

Expanding the Scope of Delivery under Public Law No. 86-272

by Gary Peric and Jonathan M. Cesaretti

In today's atmosphere of stagnant or declining tax revenues and slowly recovering economies, many state taxing authorities have become aggressive in pursuing net income taxes from corporations that are not legally or commercially domiciled in the state (hereinafter referred to as "multistate businesses"). By focusing on nexus standards that are not based on physical presence, many states have increased the risk that a multistate business's activity in a state creates an income tax filing obligation. In addition, the adoption of 100-percent sales-factor apportionment and severely punitive penalty regimes in some states has increased the potential costs of nonfiling.

Since 1959, certain multistate businesses have been able to rely on the protection afforded by the Interstate Income Tax Act of 1959 (commonly referred to as Public Law No. 86-272) to avoid filing net income tax returns.¹ Specifically, Public Law No. 86-272 prohibits a state from imposing a tax based on net income on a multistate business whose only state activities are (1) solicitation of orders for sales of tangible personal property, and (2) shipment or *delivery* of that property, if (3) the orders are sent outside of the state for approval and fulfillment.

In 1992, taxpayers and the states were given guidance on the meaning of the term "solicitation" for purposes of Public Law No. 86-272 when the Supreme Court of the United States decided *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*² The Court has not, however, provided equivalent guidance on the scope of "delivery," another key element of Public Law No. 86-272. Consequently, a number of states have sought to narrow the term "delivery" to include only the shipment of goods from a location outside the state via a third-party common carrier.

These efforts, however, are subject to challenge. Indeed, the scope of statutorily protected "delivery" is arguably significantly greater than the shipment or delivery of goods from outside the state via common carrier. Specifically, if delivery for purposes of Public Law No. 86-272 were construed under the same legal analysis that the Supreme Court in *Wrigley* applied to "solicitation," the scope of protected delivery would include not only delivery, but also activities ancillary to delivery. In other words, the dividing line between those protected and unprotected activities would, as is the case in respect of "solicitation," be between those activities that serve "no independent business function" other than delivery and those activities that the multistate business "would have reason to engage in anyway," but allocates to its instate delivery function.

Given the more than 50 years of authority and practice favoring a narrow interpretation of "delivery" under Public Law No. 86-272, this interpretation might be viewed as potentially impractical or spurious. There are a number of situations, however, where the protections provided by Public Law No. 86-272 should be construed as significantly broader than generally recognized, including situations where (1) the multistate business's presence in the state is di-

rectly related to delivery, such as the presence of company-owned delivery vehicles; and (2) the multistate business's presence in the state is entirely ancillary to the delivery of the company's goods in the state, such as the presence of reusable containers, and to delivery that includes certain scenarios with the presence of inventory in a state as well as some backhauling.

Statutory Background

Public Law No. 86-272 originally was enacted as a stopgap measure.³ It followed closely on the heels of a controversial 1959 decision of the Supreme Court of the United States in *Northwestern Cement v. Minnesota*.⁴ In that case, the Court ruled that net income from the exclusively interstate operations of a multistate business may be subjected to state taxation, as long as the levy is not discriminatory and is properly apportioned to local activities within the taxing state that create nexus. In the wake of that decision, businesses and Congress expressed concerns about the uncertainty it created for multistate businesses regarding the level of local activity required to impose net income tax.⁵ The federal statute was passed in response, providing in 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 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 (Emphasis added.)

The law also mandated a congressional study of state taxation of interstate commerce, which led in 1964 to a report commonly known as the Willis Commission Report.⁶ The multivolume report highlighted some of the ambiguities in Public Law No. 86-272:

The primary area of ambiguity in the statute revolves around the terms "solicitation" and "delivery" — the question of what kinds of activity may be considered an integral part of the process of solicitation and sale. . . . [A]lthough the statute makes it clear that delivery of goods into a State does not deprive the selling company of statutory immunity, there can be doubt about the meaning of delivery.

The drafters of the Willis Commission Report expressed uncertainty over whether installation work (which could include jobs requiring five minutes or five weeks), a retention of a security interest in the goods sold, or warranty repairs that take place on a customer's premises could be considered within the scope of protected delivery.

Supreme Court's Consideration of "Delivery"

The *Wrigley* case in 1992 was not the first time the Supreme Court weighed in on Public Law No. 86-272. Two decades before, it considered the scope of the statute's protection in *Heublein, Inc. v. South Carolina Tax Commission*.⁷ The taxpayer in that case arranged its business in South Carolina to solicit sales and to conform to the regulatory requirements of South Carolina's Alcoholic Beverage Control Act. To comply with this regulatory regime, Heublein shipped inventory into the state consigned to its employee representative. Once the inventory was received, the employee representative was required to obtain permission from the South Carolina Alcoholic Beverage Control Commission before transferring it to the local wholesaler.

Based on these activities, the state imposed income taxes on Heublein, and the company sued to recover its payments. In ruling for the state, the Supreme Court said the question was whether South Carolina's regulatory regime for liquor control "serves legitimate state purposes other than assuring that the state may tax the firm's income." Holding that the regulatory regime was valid, the Court held that the in-state activities that Heublein was required to follow as part of the regulatory regime were not protected under Public Law No. 86-272.

While *Heublein* is the only Supreme Court case that discusses the meaning of "shipment or delivery from a point outside the State," it did not provide a standard by which a multistate business can evaluate its in-state delivery activities. The activity that put Heublein outside the protection of Public Law No. 86-272 was the transfer of goods to a purchaser from the warehouse within the state, in apparent violation of the requirement that orders be shipped or delivered from a point outside the state.

The Wrigley Framework

In 1992, the Supreme Court clarified the term "solicitation" in Public Law No. 86-272 in *Wisconsin Department of Revenue v. William Wrigley, Jr., Co.*⁸ The Wisconsin Department of Revenue had asserted that at least six activities performed by the Chicago-based Wrigley gum company within its borders went beyond the "solicitation of orders" within the meaning of the federal statute and supported the imposition of an income-based franchise tax.⁹

The Supreme Court took a broader view, holding that "solicitation" includes more than merely inviting an order. Rather, it found that the statutory term extends to "the entire process associated with the invitation," elaborating:

Once it is acknowledged, as we have concluded it must be, that "solicitation of orders" covers more than what is strictly *essential* to making requests for purchases, the next (and perhaps the only other) clear line is the one between those activities that are *entirely ancillary* to requests for purchases — those that serve no independent business function apart from their connection to the soliciting of orders — and those activities that the company would have reason to engage in anyway but chooses to allocate to its in state sales force.

Notably, the Court found that Public Law No. 86-272 "was designed to increase — beyond what Northwestern States suggested was required by the Constitution — the connection that a company could have with a State before subjecting itself to tax."¹⁰

The Need for Clarity on the Scope of Delivery

Regrettably, the term "delivery" has not received the judicial explication that "solicitation" received in *Wrigley*, and in the absence of clarification — whether by the Supreme Court or Congress — the states have hewed to a very narrow definition. In particular, the states (as well as the Multistate Tax Commission¹¹) have generally asserted their position in lists of protected activities and unprotected activities.

In 1986, the MTC adopted guidelines on Public Law No. 86-272 styled "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272." The guidelines describe in-state activities that would and would not establish an income tax filing requirement for purposes of state income taxes. These guidelines were revised in 1994, after *Wrigley*, and now include delivery by company-owned vehicles on the list of unprotected activities. The guidelines did not otherwise address delivery.¹²

The better answer is to subject the definition of "delivery" as used in Public Law No. 86-272 to the principles of statutory construction that the Supreme Court applied to "solicitation" in the *Wrigley* case. Applying these principles, the scope of protected delivery includes not only those activities strictly essential for making a delivery, but ancillary activities as well.

In the context of delivery, the ancillary activities presumably would include those delivery-related activities that serve no independent business function apart from their connection to the delivery of orders filled from a location outside the state. The limit of protected delivery presumably would be reached only at the point when the multistate business's activity in the state became such that the company would have reason to engage in anyway, but chooses to allocate to its delivery function. Under the approach, the protections provided by Public Law No. 86-272 presumably would extend to situations where the multistate business's activity in the state is essential to making the delivery and under this framework would include delivery in company-owned vehicles.

The scope of the protection presumably would also extend to the multistate business's activity in the state that serves no independent business function apart from its connection to the delivery of orders and include, among other things:

- Delivery by company-owned vehicles;
- Delivery in company-owned reusable and returnable containers;
- Delivery that includes, in certain cases, the presence of inventory in the state; and
- Using company-owned trucks to backhaul goods from the point of delivery in order to defray the costs of making the delivery.¹³

Delivery by Company-Owned Vehicles

Companies commonly use their own fleet vehicles to deliver products to states where they are not commercially or legally domiciled. The question that arises is whether this activity is protected by Public Law No. 86-272. Some states have attempted to limit the protection to delivery performed by common or contract carriers.

Since the mid-1980s, though, numerous state governmental entities — including courts, legislatures, regulatory bodies, and taxing authorities — have taken the position that delivery by company-owned vehicles is a protected activity.¹⁴ Especially noteworthy are the

court decisions in two lawsuits filed by the National Private Truck Council (NPTC), a national trade association of corporations that operate their own truck fleets to transport and deliver their goods.

In 1997, in *National Private Truck Council v. Commissioner of Revenue*,¹⁵ the association challenged a Massachusetts regulation that limited immunity from state income taxation to delivery by common carrier. A number of NPTC members not incorporated or based in Massachusetts regularly solicited sales of tangible goods in the state. The orders were sent outside the state for approval and, once approved, were filled from a point outside the state. The members then used their own trucks to make deliveries to their customers in Massachusetts.

A state regulation exempted a multistate business from taxation —

if the sole activity of the corporation in Massachusetts is the solicitation by the corporation's representatives (in the name of the corporation or in the name of a prospective customer) of orders for the sale of tangible personal property, provided that the orders are sent outside Massachusetts for approval or rejection, and provided that the orders are filled by shipment or delivery by common carrier or contract carrier from a point outside of Massachusetts.¹⁶

The state's Commissioner of Revenue argued that the word "delivery," as used in Public Law No. 86-272, refers only to a transaction in which title passes from shipper to customer at a point outside the state.

The lower court rejected that tax agency's argument, finding that Congress intended to preempt regulations such as those promulgated by Massachusetts. Thus, it held that the term "delivery" in the context of Public Law No. 86-272 is not limited to out-of-state deliveries. The Massachusetts Supreme Judicial Court affirmed. It held that "the statute refers to shipment or delivery 'from' a point outside the State, not 'at' a point outside the State. The language requires only that the goods originate from out-of-State, not that the transfer of goods to the buyer occurs outside the taxing State."

The following year, the Massachusetts Department of Revenue issued a technical information release¹⁷ conforming the Commonwealth's rules to the NPTC decision. The release explained that in Massachusetts, "'delivery' is defined to include both delivery by common or contract carrier, and also delivery by use of the corporation's own vehicles."

The National Private Truck Council brought a similar challenge to a Virginia regulation, also in 1997.¹⁸ The Virginia Department of Revenue had adopted a regulation affirming the immunity from state income taxation afforded under Public Law No. 86-272 only to those instances in which the delivery of goods was accomplished by common carrier. In reviewing the law, the Virginia Supreme Court explained that Public Law No. 86-272 "does not specify common carrier, contract or private carrier, or any other particular method of delivery." It concluded that in the absence of a qualification in the federal statute, the Virginia Department of Revenue could not add conditions to or otherwise limit the protection offered by Public Law No. 86-272. Thus, the Virginia court held that the regulation violated the plain meaning of the federal statute.

The most recent version of the MTC guidelines on Public Law No. 86-272,¹⁹ adopted 2001, removed delivery by company-owned vehicles from the list of unprotected activities but did not add such delivery to the protected activities list, leaving a vacuum in which states and multistate businesses continue to duke it out in the absence of explicit federal authority.²⁰

Public Law No. 86-272 provides protection for a multistate business that ships "or" delivers goods into a state from a location outside the state. The coordinating conjunction "or" presents an alternative between "shipment" or "delivery." The term "shipment" likely refers to delivery via common carrier. The term "delivery," in contrast, has a greater scope. The question, therefore, is not whether the activity of making a delivery in a company-owned vehicle falls within the scope of the federal statute, but what other activities that relate to making that delivery are protected.

Company-Owned Reusable and Returnable Product Containers

Many products are required to be delivered in specialized durable containers, which are built to be reused and are returned to the company for reuse. Because these items, owned by the seller, frequently sit at the customer site awaiting return to their owner, states typically take the position that the use of such containers and their continuing presence in the state exceeds the protection of Public Law No. 86-272. Taxpayers disagree.

This is not a new issue. It notably was addressed by the *Oregon Supreme Court in Olympia Brewing Co. v. Department of Revenue*.²¹ In that 1973 case, a brewery sold beer to Oregon retailers in kegs. The court, adopting the Oregon Tax Court's reasoning, held that the company's ownership of the beer kegs used in dispensing draft beer subjected it to the Oregon tax. In holding for the state, the trial court stated that the presence of Olympia's kegs in Oregon were not a part of solicitation under Public Law No. 86-272, their presence in the state was not a protected activity.²² The Tax Court had explained:

Although the court recognizes that the use of the beer kegs in the delivery of beer is quite possibly an inseparable factor of the business, and the kegs move in and out of the state with some frequency, the fact of their presence and use is fatal to the plaintiff's cause, being outside the permitted activities of P.L. 86-272. . . .

The presence of the beer kegs has the same legal effect as if plaintiff loaned its vehicles for the local distribution of its product, obtaining its consideration as part of the price of the product.

Regrettably, the Oregon court focused on the wrong question. Maintaining personal property such as durable containers in a state should not be sufficient to lose protection under Public Law No. 86-272, because this activity is properly within the scope of protected delivery. In other words, keeping durable packaging that originates out-of-state and is required by retail customers to resell the goods is ancillary to the delivery of those goods.

Inventory Delivered to a Customer

Using the "ancillary to delivery" standard, there are scenarios where a multistate business would not subject itself to taxation by

keeping inventory in a state in order to further a delivery. For example, where inventory is in transit and is sitting at the customer location awaiting possession appear to be the most subject to protection as such inventory storage serves no independent business function aside from making a delivery, but for the delivery, the inventory would not be in the state. To be sure, the existence of inventory in a state should be a starting point of any discussion of whether the taxpayer is afforded Public Law No. 86-272 protection, but by itself it should not be the basis for concluding what falls outside the scope of the federal legislation.²³

In *Wrigley*, salespeople would sometimes supply their customers with a quantity of gum from inventory kept in their car. The salespeople would then issue "agency stock checks" to the retailer and send a copy of the documents to the Chicago office or the wholesaler. Ultimately the customer would be billed the proper amount for the gum either by Wrigley or by a wholesaler.

The Supreme Court held that this activity exceeded the protections of Public Law No. 86-272, as follows:

We conclude that ... the supplying of gum through "agency stock checks," and the storage of gum were not ancillary. . . .

The provision of gum through "agency stock checks" presents a somewhat more complicated question. It appears from the record that this activity occurred only in connection with the furnishing of display racks to retailers, so that it was arguably ancillary to a form of *consumer* solicitation. Section 381(a)(2) shields a manufacturer's "missionary" request that an indirect customer (such as a consumer) place an order, if a successful request would ultimately result in an order's being filled by a Section 381 "customer" of the manufacturer, *i.e.*, by the wholesaler who fills the orders of the retailer with goods shipped to the wholesaler from out of state. *Cf. Gillette, 56 A.D.2d at 482, 393 N.Y.S.2d at 191* ("Advice to retailers on the art of displaying goods to the public can hardly be more thoroughly solicitation ..."). It might seem, therefore, that setting up gum-filled display racks, like Wrigley's general advertising in Wisconsin, would be immunized by Section 381(a)(2). What destroys this analysis, however, is the fact that Wrigley *made the retailers pay for the gum*, thereby providing a business purpose for supplying the gum quite independent from the purpose of soliciting consumers. Since providing the gum was not entirely ancillary to requesting purchases, it was not within the scope of "solicitation of orders." And because the vast majority of the gum stored by Wrigley in Wisconsin was used in connection with stale gum swaps and agency stock checks, that storage (and the indirect rental of space for that storage) was in no sense ancillary to "solicitation."

Thus, the Supreme Court held that the reason this activity exceeded Public Law No. 86-272 was that Wrigley and its wholesalers required the retailers pay for the gum. The existence of the inventory held by the salesmen for the purpose of setting up gum-filled display racks was otherwise within the permitted scope of "solicitation." Given the Court's silence on the issue of the presence of inventory in the state, it is not unreasonable to construe "delivery" similar to how it construed "solicitation," thereby treating inven-

tory that is in a state in order to further a delivery as protected by Public Law No. 86-272.

Backhauling

Backhauling occurs when a company-owned vehicle carries a load on its return trip after making a delivery, rather than travelling empty. The return load typically consists of defective products, products that do not meet customer specifications, or trim and scrap from the delivery that will be recycled. It could also include goods (other than delivered products) from its customers or other entities that will be delivered to a location in the seller's state.

Backhauling offers significant benefits to the seller, and public policy considerations related to the environment, energy consumption, and infrastructure wear-and-tear favor the concept of backhauling. As such, tax policies should encourage backhauling, not discourage it by using it to subject a multistate business to taxation.

Some states, nonetheless, have subjected multistate businesses to income taxation based on their backhauling activities.²⁴ These rulings, however, have focused primarily on whether backhauling was ancillary to the solicitation of orders instead of whether it was ancillary to delivery. In a 1997 revenue ruling, for example, the Tennessee Department of Revenue found that "when company employees in company vehicles come into Tennessee and pick-up defective products or trim and scrap from customers, haul it out of Tennessee for recycling, and give the customers credit on their accounts, such activities clearly exceed solicitation of sales activities protected by Public Law 86-272." The ruling, however, did not address whether these activities exceeded the definition of making a delivery.

An advisory opinion issued in 1997 by the State of New York Commissioner of Taxation and Finance in a similar situation considered the delivery issue, but also found the activity beyond the scope of the federal legislation.²⁵ The taxpayer's backhauling activities included picking up goods (other than delivered products) from its customers or goods from other entities and delivering them to a location in the company's home state (not necessarily its facility). The ruling concluded that these activities were not protected by Public Law No. 86-272 because they were "unrelated to the delivery of [its] products" and generated four percent of the taxpayer's New York revenues.

Applying a *Wrigley*-like ancillary-to-delivery analysis supports treating certain instances of backhauling as a protected activity under Public Law No. 86-272. There are some situations, however, where backhauling could arguably become a new "independent business function," thereby no longer being ancillary to delivery (for instance, hauling goods from a location other than the point of delivery).

Conclusion

The absence of explicit federal authority on the scope of "delivery" in Public Law No. 86-272 leaves multistate businesses with a troubling uncertainty when determining their out-of-state income tax filing obligations. Many states are taking advantage of the void in federal guidance in order to assert that certain delivery-related activities performed by such corporations do not constitute a "protected activity." Properly understood, Congress intended Public Law No. 86-272 to be interpreted broadly to protect these activities from interstate taxation and that a *Wrigley*-like analysis supports the conclusion that delivery-related activities that serve no independent business func-

tion apart from their connection to the delivery of orders should be protected from state income taxation. Thus, the scope of Public Law No. 86-272 protections are far greater and provide more meaningful protection than current practice suggests.

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1. Public Law No. 86-272 applies for taxable years ending after September 15, 1959.
2. 505 U.S. 214 (1992).
3. S. Rep. No. 658 (Aug. 11, 1959).
4. 358 U.S. 450 (1959).
5. *Heublein, Inc. v. South Carolina Tax Commission*, 409 U.S. 275 (1972).
6. Special Subcommittee on State Taxation of Interstate Commerce of the House Committee on the Judiciary of the U.S. House of Representatives, *State Taxation of Interstate Commerce*, H.R. Rep. No. 1480, 88th Cong., 2d Sess. (1964) (hereafter referred to as "Willis Commission Report"); see 2 Willis Comm. Report, at 146.
7. 409 U.S. 275 (1972).
8. 505 U.S. 214 (1992).
9. The six activities that the Wisconsin Department of Revenue asserted placed Wrigley outside the scope of Public Law No. 86-272 protection were:
 - Replacing stale gum by sales representatives;
 - Supplying gum through agency stock checks;
 - Storing gum, racks, and promotional materials;
 - Renting space for storage;
 - Recruiting, training, and evaluating employees by regional managers; and
 - Intervening in credit disputes by regional managers.
10. The Court also held that even in-state activity other than "solicitation of orders" will be considered *de minimis* (and therefore protected nonetheless) unless the activity establishes a nontrivial additional connection with the taxing state.
11. The Multistate Tax Commissions (MTC) was created in 1967 as an effort by states to protect their taxing authority in the face of various proposals, including some in the Willis Commission Report, to bring uniformity to state income taxes via comprehensive federal legislation. As of August 2011, 48 states are MTC participants — 20 as Compact Members

- (which have enacted the Multistate Tax Compact into their state law), 6 as Sovereignty Members, and 22 as Associate or Project Members.
12. At least 16 states have adopted the guidelines, formally or informally, as representing their interpretation of Public Law No. 86-272 (several of these states adopted the guidelines with exceptions or additions).
13. One could also see under this framework an argument that a limited degree of installation service activity would also be protected.
14. See, e.g., Alabama Reg. 810-27-1-4-.19; Arizona Corporate Tax Ruling, CTR 99-5; Maryland Income Tax Administrative Release No. 2; Nebraska Rev. Rul. 24-01-01; *Chester A. Asher, Inc.*, 22 N.J. Tax 582 (2006); New York State Tax Commission, TSB-A-84(11)C; Ohio Corporation Franchise Tax – Nexus Standards; Oklahoma Tax Commission, Decision No. 2005-05-10-22; South Carolina Rev. Rul. No. 97-15; Texas Comptroller of Public Accts, Hearing No. 36,590.
15. 426 Mass. 324, 688 N.E. 2d 936 (1997).
16. *Id.*, citing 830 Code Mass. Regs. Sec. 63.39.1(5)(a).
17. TIR 98-13 (1998).
18. *National Private Truck Council v. Virginia*, 253 Va. 74 (1997).
19. Available at http://www.mtc.gov/uploadedFiles/Multistate_Tax_Commission/Uniformity/Uniformity_Projects/A_-_Z/StatementofInfoPublicLaw86-272.pdf. The MTC has declined to report how many states have adopted the 2001 version.
20. In the MTC guidelines on Public Law No. 86-272, which were adopted in 2001, the place of this missing unprotected activity has been reserved.
21. 266 Or. 309, 511 P.2d 837 (1973).
22. *Olympia Brewing Co. v. Department of Revenue*, 5 OTR 99, 110 (1972).
23. Two notable cases that involve inventory in a state are *John Ownbey v. Butler*, 211 Tenn. 366, 365 S.W.2d 33 (1963), and *Coors Porcelain Co. v. State*, 183 Colo. 325, 517 P.2d 838 (1973). In the first, several Tennessee companies that were not taxed by any other states apportioned their net earnings for state excise tax (net income) purposes. After they filed their tax returns, the Tennessee Revenue Commissioner informed the companies that they could not use the state apportionment formula because, under Public Law No. 86-272, their sales to states outside of Tennessee and the way in which those sales were conducted could not be taxed in interstate commerce. The Tennessee Supreme Court agreed, holding that a company cannot be taxed in other states when the company shipped goods from Tennessee to its representatives in other states and the representatives stored the goods in local warehouses until required for delivery. It is not, however, clear from the case when title transferred to the representative. Similarly, in *Coors Porcelain*, the Colorado Supreme Court considered the case of a Colorado-based company that included in its state income tax returns for 1963-1966 only the income allocable to the state. The court concluded that the company was not doing business outside of the state: "The only possible extension by Coors' out-of-state representatives beyond the solicitation of orders is the statement that 'on occasion they possessed Coors products for shipment to the customer and also retained Coors products that have been rejected by the customer by delivery.' It appears that these acts are not in common practice and are the exception rather than the rule." Thus the acts, including holding inventory for shipment, did not subject the company to out-of-state taxation.
24. See, e.g., Tennessee Department of Revenue, Rev. Ruling 97-15; *Chester A. Asher, Inc.*, 22 N.J. Tax 582 (2006).
25. New York Department of Taxation and Finance, TSB-A-97(8)(c) (1997).