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[For Businesses](#)
[For Local Officials](#)
[For Tax Professionals](#)

[Home](#) > [Businesses](#) > [Help & Resources](#) > [Legal Library](#) > [Letter Rulings](#) > [Letter Rulings - By Year\(s\)](#) > [\(2000-2004\) Rulings](#) >

Letter Ruling 00-4: Throwback Sales under G.L. c. 63, s. 38(f)

March 3, 2000

You ask for a letter ruling regarding the applicability of the Massachusetts sales throwback provisions of G.L. c. 63, § 38(f) to catalog sales generated by customers from telephone, fax, or mail orders and received by certain out-of-state sales representatives of the taxpayer, ***** (Seller"). In support of your request, you state the facts as follows.

I. FACTS

"Seller" is a Massachusetts corporation whose product line consists of office supplies, industrial shipping and packaging products, and clothing. Seller also owns land and/or buildings in Arizona, Missouri, New Hampshire, and Georgia. In addition to owning a manufacturing and administrative facility in Massachusetts, Seller owns a Massachusetts building that provides office space for marketing, sales administrative, information resource, purchasing, financing, and executive personnel. Seller also leases office space in Massachusetts and Wisconsin, and sub-leases office space to a third party in Arizona. Seller also owns a sales and customer service facility in Arizona.

Seller's marketing efforts are accomplished through the direct mailing of promotional materials advertising the Seller's products. Potential customers are contacted primarily through Seller's mail order catalogs, which are sent out from non-Massachusetts printers. Customers may place their orders via telephone, facsimile, mail or Internet. Telephone calls are primarily routed based on time of day and time zone consideration, to a call center located in either Arizona or Massachusetts and handled by the respective Telesales Departments.

Among other people, Seller's Arizona Telesales Department employs "Inbound" Telesales Representatives (herein "Inbound Representatives"), and "Outbound" Telesales Representatives. The Representatives are compensated by way of a fixed base salary plus a percentage commission. The Inbound Representatives are compensated through a fixed base salary and up to 15% of base in incentives. The Outbound Representatives are compensated through a program which provides for a 70% base and a 30% commission.^[1]

Inbound Representatives are the principal contact between customers and Seller. They consistently solicit sales of additional products from every customer who calls in to place orders or request information. This solicitation is accomplished in a variety of ways, including identifying products that complement those customarily ordered by a particular customer, or through apprising customers of current promotions, discounts or other purchase incentives. "Inbound" Representatives also answer product-related questions as a means to sell additional products or to convert customer inquiries to sales orders. They have discretionary authority to offer volume discounts to customers, including

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discounts, that have already expired. Inbound Representatives also have discretionary authority to allow additional product discounts beyond the standard generally allowed in order to secure or maintain a customer relationship. Pursuant to their job descriptions and compensation arrangements, Inbound Representatives are expected to increase sales over and above the orders originally requested by customers through various solicitation activities.

II. ISSUE

Assuming Seller is not subject to tax in the state of the purchaser, are Seller's catalog sales subject to the Massachusetts sales throwback provisions of G.L. c. 63, § 38(f) when customers, who have received mail-order catalogs call, fax or write in orders to Inbound Representatives in Seller's Arizona sales office?

III. RULING

For reasons discussed below, we conclude that catalog sales generated from customer-initiated contact by telephone, fax, or mail orders, to the Arizona Inbound Representatives are not subject to the Massachusetts sales throwback provisions of G.L. c. 63, § 38(f).

IV. DISCUSSION

The allocation and apportionment of income of domestic corporations (and foreign corporations having income that is taxable within and outside Massachusetts) is governed by G.L. c. 63, § 38(b)-(g). Seller does not allocate the whole of its taxable income to Massachusetts, since it has income from business activity taxable in another state. See G.L. c. 63, § 38(b).^[2]

The taxable net income of a corporation which has income from business activity taxable both within and without Massachusetts, must be apportioned to Massachusetts by "multiplying the taxable net income, as determined under § 38(a), by a fraction, the numerator of which is the property factor plus the payroll factor plus two times the sales factor, and the denominator of which is four." See G.L. c. 63, § 38(c). The property and payroll factors are not at issue in this ruling request.

a. Sales Factor

Massachusetts General Laws, Ch. 63, § 38(f), and the Department of Revenue's Apportionment of Income regulation promulgated pursuant to this provision, 830 CMR 63.38.1, contain the Massachusetts sales factor^[3] apportionment rules. Under G.L. c. 63, § 38(f), the sales factor is a fraction, the numerator of which is the total sales of the corporation in Massachusetts during the taxable year, and the denominator of which is the total sales of the corporation everywhere during the taxable year.

The Apportionment of Income regulation provides that for purposes of the sales factor, there are two rules for determining whether a sale of tangible personal property is in Massachusetts: the primary ("destination") rule and the secondary ("throwback") rule. Under the primary (destination) rule, a sale is in Massachusetts if the property is delivered or shipped to a purchaser, including the U.S. government, who takes possession in Massachusetts, regardless of the F.O.B. point or other conditions of sale. See 830 CMR 63.38.1(9)(c).

Under the secondary (throwback) rule, a sale is in Massachusetts if the seller is not taxable in the state where the property sold is delivered to the purchaser, and the property is not sold by an agent of the seller who is chiefly situated at, connected with, or sent out from the Seller's owned or rented business premises outside of Massachusetts. *Id.* If tangible personal property is delivered or shipped to a purchaser outside of Massachusetts, the taxpayer has the burden of proving either that the taxpayer is taxable in the state of the purchaser or that the tangible personal property was sold by an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented premises outside of Massachusetts. 830 CMR 63.38.1(9)(c)2.a. In other words, assuming that Seller is not taxable in the state where the property sold is delivered to a purchaser, sales are apportioned to Massachusetts unless they are sold by an agent who is clearly identifiable

with a corporate sales office in another state. See *State Tax Commissioner v. John H. Breck*, 336 Mass. 277, 285 (1957); See also *Commissioner of Corporations and Taxation v. Ford Motor Co.*, 308 Mass. 558; 556 (1941) (predecessor statute).

In order to determine whether property was sold by an agent who is chiefly situated at, connected with, or sent out from business premises outside of Massachusetts a three-fold inquiry is necessary: (1) is the seller's employee who responds to customer telephone calls an "agent" of the seller, (2) did the agent actually "sell" the property, and (3) is the agent chiefly situated at, connected with or sent out from a location outside of Massachusetts?

1. Arizona Inbound Representatives are "agents" of Seller

According to the Apportionment of Income Regulation, 830 CMR 63.38.1, an "agent" is generally defined as any taxpayer employee or other representative acting under the direction and control of the taxpayer. However, bona fide independent contractors retained by the taxpayer are not agents of the taxpayer. 830 CMR 63.38.1(2). Here, the persons responsible for telephone sales are employees of Seller who are on Seller's payroll, and are under the full direction and control of Seller's management in Arizona. Based on the facts as you state them, we conclude that Seller's Inbound Representatives are "agents" of the corporation.

2. Arizona Inbound Representatives actually "sold" the property ordered by customers

The second prong of the analysis requires a determination as to whether the agents actually "sold" the property ordered by customers through Seller's catalogs. The rules for making this determination are set forth in Section 9 (c) 2.c.ii of the regulation. The taxpayer has the burden of proving who sold the property. With respect to catalogue sales, this section provides as follows:

A taxpayer's catalogue sales made when a customer, who has received mail-order solicitations from the taxpayer telephones or sends a written order to a Massachusetts location of the taxpayer are not sales made by an agent from premises outside Massachusetts.

Id.

Neither this provision nor any other provisions of the regulation specifically address the sourcing of catalogue sales made when a customer telephones or sends a written order to a location of the taxpayer outside of Massachusetts. The above provision implies, however, that since catalogue sales made as a result of customer-initiated contact with a Massachusetts location of a taxpayer are not sales made by an agent from premises outside Massachusetts, a catalogue sale may be sourced to the location where the order is received. This interpretation is especially plausible in situations such as this one, where there is no sales activity whatsoever in Massachusetts with respect to catalogue orders placed to Arizona's call center.

It is equally true under this provision that in order for property to be "sold" by the Arizona Inbound Representatives, any "sales" resulting from customer-initiated calls to Arizona must be the result of activity that goes beyond mere clerical approval, acceptance, or processing of the order. You assert that the Inbound Representatives actually negotiate and effect the telephone sales of Seller's products. In support of this assertion, you indicate that they not only are the principal contact with customers in terms of *receiving* telephone orders, but also that they actively *solicit* orders by 1) encouraging callers to upgrade orders either in terms of quality or quantity, and 2) negotiating the terms of sale via discounts and incentives. You further emphasize that the "base plus commission" compensation arrangement, and the sales incentive plan, indicate that the Arizona Inbound Representatives are not merely encouraged, but are expected to meet sales goals. This assertion is further substantiated by the official job descriptions for the Inbound Representatives, which include sales solicitation activities as being a significant part of the employees' duties and responsibilities. Such salary plus commission arrangements are indicative of the emphasis placed by Seller upon the sales promotion activity of its Arizona-based Inbound Representatives.

Here, we note that some customer orders were the direct result of increased sales efforts of the Inbound Representatives following the initial call. Other customer-initiated orders appear to have been merely clerically approved, accepted, or processed by the Inbound Representatives. In both cases, however, the duties and expectations regarding the sales activities of the Inbound Representatives are identical. Since all of the activity creating the sales, whether the result of mere order-taking or additional sales-inducing tactics, occurs entirely outside Massachusetts, we conclude that the Arizona Inbound Representatives "sold" the property ordered by customers through the Arizona call center.

3. Chiefly Situated Outside Massachusetts

The third prong of the analysis examines whether the agent selling the property is "chiefly situated at, connected with or sent out from premises for the transaction of business owned or rented by the corporation outside [Massachusetts]." M.G.L. c. 63, § 38(f). Where a taxpayer is not taxable in the state of the purchaser, sales that are not the direct result of the efforts of an agent of the taxpayer who is chiefly situated at, connected with, or sent out from the taxpayer's owned or rented business premises outside of Massachusetts are sales in Massachusetts. 830 CMR 63.38.1(9)(c)2.c. For purposes of the sales factor, the Apportionment of Income Regulation requires that

owned or rented premises for the transaction of business (business premises) is the [corporation's] owned or rented sales office that the selling agent customarily uses to receive instructions, directions, or supervision from the [corporation], or communications from customers. . . or to perform any other function necessary to the selling of the [corporation's] tangible personal property. An agent is chiefly situated at a business premises if he or she spends at least fifty percent (50%) of his or her time at such business premises.

830 CMR 63.38.1(9)(c)2.c.iii.

Seller's Arizona Inbound Representatives spend one hundred percent (100%) of their time in the Arizona office and receive all instructions from department heads also located in those offices. Hence, the Arizona Inbound Representatives are "chiefly situated at, connected with, or sent out from Seller's owned or rented business premises outside of Massachusetts."

IV. CONCLUSION

Based upon the foregoing facts and discussion of law, we conclude that those catalog sales generated from telephone, fax or mail orders and received by Seller's Arizona Inbound Representatives are not subject to the Massachusetts throwback provisions of M.G.L. c. 63, § 38(f).

Very truly yours,

/s/Frederick A. Laskey

Frederick A. Laskey
Commissioner of Revenue

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[1] Outbound Representatives solicit the sale of products through direct calls to potential customers.

These outbound calls, which currently account for approximately 5% to 10% of Sellers' total customer sales, are not at issue in this ruling. You indicate that it is undisputed that Seller's activities fall outside the scope of Public Law 86-272, 15 U.S.C. 381-385, which offers protection from a state's taxing authority when the sole activity of a corporation in such state is the mere solicitation of orders for the sale of tangible personal property.

[2] For purposes of section 38(b), a corporation is taxable in another state if (1) in that state such corporation is subject to a net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax, or (2) that state has jurisdiction to subject such corporation to a net income tax regardless of whether, in fact, the state does or does not. See *Amray, Inc. v. Commissioner of Revenue*, A.T.B. Docket No. 119875 (1986). The United States Supreme Court has held that a state has jurisdiction to tax a corporation when such corporation has employees providing customer service activities within its boundaries. See *Standard Pressed Steel Co. v. Washington*, 419 U.S. 560 (1975); *General Motors Corp. v. Washington*, 377 U.S. 436 (1984).

[3] As the Massachusetts Appellate Tax Board has noted, the sales factor recognizes that the state providing a market for the products of another state is entitled to revenue from income that it has helped to produce; but if the market state provides no benefits that it has jurisdiction to tax, it is proper to attribute the production of income entirely to the state of manufacture under the second condition stated in footnote 2, above. See, *Amray, supra*.