STATE OF ALASKA
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OFFICE OF TAX APPEALS
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STATE OF ALASKA

IN THE MATTER OF:	Case No. 35-OTA-2000
WESTWARD SEAFOODS, INC. Corporate Income Tax 1994 & 1995	DECISION

Introduction/Procedural Background

The issue in this case is whether the taxpayer, Westward Seafoods, Inc., ("WSI"), established a taxable nexus in Japan in 1994 and 1995. If WSI was taxable in Japan in 1994 and 1995 then its sales to Japan should not be "thrown back" to Alaska for purposes of calculating WSI's apportionment factors.

WSI contends that the activities of certain of its employees who traveled to Japan in 1994 and 1995 established a taxable nexus with Japan so that that all seafood sales that were shipped from Alaska to Japan should be excluded from the numerator of the sales factor in determining the portion of WSI's income that is apportioned to Alaska. The Department of Revenue ("DOR") contends that the activities in Japan did not exceed solicitation of sales under P.L. 86-272 and therefore WSI did not have a taxable nexus with Japan in 1994 and 1995.

WSI filed this appeal with the Office of Tax Appeals on June 16, 2000. At the outset DOR challenged the timeliness of the appeal. That issue became moot when WSI paid the disputed tax and DOR agreed that the appeal would proceed as a timely appeal by WSI of DOR's denial of its refund claim.

An evidentiary hearing was held in Juneau on April 10, 2001. WSI was represented by Garry Fujita of the Seattle law firm Davis, Wright, Tremaine. WSI presented testimony from two WSI officials. President F. Gregory Baker testified in person. Inao Kuramoto, Vice President of Sales, Marketing and Administration, testified by telephone from Seattle through an interpreter. Tim Cottongim, Appeals Officer, represented DOR. Extensive documents, including affidavits, were admitted as evidence at the hearing.

The record remained open after the hearing for evidentiary motions and submission of post-hearing briefs. For many months after the hearing counsel for WSI and DOR attempted to resolve DOR's objections to certain statements presented by WSI witnesses at the hearing. Those efforts failed because WSI was unable to compel unwilling third-party witnesses in Japan to appear for cross-examination by DOR.

On October 8, 2002, DOR filed a motion to exclude from the record two witness statements from Japanese executives of companies that purchased WSI seafood products. Both contested exhibits describe meetings in Japan between a WSI representative and Japanese customers regarding concerns about the quality of WSI products. On October 22, 2002 DOR filed a motion to supplement the record with four exhibits.

On November 21, 2002 the ALJ issued an order denying DOR's motion to exclude the two taxpayer exhibits and granting DOR's motion to supplement.

On May 23, 2003 the ALJ ordered supplemental briefing on two questions: (1) If WSI is unitary with Maruha, as DOR argued in its post-hearing brief, what is the impact on the nexus issue?; and (2) If Japan had a corporate income tax in 1994 and 1995 and WSI was not taxable in Japan, what is the impact on nexus? Supplemental briefing concluded on July 21, 2003 when DOR filed its reply.

Facts

WSI was incorporated in Alaska in 1989. WSI is 100% owned by Maruha Corporation, the largest Japanese seafood company. WSI operates a fish processing plant at Unalaska. Its headquarters and sales offices are in Seattle.

WSI's principal product is surimi, a paste-like product processed from pollack. WSI makes domestic and export sales at the first wholesale level.

Maruha is a direct importer of seafood products (mainly surimi) from WSI and other companies. The sole written sales agreement between WSI and Maruha is a 1991 Purchase and Sale Agreement for Pollock Surimi between WSI and Maruha's predecessor, Taiyo. In 1994-1995 WSI sold 50 to 70% of its total product to Maruha. After WSI ships surimi to Maruha in Japan, Maruha places it in cold storage and then distributes the surimi to end-users/customers who re-process the surimi into end products like artificial crab.

For re-processing surimi, its quality, especially its jell-strength, whiteness and moisture content, is of paramount importance. Producing surimi with certain qualities requires expertise. WSI employs surimi production technicians with years of training and experience to decide what grade of surimi to produce from each load of pollock and to process the fish into different specific grades. Although some of WSI's competitors no longer use surimi technicians, the technicians are an important part of WSI's business strategy of marketing special grades of surimi.

The 12-13 surimi technicians that WSI employed during 1994-1995 came from Japan. Maruha trained and supplied the technicians under a long term Technical Assistance Agreement with WSI. WSI pays the salaries and all taxes for the technicians, as well as for its officers who traveled to Japan, including state and federal payroll taxes and the Japanese form of Social Security, which WSI pays to Maruha which then pays the Japanese government.

Inao Kuramoto was the Vice President of Sales, Marketing and Adminstration for WSI in 1994 and 1995. He worked in the Seattle office. During this time period Mr. Kuramoto was WSI's only sales person. He did not have a written employment contract with WSI. Maruha's predecessor, Taiyo, applied in 1990 for the E2 visa which authorized Kuramoto, a Japanese citizen, to work for WSI in Seattle for a five-year term. Kuramoto's visa was renewed in 1994 for another five years.

In 1994 and 1995 Mr. Kuramoto made seven trips to Japan. Mr. Nozawa, another WSI offical, accompanied Kuramoto on three of those trips. The purpose in making these trips was to work with the end users of WSI surimi prior to each pollock fishing season to make decisions regarding surimi sales price ranges, quantity, grade and grade mix. On his trips to Japan, Mr. Kuramoto would frequently meet with Maruha's customers, the end-users, for the purpose of negotiating the sale of WSI surimi to be produced during the next harvest season. Mr. Kuramoto had the authority, and exercised the authority, to accept terms and conditions and conclude agreements with these customers. WSI paid Mr. Kuramoto's travel expenses for his trips to Japan.

During his trips to Japan Mr. Kuramoto often met with Maruha customers at their request to discuss custom grades that the customer wanted. At these meetings the customer would typically specify the grade or mix that they wanted and Kuramoto would then negotiate over grade, quantity and price for WSI to produce the product that met the customer's specifications. Mr. Kuramoto considers this part of the production function as well as a sales function. He also considered Maruha's customers, the end-users, to be WSI customers.

In 1995 WSI sent Mr. Goodfellow, WSI Plant Manager, and Mr. Suzuki, WSI Deputy Plant Manager, to Japan to meet with four companies that had previously purchased WSI crab from Maruha and had complaints about the crab quality. Goodfellow and Suzuki discussed the complaints with the customers and negotiated changes in WSI's crab processing to address the customers' concerns/complaints.

Maruha does not approve WSI sales or orders. Maruha does not have any day to day involvement in WSI's operations. Maruha officials never travel to Seattle or Alaska to oversee operations. WSI provides quarterly financial statements to Maruha but that is the only regular reporting to the parent on WSI business.

Analysis

DOR and Westward agree that the issue is whether WSI employees engaged in activities in Japan that exceeded the tax protection of Public Law 86-272.

Public Law 86-272, enacted by Congress in 1959, restricts the power of states to tax interstate business. Public law 86-272 precludes a state from imposing an income tax on a taxpayer whose sole activity in the state consists of the solicitation of orders for sales of tangible personal property, where such orders are accepted in another state and filled from a supply of goods outside the state. Where sales are made into a state which is precluded by P.L. 86-272 from taxing the seller, such sales are "thrown back' to the state of origin which does have jurisdiction to tax the income derived from the sales.

The Alaska Multistate Tax statutes make clear that the question of whether WSI's sales that were shipped to Japan in 1994 and 1995 should be "thrown back" to Alaska, i.e. counted as Alaska sales for the purpose of apportioning income to Alaska, turns on whether WSI's activities in Japan exceeded P.L. 86-272 and made WSI taxable by Japan. AS 43.19.010 (Article IV, section 16 of the Multistate Tax Compact) provides that sales will be allocated to Alaska if the property sold is shipped from Alaska and the taxpayer is not taxable in the state of the purchaser. Article IV, Section 3 provides that a taxpayer will be taxable in the destination state if the taxpayer is subject to a net income tax in that state *or* that state has jurisdiction to subject the taxpayer to a net income tax regardless of whether, in fact, the state does or does not tax the taxpayer.

15 AAC 19.121 further defines when a foreign country (or state) has jurisdiction to tax sales from Alaska into that country. The regulation reads as follows:

> The second test, that of the state having jurisdiction to subject the Taxpayer to a net income tax regardless of whether, in fact, the state does or does not, applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 USCA Sections 381-385. In the case of any "state as defined in AS 43.19.010, Article IV.1(h), other than a state of the United State or political subdivision of such a state, the determination of whether that "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that "state". If jurisdiction is otherwise present, the "state" is not considered as without jurisdiction by reason of the Provisions of a treaty between the state and the United States.

This Alaska tax regulation makes clear that in determining whether a foreign country has jurisdiction to tax, the foreign country is treated like another state and the same jurisdictional

standards apply, including P.L. 86-272. In addition, this regulation specifically provides that if a foreign country has jurisdiction to impose an income tax but does not actually impose the tax because of a treaty with the United States, the treaty restriction is not considered as depriving the foreign country of jurisdiction to tax.

In this case, it is undisputed that WSI did not in fact pay Japanese income taxes because it was protected from tax by treaty. Japan has a corporate income tax but WSI did not file returns in 1994 or 1995 because Japan has agreed by treaty with the United States not to tax U.S. corporations that do not have a permanent establishment, or fixed place of business, in Japan.[1] Although WSI was not *in fact* subject to income tax in Japan, DOR is precluded by its own regulation from taxing WSI's Japan sales if Japan *theoretically had jurisdiction to tax WSI.* And the jurisdiction issue turns on whether the activities of WSI's employees in Japan exceeded solicitation protected under P.L. 86-272.

P.L. 86-272 protects "solicitation" but does not define that term. However, in *Wisconsin Dept. of Revenue v. William Wrigley, Jr. Co.,* 505 U.S. 214 (1992) the United States Supreme Court addressed the meaning of "solicitation" and whether there is a de minimus exception under P.L. 86-272. The Court held that "solicitation of orders" covers more than what is strictly essential to making requests for purchases; the statutory term covers 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..." *Id.* At 228-229. The Court applied this standard to the facts of the case and concluded that providing a car and free samples to salesmen was solicitation because the only reason to do it was to facilitate orders. On the other hand, employing salesmen to repair and service Wrigley's products went beyond solicitation. Id. At 229-230. The Court also recognized a de minimus exception, stating that minor non-solicitation activities that were not regular and continuous would not cost the company its tax protection under P.L. 86-272.

After the *Wrigley* decision the Multistate Tax Commission issued an official statement which identified protected and unprotected activities under P.L. 86-272. The list of unprotected activities (activities that are not ancillary to solicitation) includes several that are at issue in this case: approving or accepting orders; investigating, handling or otherwise assisting in resolving customer complaints, other than mediating direct customer complaints for the sole purpose of ingratiating the sales personnel with the customer; and hiring, training or supervising personnel.

DOR contends that WSI has failed to prove[2] that the activities performed by WSI employees in Japan exceeded solicitation of sales under P.L. 86-272. More specifically, DOR contends that WSI employees: 1) did not accept or approve orders on behalf of WSI while in Japan, 2) did not resolve customer complaints in Japan, and 3) did not perform any other activities beyond those protected from taxation under P.L. 86-272. The lynch-pin of the Department's position is that the WSI officials that traveled to Japan and met with Maruha's customers in 1994 and 1995 wore

[1] Article 8 of the Convention Between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, entered in 1972.

[2] The taxpayer, WSI, has the burden of proving by a preponderance of the evidence the facts establishing taxable nexus in Japan.

two hats. DOR argues that the WSI officials were temporary WSI employees but they remained on the Maruha payroll during their assignment to WSI and were actually acting on behalf of Maruha in meeting with Maruha's customers.

Both DOR and WSI focus their arguments on the activities of Mr. Kuramoto. DOR readily concedes that if Mr. Kuramoto had negotiated and approved sales terms on behalf of WSI in Japan with Maruha, WSI's direct customer, Mr. Kuramoto's actions would have exceeded the protections of P.L. 86-272 and would have established taxable nexus for WSI in Japan. (DOR Supplemental Memorandum, p. 5) But DOR argues that Mr. Kuramoto was actually acting for Maruha, not WSI, when he negotiated and approved sales terms in Japan. DOR argues that the following facts show Kuramoto was actually acting as an agent of Maruha: Mr. Kuramoto met with Maruha's customers; Maruha gave him unique authority to negotiate and approve sales terms with Maruha customers; Maruha continued to pay Japanese social security for Mr. Kuramoto while he was working for WSI; and Maruha had a "unitary relationship" with WSI.

WSI contends that DOR mischaracterizes the evidence in arguing that Mr. Kuramoto was an agent of Maruha. WSI contends that the evidentiary record shows that Mr. Kuramoto represented WSI, not Maruha when he traveled to Japan. I agree. I find that that Mr. Kuramoto was acting for WSI, and not for Maruha, when he negotiated sale terms and accepted orders in Japan and that this activity exceeds solicitation.

Mr. Kuramoto was a highly credible witness and according to his testimony he was employed by WSI, not Maruha in 1994-1995. Mr. Kuramoto lived in the Seattle area and worked in WSI's Seattle office for ten years starting in 1990. Employment for that length of time is not temporary, although the visas he was working under described his position with WSI as "temporary". In addition, according to the credible testimony of Gregory Baker, WSI President, WSI, not Maruha, paid Mr. Kuramoto's salary. According to Baker, no WSI officers or employees were on the Maruha payroll although Maruha directly paid the Japanese government for the social security taxes for Kuramoto and the surimi technicians.

Mr. Kuramoto traveled to Japan for business seven times during 1994-1995 and WSI, not Maruha, paid his travel expenses for these trips. On these trips, Mr. Kuramoto met directly with Maruha's customers, accompanied by Maruha representatives, when the customers requested specific grades or recipes because WSI produced the surimi and the requests for specific grades/recipes raised production issues. Discussing recipes and negotiating specific grades with the customers helped to sell WSI surimi but also served an independent business purpose of planning for production.

Although the customers purchased WSI surimi from Maruha instead of producer WSI, Mr. Kuramoto reasonably considers those Maruha customers to be WSI customers given the fact that Maruha was simply the middleman-distributor. The prices that Mr. Kuramoto negotiated with the customers/end-users for WSI to produce certain grades or quality of surimi, established the prices that Maruha would pay WSI. As Mr. Kuramoto explained it, the prices he negotiated with Maruha customers on behalf of WSI were "indirectly paid" to Maruha.

Mr. Kuramoto's negotiation and acceptance of sale terms for WSI's surimi sales in Japan is sufficient non-solicitation activity to establish a taxable nexus for WSI in Japan on its own. But in this case there is additional evidence of activity that is unprotected under P.L. 86-272. There is reliable evidence that WSI production managers were sent to Japan to investigate and resolve customer complaints about the quality of WSI crab. Mr. Goodman and Mr. Suzuki were production managers whose purpose in meeting with Japanese customers was not to solicit sales but to address serious customer concerns about the quality of WSI production. Although only one meeting in Japan to investigate and resolve customer complaints is well documented for the two years at issue, that meeting cannot be dismissed as de minimus activity, given the context of WSI's business strategy of marketing its seafood products to Japanese customers.

Finally, WSI's Technical Assistance Agreement with Maruha is additional evidence that WSI engaged in activity exceeding solicitation in 1994 and 1995. WSI contracted with Maruha to have Maruha recruit and train in Japan the surimi technicians that supervise WSI's surimi production. The surimi technicians are important to WSI's production and marketing strategy and it is significant for nexus purposes that the technicians were recruited and trained in Japan for WSI.

DOR does an excellent job, given the difficult facts and its own unhelpful regulation[3], in arguing that the activities of WSI employees in Japan were insufficient to establish taxable nexus for WSI. However, based on the findings and reasons discussed above, I conclude that WSI has proven, by a preponderance of the evidence, facts that establish taxable nexus with Japan in the tax years at issue.

Conclusion

Having proven taxable nexus in Japan for the tax years at issue, WSI is entitled to a refund of the disputed corporate income taxes attributable to throwing the Japan sales back to Alaska, plus interest.

This is the final decision of the Administrative Law Judge under AS 43.05.465. Due to the fact that the current term of the undersigned ALJ ends before the time for filing motions to reconsider and no new appointment will be made in the near future, the Department may not request

[3] 15 AAC 19.121 provides that the jurisdiction of a foreign country to tax sales into that country is determined under U.S. jurisdictional standards and P.L. 86-272 and that treaty restrictions on taxing such sales are deemed not to impact the jurisdictional analysis. The policy of treating a foreign country just like a state, and ignoring treaty restrictions, is troubling because in this case it results in prohibiting Alaska from taxing the income from WSI's sales to Japanese customers despite the fact that Japan doesn't tax that income either—the income from WSI's sales to Japan is "nowhere income" for income tax purposes.

reconsideration of this decision.[4] Pursuant to AS 43.05.465 (f) this decision becomes final for purposes of seeking judicial review sixty days from the date of service.

Dated: January 6, 2004.

[redacted]
Administrative Law Judge

CERTIFICATE OF SERVICE

I certify that on Jan. 6, 2004 a true and correct copy of the Decision was sent by first class mail, or inter-departmental mail, to:

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[redacted]
Office of Tax Appeals

[4] Foregoing a request for reconsideration should not be objectionable to the Department given the fact that in recent years the Department has consistently filed for judicial review without seeking reconsideration of decisions in which the taxpayer prevailed.