1987 Ariz. Tax LEXIS 34

Arizona Board of Tax Appeals

February 05, 1987

Docket No. 395-85-I

Reporter
1987 Ariz. Tax LEXIS 34 *

AIRBORNE NAVIGATION CORPORATION Appellant, vs. ARIZONA DEPARTMENT OF REVENUE, Appellee

Core Terms

solicit, income tax, apportionment, customer, unitary, interstate commerce, unitary business

Opinion

[*1]

NOTICE OF DECISION: FINDINGS OF FACT AND CONCLUSIONS OF LAW

The State Board of Tax Appeals, Division Two, having considered all evidence and arguments presented, and having taken the matter under advisement, finds and concludes as follows:

FINDINGS OF FACT

Appellant, ***Airborne Navigation*** Corporation, was an Arizona corporation. Appellant's income tax returns were audited by the Arizona Department of Revenue (Department) for the 1978, 1979, and 1980 tax years. During the audit period, Appellant was a wholly-owned subsidiary of Global ***Navigation*** Incorporated (Global). These corporations, along with Global Financial Corporation and Global ***Navigation*** International Corporation, are conceded to have constituted a unitary business group.

Appellant was a manufacturing corporation which sold all of its output to Global; Global was a marketing corporation. According to Appellant, all of Global's activities were carried on in California, and it was through those marketing offices that sales to Arizona customers were solicited. Global did not have any offices in Arizona.

During the years in question, Appellant and Global filed unitary combined returns together with the **[*2]** other members of the business group. On December 31, 1980, Appellant was dissolved in a merger with Global; it continued to function as a corporate division.

The Department issued an assessment against Appellant in the amount of $352,549 in tax, plus interest. The assessment was modified in response to Appellant's protest and further explanation of the critical facts. The modified assessment, issued on November 10, 1983, totalled $214,246 in tax, plus interest. Appellant timely protested the assessment; an administrative hearing was held to resolve the matter.

When apportioning the business income of a unitary group, the Income Tax Section typically employs the following apportionment ratio:

property, payroll, and sales in Arizona / property, payroll, and sales of the unitary group

In calculating the original assessment, the Department did not include the "sales factor" of the three-factor apportionment formula used by Appellant to apportion its income to Arizona. Prior to the hearing, the Department agreed to utilize the sales factor; Appellant disagreed with the Department's inclusion of Global's Arizona sales in the numerator of said factor.

Appellant contended that: **[*3]** a) Global is not subject to the taxing jurisdiction of Arizona, pursuant to *15 U.S.C. § 381,* as it did nothing more than solicit sales in this state; and, b) Global's Arizona sales cannot be included in the sales factor due to a lack of nexus, therefore, the numerator of the factor should be zero.

The Income Tax Section contended that: a) sufficient nexus exists; and, b) all sales by the unitary group to Arizona customers should be included in the numerator.

The Hearing Officer denied Appellant's appeal, concluding that: a) if Global owned and therefore controlled all of the manufacturing activities in Arizona, Appellant can hardly contend that all it did was solicit orders here; and, b) the Supreme Court acknowledged that a sufficient nexus exists if at least "some part" of the unitary business is conducted in the taxing state. See *Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983)* at 167.

Appellant timely appealed the proposed decision to the Department Director. Upon review, the Director upheld the proposed decision, concluding that: a) the Appellant has the distinct burden of showing clear and cogent evidence that **[*4]** the state tax results in extraterritorial values being taxed. Container at 2995; b) Appellant has not attempted to show that the method of apportionment is arbitrary or that an unreasonable result occurred; and, c) Once an activity in a state by a unitary business goes beyond mere solicitation, Pub. L. No. 86-272 is not a barrier to the imposition of a tax. See *Heublein Inc. v. South Carolina Tax Commission, 409 U.S. 275 (1970).*

Appellant timely appealed the Director's Final Order to this Board. Appellant contends that the Department is precluded by Pub. L. No. 86-272 from including Global's Arizona destination sales in the numerator of the "sales factor". The Department contends that all sales by the unitary business to Arizona customers should be included in the "sales factor". A hearing was held before this Board on September 18, 1986.

DISCUSSION
Public Law 86-272:

Section 101(a) of Pub. L. No. 86-272 states that:

No State, . . ., shall have power to impose, for any taxable year ending after the date of this enactment of this Act, a net income tax on the income derived within such State by any person from interstate commerce if **[*5]** the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:

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

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

Act of Sept. 14, 1959, Pub. L. No. 86-272 § 101(a), 1959 U.S. Cong. & Ad. News (86 Stat.) 613 (emphasis added).

In said law, Congress intended the word "person" to include corporations, companies, associations, firms, partnerships, societies, and joint stock companies. See S. Rep. No. 658, 86th Cong., 1st Sess., reprinted in 1959

U.S. Cong. & Ad. News 2548 at 2555. It would not **[*6]** be stretching this definition to say that Appellant and the other corporations in the unitary business group could be considered one "person" for purposes of this law.

The legislative history reads:

[u]nder the provisions of section 1 of the bill no net income tax on income derived within the State by any person from interstate commerce may be imposed by a State . . . for any taxable year ending after the date of enactment of the act if the only business activities by on on behalf of such person are those described above in section 1 (a) and (c). Consequently, if the only business presence within the State by a person engaged in interstate commerce is the solicitation by his salesmen of orders for sales of tangible personal property and the orders are sent out of the State for approval or rejection, and if the order is approved, it is filled by shipment of delivery from a stock of goods, warehouse, plant or factory located out of the State, the net income tax of the State . . . on income derived within the State by such person from interstate commerce may not be imposed. . . . The provisions of subsection (a) of section **[*7]** 1 of the bill will not be available to grant immunity to a person where the orders are filled by a shipment or delivery from a stock of goods, warehouse, plant, or factory maintained by the person within the State.

Id. at 2553 (emphasis added).

Appellant should not be able to qualify for the immunity provided by this law, as there were business activities performed in this State by Appellant outside of mere solicitation; Appellant had a business presence in Arizona by way of manufacturing.

In Container, the Supreme Court determined that the Due Process and Commerce Clauses of the Constitution impose ". . . the obvious and largely self-executing limitation that a State not tax a purported 'unitary business' unless at least some part of it is conducted in the State." Id. at 167. It seems that the Department's reliance upon the Supreme Court's minimum standards for an adequate nexus to tax a unitary, multistate corporation is on point, as Congress stated that:

[w]hether business activities other than those described **[*8]** in the bill constitute a sufficient basis for the imposition by a State . . . of a net income tax on income derived from interstate commerce is left for future determination by the Congress, or in the absence of congressional action, by the courts.

S. Rep. No. 658, 86th Cong., 1st Sess., reprinted in 1959 U.S. Cong. & Ad. News 2548 at 2554. Since the law in question is almost twenty years old, one can conservatively say that there has been an absence of congressional action, and that this situation has been properly reviewed by the courts.

CONCLUSIONS OF LAW

1. Appellant does not qualify for the exemption provided by Pub. L. No. 86-272, as it had a business presence within Arizona which extended beyond mere solicitation. See S. Rep. No. 658, 86th Cong., 1st Sess., reprinted in 1959 U.S. Cong. & Ad. News 2548 at 2554.

2. The apportionment formula utilized by the Department is valid.

ORDER

THEREFORE, IT IS HEREBY ORDERED that Appellant's appeal is denied, and the Final Order of the Director is upheld.

A rehearing or review of the decision may be granted on motion filed by the aggrieved party within **[*9]** (15) days from receipt of such order or decision as provided in the Board's regulation R16-3-121.

This decision becomes final upon the expiration of thirty (30) days from receipt, unless either the State or the taxpayer brings an action in Superior Court as provided in A.R.S. § 42-124.

DATED this 5th day of February, 1987.

STATE BOARD OF TAX APPEALS

Morris A. Kaplan, Chairman

Division Two

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