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## TAX INFORMATION RELEASE NO. 2020-05

RE: Application of Public Law 86-272 to Hawaii Net Income Tax

This Tax Information Release (TIR) provides guidance regarding Public Law (P.L.) 86-272<sup>1</sup> both in general and specifically in light of Act 221, Session Laws of Hawaii 2019 (Act 221). Act 221 is codified at Hawaii Revised Statutes (HRS) section 235-4.2. This TIR supersedes TIR No. 95-3.

### **Background**

P.L. 86-272 restricts a state from imposing a net income tax on income from interstate commerce if the only business activity of the taxpayer within the state is the solicitation of orders for sales of tangible personal property, which orders are sent outside the state for acceptance or rejection, and, if accepted, are filled by shipment or delivery from a point outside the state. The term “net income tax” includes the corporate income tax under HRS chapter 235.

Act 221 established economic nexus standards for Hawaii net income tax. Act 221 states that any taxpayer without a physical presence in the State that has either \$100,000 or more in gross income attributable to Hawaii or 200 or more business transactions within Hawaii during the current or preceding calendar year is systematically and regularly engaging in business in Hawaii.

### **Application of P.L. 86-272**

The net income tax under HRS chapter 235 applies to the fullest extent permissible under the United States Constitution. In general, preemption of state taxation required by P.L. 86-272 will be limited to activities falling within the “clear and manifest purpose of Congress.”<sup>2</sup>

#### *Solicitation of Sales of Tangible Personal Property*

P.L. 86-272 protects solicitation of sales of tangible personal property only. Solicitation means speech or conduct that explicitly or implicitly invites an order. Therefore, only

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<sup>1</sup> 15 U.S.C. §§ 381-384.

<sup>2</sup> See *Department of Revenue of Oregon v. ACF Industries, Inc. et al.*, 510 U.S. 332 (1994); *Cippolone v. Liggett Group, Inc.*, 505 U.S. 504 (1992); *Heublein, Inc. v. South Carolina Tax Com.*, 409 U.S. 278 (1972).

solicitation for orders of tangible personal property are protected. The leasing, renting, licensing, or other disposition of tangible personal property, or any transactions involving intangibles or services are not protected under P.L. 86-272.

#### *Activities Ancillary to Solicitation*

In *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*<sup>3</sup>, the United States Supreme Court interpreted solicitation, for purposes of P.L. 86-272 protection, to include activities “entirely ancillary” to solicitation.

Ancillary activities are those activities that serve no independent business function for the seller apart from their connection to the solicitation or orders. Activities that a seller would engage in apart from soliciting orders shall not be considered as ancillary to the solicitation of orders. P.L. 86-272 only protects activities that facilitate sales; activities promoting sales are not protected. Ancillary activities are similarly limited in that such activities must be ancillary to the facilitation of sales to be protected. Activities that seek to promote sales or are ancillary to the promotion of sales are not protected. Activities not conforming to the definition of solicitation or not qualifying as ancillary to solicitation are not protected by P.L. 86-272 and will cause a taxpayer to lose its protection, unless the unprotected activities are de minimis (see below).

#### *Shipping and Delivery*

Shipping and delivery are also protected when the taxpayer’s solicitation for orders of tangible personal property are protected by P.L. 86-272. The Department considers shipment and delivery to be an example of what the Court in *Wrigley* identified as activities “entirely ancillary” to solicitation. The Department does not recognize protection under P.L. 86-272 for activities that are ancillary to shipment and delivery.

In addition to shipping and delivery by common carrier, delivery of the products by the taxpayer in its own vehicles are a protected activity under P.L. 86-272. However, activities such as warehousing of products or storage/maintenance of the delivery vehicles are unprotected activities. Due to the geographic location of the State of Hawaii, the use of a taxpayer’s own vehicles for delivery without engaging in unprotected activities is impracticable if not impossible. Therefore, as a practical matter, a taxpayer delivering goods into Hawaii in its own vehicles will not have protection under P.L. 86-272.

#### *De Minimis Activities*

The Court in the *Wrigley* interpreted P.L. 86-272 to include an exception to protect de minimis unprotected activities. De minimis activities are those that in the aggregate establish only a trivial connection with the state. Regular or systematic activities are normally not considered de minimis.

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<sup>3</sup> 505 U.S. 214 (1992).

Whether activities are de minimis is determined both qualitatively and quantitatively. If an unprotected activity is non-trivial either qualitatively or quantitatively, the activity exceeds the protection of P.L. 86-272 and the taxpayer is not protected by P.L. 86-272. However, if the unprotected activities are de minimis, both qualitatively and quantitatively, then the taxpayer is protected by P.L. 86-272.

### **Protected and Unprotected Activities**

For purposes of administering Hawaii's net income tax given P.L. 86-272, the Department provides the following lists of unprotected and protected activities.

#### **Unprotected Activities**

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 Hawaii by sales personnel;
14. Maintaining a sample or display room in excess of 14 days at any one location within Hawaii 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 facilitates or property in Hawaii:
  - a. Repair shop;
  - b. Parts department;
  - c. Office of any kind (other than a home office as described in this TIR);
  - 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 capacity;
  - h. Mobile stores, i.e., vehicles with drivers who are sales personnel making sales from the vehicles; and
  - 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 as described below, including a telephone listing or other advertisement or indication of a contact point within Hawaii;
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 license within Hawaii;
20. Conducting any activity not listed as a protected activity below which is not entirely ancillary to requests for orders, even if such activity helps to increase purchases;
21. Checking of customers' inventories without a charge therefor for purposes of quality control;

22. Making sales that equal or exceed \$100,000 during the current or preceding calendar year; and
23. Engaging in 200 or more business transactions with persons within Hawaii during the current or preceding calendar year.

**Protected Activities**

1. Soliciting orders for sales by any type of advertising;
2. Soliciting or orders by an in-state resident employee or representative of the company;
3. Maintenance of an in-home office within the residence of the employee or representative that is:
  - a. Not publicly attributed to the company or to the employee or representative of the company in an employee or representative capacity; and
  - b. Used only to solicit and receive orders from customers, transmit such orders outside the state for acceptance or rejection by the company, or to engage in other activities that are protected under P.L. 86-272 or by this TIR.
4. Carrying samples and promotional materials only for display or distribution without charge or other consideration;
5. Normal distribution and use of business cards;
6. Furnishing or setting up display racks and advising customers on the display of the company's products without charge or other consideration;
7. Providing automobiles to sales personnel for their use in conducting protected activities;
8. Passing orders, inquiries, and complaints on to the home office;
9. Missionary sales activities; i.e., the solicitation of indirect customers for the company's goods;
10. Coordinating shipment or delivery without payment of other consideration and providing information relating thereto either prior or subsequent to the placement of an order;
11. Checking of customers' inventories without a charge therefor for purposes of re-order;

12. Maintaining a sample or display room for 14 days or less at any one location within Hawaii during the tax year;
13. Recruiting, training, or evaluating sales personnel, including occasionally using homes, hotels, or similar places for meetings with sales personnel; and
14. Mediating direct customer complaints when the purpose thereof is solely for ingratiating the sales personnel with the customer and facilitating requests for orders.

### **Independent Contractors**

P.L. 86-272 provides additional protection to independent contractors. An independent contractor means a commission agent, broker, or other independent contractor who is engaged in selling tangible personal property or soliciting orders for the sale tangible personal property. Any person representing a single principal is not considered an independent contractor. In addition to the protected activities listed above, independent contractors may engage in the following protected activities in Hawaii without the principal's loss of protection under P.L. 86-272:

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

For more information, please contact the Rules Office at (808) 587-1530 or by email at [tax.rules.office@hawaii.gov](mailto:tax.rules.office@hawaii.gov).

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