are marketed in California exclusively through independent dealer representatives. No inventory is stored and no sales offices are maintained in California. Orders are approved in and products are shipped from Illinois. During the years at issue, appellant's employees entered California to perform warranty repairs and for what appellant refers to as sales start-up supervision. During the income years 1977, 1978, and 1979, appellant's employees performed warranty work in California for 87, 26, and 16 days, respectively. During income year 1980, appellant's employees performed no warranty work in California but did spend 14 days in this state performing sales start-up supervision. After 1980, appellant altered its method of operation in California in order to eliminate the possibility of being subject to California franchise tax.

Appellant did not file California franchise tax returns for the years at issue. Respondent determined that appellant was doing business in California during all the years at issue and was, therefore, subject to the state's franchise tax. Respondent issued notices of proposed assessment, which it affirmed after considering appellant's protest. This timely appeal followed.

The franchise tax is imposed upon "every corporation doing business within the limits of this state ... for the privilege of exercising its corporate franchises within this state. ..." (Rev. & Tax. Code, § 23151, **subd.** (a).) "'Doing business' means actively engaging in any transaction for the purpose of financial or pecuniary gain or profit." (Rev. & Tax. Code, § 23101.) The reach of the Bank and Corporation Franchise Tax Law is coextensive with the state's constitutional power to tax. (Butler Bros. v. McColgan, 17 **Cal.2d** 664 [**111 P.2d 334**] (1941), affd., 315 U.S. 501 (86 **L.Ed. 991**) (1942); Appeal of Atlantic, Gulf and Pacific Company of Manila, Inc., Cal. St. Bd. of Equal., Nov. 17, 1982.)

Appellant contends that it is not subject to the franchise tax by virtue of Public Law 86-272 (15 U.S.C. § 381 et seq.). Public Law 86-272 limits the power of a state to impose a net income tax on income

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earned from interstate commerce by an out-of-state taxpayer. Subdivision (a) of section 101 of that law provides, in pertinent part:

No State, ... shall have power to impose, ... a net income tax **on the** income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of **such** person during such taxable year are . . . the following:

(1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State: . . .

In enacting Public Law 86-272, Congress carved out a specific area of immunity from state taxation. Courts and this board have held that immune activities are strictly limited to solicitation or activities incidental to solicitation. (See Appeal of Nardis of Dallas, Inc., Cal. St. Bd. of Equal., Apr. 22, 1975, and the cases cited therein.) Public Law 86-272 sets forth no test to be applied when determining whether an employee's activities go beyond solicitation. Each case must be judged on its own facts, with particular emphasis placed on the totality of the taxpayer's activities within the state. (Department of Revenue v. Kimberly-Clark Corp., 275 Ind. 378 [416 N.E.2d 1264] (1981); Iron Fireman Manufacturing Co. v. State Tax Commission, 251 Or. 227 [445 P.2d 126] (1968).)

Courts have concluded that "solicitation" as used in Public Law 86-272, should be given its generally accepted meaning (Miles Laboratory, Inc. v. Department of Revenue, 274 Or. 395 [546 P.2d 1081] (1976) and should be "limited to those generally accepted or customary acts in the industry which lead to the placing of orders, not those which follow as a natural result of the transaction" (Olympia Brewing Company v. Dept. of Rev., 50 T.R. 99, 110 (1972), affd., 266 Or. 309 [511 P.2d 837] (1973), cert. denied, 415 U.S. 976 [39 L.Ed.2d 872] (1974).)

The performance of warranty repairs is a consequence of prior solicitation rather than a part of the

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original solicitation. Therefore, it is not an activity which is immune from taxation under Public Law 86-272. This conclusion is in accord with the decisions of courts of other states holding that the servicing or replacing of faulty goods and handling of customers' complaints exceed solicitation. (Chattanooga Glass Co. v. Strickland, 244 Ga. 603 [261 S.E.2d 599] (1979); Department of State Revenue v. Continental Steel Corp., 73 Ind. Dec. 578 [399 N.E.2d 754] (Ct.App. 1980); Miles Laboratories, Inc. v. Department of Revenue, supra; see also Olympia Brewing Company v. Department of Revenue, supra.) Since appellant performed warranty repairs in California during income years 1977, 1978, and 1979, it was subject to California franchise tax during those years.

Appellant performed no repairs in California during the income year 1980, but it did perform sales start-up supervision in California during that year. The only information in the record regarding this activity is appellant's description of it as a sales technique which consists of a sales person visiting the job site to see that the equipment sold by appellant is in proper condition prior to its operation. Although the record does not detail what is involved in this process, it would appear that this activity follows as a result of a sale, since the service is performed after appellant's products are installed by the customer. In addition, the activity seems to involve a complete inspection of the equipment involved since in income year 1980, an employee spent 14 days at one job site. This board has held that the seller's inspection of complex equipment after its installation is not part of the solicitation of orders and, therefore, the seller is not immune from taxation under Public Law 86-272. (Appeal of Riblet Tramway Company, Cal. St. Bd. of Equal., Dec. 12, 1967.) Since appellant has the burden of proving respondent's determination to be erroneous and has not established that its activities differed from those engaged in by the taxpayer in the Riblet Tramway Company appeal, we conclude that our decision in that case controls the instant appeal.

Since we have found that appellant's activities in each of the income years on appeal exceeded mere solicitation, Public Law 86-272 did not shield it from taxation and appellant was subject to the California franchise tax. Therefore, the action of respondent must be sustained.

