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An Insider's View of the MTC's P.L. 86-272 Project

by Brian Hamer

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In this installment of Revenue Matters, Hamer reviews the MTC's revisions to its statement of information regarding P.L. 86-272 and reactions to its proposal.

For more than a year, I worked with representatives from a dozen states on a Multistate Tax Commission project to update the commission's statement of information concerning P.L. 86-272.[1] To my initial surprise, this project has attracted the attention of many practitioners, tax administrators, and academics — who have tendered public input and off-the-record comments, published commentaries, and participated on numerous panels addressing issues relating to the project. What has become clear is that many businesses still look to P.L. 86-272 to provide immunity from state income tax obligations and that at least a subset of tax professionals find the issues raised by the project inherently interesting. There certainly is much to ponder.

P.L. 86-272, a federal statute enacted in 1959 to limit state taxing authority, cannot be elegantly summarized.[2] It provides in key part that "no state or political subdivision thereof" may impose a net income tax "on 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 . . . are the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property that are sent outside the state for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the State. . . ." The statute also provides that independent contractors making sales, or soliciting orders for sales, of tangible personal property "on behalf of" a person will not defeat that person's immunity from tax.

As I will discuss in this article, key elements of the statute are unclear, which has resulted in many legal disputes over the years. To address the resulting uncertainty and provide guidance to taxpayers, the commission in 1986 issued the original version of the statement of information. The statement described how signatory states interpret the statute and how they would apply it to various business activities. In Article IV, the statement listed (1) those in-state activities that are protected by P.L. 86-272, meaning that their exercise by a business would not subject the business to taxation by states where its

[1] The statement's full title is "Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272."

[2] The statute, officially titled "AN ACT Relating to the power of the States to impose net income taxes on income derived from interstate commerce, and authorizing studies by congressional committees of matters pertaining thereto," is codified at 15 U.S.C. sections 381-384.

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customers are located; and (2) various in-state activities that are not protected by P.L. 86-272. Since 1986 the commission has revised the statement three times, most recently in 2001, as new issues arose and case law continued to develop.[3]

In the fall of 2018, the MTC's Uniformity Committee initiated the current project and created a work group consisting of state representatives. The committee asked the work group to consider how P.L. 86-272 — now more than six decades old — applies to modern business activities, most notably those business activities conducted via the internet, and to recommend appropriate revisions to the statement. From February 2019 to February 2020, the work group met 23 times. During those public meetings, work group members discussed the pros and cons of various analytical approaches, considered the taxability of numerous business activities, and debated specific language changes to the statement. This was no easy task, given the fact that many now common business activities (at least in their current form) were never contemplated by the statute's drafters. The work group achieved a high degree of consensus, however, and last spring submitted a revision of the statement to the Uniformity Committee for the committee's consideration.[4]

The Uniformity Committee approved the proposed revision. Professor and former law school Dean Robert J. Desiderio then conducted a public hearing on the proposal and issued a report that recommended no substantive changes. The MTC's Executive Committee, after considering the hearing officer's report, approved the proposal for consideration by the commission, which is expected to occur following a survey of compact and sovereignty member states.

History Leading to the Proposed Revision of the Statement

Congress enacted P.L. 86-272 in response to a series of momentous court decisions that addressed the extent to which the U.S. Constitution permits states to tax interstate commerce. When these decisions were handed down, the U.S. Supreme Court was in the process of revising its view of state taxing jurisdiction, moving from a formalistic set of principles to the modern view that would eventually be encapsulated in a landmark tax case, *Complete Auto Transit Inc. v. Brady*.[5]

The first decision, issued by the Court on February 24, 1959, was *Northwestern States Portland Cement Co. v. Minnesota*,[6] which considered two consolidated cases. In the first case, Minnesota assessed tax on an Iowa manufacturer that sold cement to customers in Minnesota. All orders were approved in Iowa and shipped from the company's plant there. The business employed four salespersons and a secretary in Minnesota and leased a small office there. In the second case, Georgia assessed tax on a Delaware corporation that sold valves and pipe fittings to wholesalers and jobbers in Georgia. The company's principal office and plant were in Birmingham, Alabama. Orders were approved in — and shipped from — Birmingham. The company employed one salesperson and a secretary in Georgia and maintained a small office in Atlanta for their use.

The Court began its opinion by characterizing the question before it: whether a state may tax net income earned from "*business activities within the taxing State* when those activities are exclusively in furtherance of interstate commerce."[7] Noting that, in both cases, the income subject to tax was fairly apportioned (based on the company's activities in the taxing state), the Court explained that it was appropriate under both the due process and commerce clauses for each state to impose tax, regardless of the fact that the activities were in interstate commerce: "It is axiomatic that the

[3]The current version of the statement is posted on the MTC's website.

[4]*See* MTC, P.L. 86-272 Statement of Information Project ("project's webpage").

[5]430 U.S. 274 (1977).

[6]358 U.S. 450 (1959).

[7]*Id.* at 452 (emphasis added).

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founders did not intend to immunize such commerce from carrying its fair share of the costs of the state government in return for the benefits it derives from within the State," the Court explained.[8]

Just before the *Northwestern States* ruling, the Louisiana Supreme Court reviewed two cases involving similar issues. In *Brown-Forman Distillers Corp. v. Collector of Revenue*, Louisiana assessed income tax on a Kentucky whiskey distiller "engaged entirely in interstate commerce." The company employed "missionary men" who called on wholesale dealers and occasionally accompanied wholesalers' sales staff when they visited retailers in Louisiana. All orders received by the missionary men were approved in and shipped from Kentucky. Unlike the companies in *Northwestern States*, the distiller did not maintain an in-state office (and did not have a warehouse or any inventory) in Louisiana.[9] In *International Shoe Co. v. Fontenot*, Louisiana assessed tax on a shoe manufacturer that was incorporated in Delaware and that, according to the court, operated its offices, warehouses, "and all of its business outside of the State of Louisiana." The company's only Louisiana activity consisted of the solicitation of orders by 15 salespersons.[10]

In both cases, the Louisiana court rejected the taxpayer's claim that imposing tax on the out-of-state seller violated the Constitution. Then, just seven days after issuing its opinion in *Northwestern States*, the U.S. Supreme Court declined to hear an appeal of the *Brown-Forman Distillery* case. Two months later, the Court denied certiorari in *International Shoe Co.*

The business community reacted quickly and vigorously to *Northwestern States* and the Supreme Court's decision not to review the Louisiana cases, calling upon Congress to impose restrictions on state taxing authority. They argued that a bright-line rule was needed to avoid uncertainty about the amount of activities necessary to establish nexus. They also pointed to the compliance burdens faced by businesses that sold products into multiple states, particularly the burden on small and medium-size businesses. And they complained that tax codes around the country used different definitions and rules, resulting in excessive complexity and the possibility of multiple taxation.[11]

Disregarding the plea of the National Association of Tax Administrators to avoid hasty action, Congress moved quickly.[12] Before the end of July 1959, both the Senate Small Business Committee and the Senate Finance Committee held hearings.[13] Less than 20 days after concluding its hearings, the Finance Committee reported out a bill. The bill (S. 2524) was promptly approved by the full Senate, slightly modified in conference committee, and passed by both chambers. It was signed by President Dwight D. Eisenhower on September 14, 1959 — less than seven months after *Northwestern States* was issued.

Determining intent from legislative history is often not an easy task. But what is clear from the floor debates and legislative reports leading to the passage of P.L. 86-272 (as well as the language of the statute itself) is that, in the wake of *Northwestern States*, Congress sought to ensure that solicitation of orders alone would not cause a business selling into a state to become subject to the state's income tax. The Senate Finance Committee report accompanying S. 2524 expressed that *Northwestern States* "has created considerable concern and uncertainty" within the business community, and that the committee itself was concerned that:

> businesses, particularly small- and medium-sized businesses, may be hesitant to develop new markets in some States by extending their solicitation

[8] *Id.* at 461-462.

[9] 101 So. 2d 70 (La. 1958), *appeal dismissed and cert. denied*, 359 U.S. 28 (1959).

[10] 107 So. 2d 640 (La. 1958), *cert. denied*, 359 U.S. 984 (1959).

[11] It is striking how these arguments closely mirror the ones later made by supporters of the sales and use tax physical presence rule established by the Supreme Court in *National Bellas Hess Inc. v. Department of Revenue*, 386 U.S. 753 (1967), then rejected by the Court in *South Dakota v. Wayfair Inc.*, 585 U.S. ___, 138 S. Ct. 2080 (2018).

[12] *See* Note, 46 *Va. L. Rev.* 297, 305 (1960) (describing the National Association of Tax Administrators' action). A resolution directed to Congress was passed unanimously by state tax officials meeting in Buffalo, New York.

[13] According to Robert Roland, the collector of revenue for Louisiana, while dozens of business representatives testified before the Finance Committee, only two states were allowed to do so. Robert Roland, "Public Law 86-272: Regulation or Raid," 46 *Va. L. Rev.* 1172 (1960).

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> activities to such States . . . should *mere solicitation of orders* be regarded as a local activity, forming sufficient 'nexus' with the State. . . .[14]

A House Judiciary Committee report made a similar point:

> Although it may be argued that the Supreme Court has not yet decisively disposed of the precise question of whether solicitation alone is a sufficient activity for the imposition of a State income tax upon an out-of-state business, the very fact that this question is unresolved is perhaps the strongest argument for Congress to act at this time. Businessmen should not be forced to guess about their tax liability.[15]

This focus on solicitation was neatly summarized by Rep. William Miller, one of the House-Senate conferees who advocated for the conference bill on the floor of the House. He said that the bill "is very narrow, indeed. It covers only the single and simple area where a corporation does nothing more within a State than solicit orders."[16]

Putting the statute's policy issues aside, P.L. 86-272 contained at least two serious flaws, perhaps because of the speed at which it was birthed.

First, key terms were not defined. The failure to define "solicitation" is particularly troubling, given the central role that the term plays in the statute and the word's inherent ambiguity, a problem that the Supreme Court eventually addressed but did not fully resolve.[17] The failure to define the phrase "business activities within such State" raises questions that were at the very center of the work group's discussions. Does this phrase somehow signal that Congress intended to create a kind of precondition for state taxation? And if so, does the phrase encompass only activities conducted by a seller physically present in the taxing state, as some taxpayer representatives have asserted? Congress certainly could have used clear language to make physical presence a precondition of taxation, but elected not to. The failure to define the term "tangible personal property" is perhaps more understandable, given the common understanding of that term in 1959. But over time, the term's meaning has become much less clear. For example, in 2009 my Illinois Department of Revenue colleagues and I were taken by surprise when the Illinois Supreme Court upended what we thought was settled law and ruled that electricity was tangible personal property.[18]

Second, the law did not establish any mechanism to provide binding administrative guidance to taxpayers, thereby exacerbating the negative impact of not defining the statute's key terms. This is a problem with federal preemption legislation generally, which sits on top of and interacts with the existing fabric of state tax laws, often creating complex issues and substantial litigation. Neither tax administrators nor taxpayers would welcome the passage by a state legislature of a complicated tax statute that failed to authorize the issuance of regulations or other guidance, but that is exactly what Congress did here. Thus, it is left to state revenue departments to provide (nonbinding) guidance to taxpayers.

To add insult to injury, P.L. 86-272 (like other federal tax preemption statutes) seems to have been written in stone. During the legislative process, Congress acknowledged that S. 2524 should not be the final word on the subject of state taxation of interstate commerce. The Senate report that accompanied the bill stated that it was "a temporary solution while further studies are made"[19] — and the conference report envisioned both additional study and the enactment of

[14] Senate Rept. No. 658, 86th Cong. 1st Sess. (emphasis added).

[15] House Rept. No. 936, 86th Cong. 1st Sess.

[16] Cong. Rec., Sep. 2, 1959, at 17771.

[17] *See Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214 (1992). The Court in *Wrigley* held that P.L. 86-272 protects not only solicitation itself but also activities that are entirely ancillary to solicitation or that are de minimis. Use of the term "solicitation" in this article encompasses all of these activities.

[18] *See Exelon Corp. v. Department of Revenue*, 234 Ill. 2d 266 (2009).

[19] Senate Rept. No. 658, 86th Cong. 1st Sess.

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further legislation.[20] But more than 60 years have passed since the bill's passage and, notwithstanding the fact that the way business is conducted has changed in substantial ways, the statute has never been updated, revised, or repealed.

This is the context in which the MTC work group set out to do its work.

The Work Group's Proposed Revision

The work group's primary — but by no means only — focus was the application of P.L. 86-272 to business activities conducted via the internet. All work group members agreed that when considering whether an activity conducted via the internet is protected by the statute, the first question is whether the activity constitutes solicitation of orders for tangible personal property. If the answer is yes, then the activity is protected. This question received little attention because the statute clearly protects solicitation, regardless of how it is accomplished, and because the meaning of solicitation is addressed by the current version of the statement.

The work group instead addressed a second question: If business activities conducted by an internet seller extend beyond solicitation, are they "business activities within [the taxing] State"?[21] If the answer is yes, then the activities are not protected by the statute. After much discussion, the work group adopted a framework to answer this question, and language describing that framework was inserted into the proposed revision of the statement. This agreed-upon language reads as follows:

> As a general rule, when a business interacts with a customer via the business's website or app, the business engages in a business activity within the customer's state. However, for purposes of this Statement, when a business presents static text or photos on its website, that presentation does not in itself constitute a business activity within those states where the business's customers are located.

To provide further guidance, the work group added to the proposal 11 factual scenarios involving the interaction between an internet seller and its customers, and indicated in each case whether the described business activity was or was not protected by the statute, together with a brief explanation. In each scenario, the business operates a website offering for sale only items of tangible personal property (unless otherwise indicated) and has no contacts with the customer's state other than what is described. Orders are approved or rejected, and the products are shipped from a location outside the customer's state. The scenarios are as follows:

1. Post-sale assistance provided by posting static FAQs: The business provides post-sale assistance to in-state customers by posting a list of static FAQs with answers on the business's website. This posting of the static FAQs does not defeat the business's P.L. 86-272 immunity because it does not constitute a business activity within the customers' state.

2. Post-sale assistance provided via electronic chat or website email: The business regularly provides post-sale assistance to in-state customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website. For example, the business regularly advises customers on how to use products after they have been delivered. This in-state business activity defeats the business's P.L. 86-272 immunity in states where the customers are located because it does not constitute — and is not entirely ancillary to — the in-state solicitation of orders for sales of tangible personal property.

3. Credit cards: The business solicits and receives online applications for its branded credit card via the business's website. The issued cards will generate interest income and fees for the business. This in-state business activity defeats the business's P.L. 86-272 immunity in states where the online application for cards is available to customers because it does not constitute — and is not entirely ancillary to — the in-state

[20] Conference Rept. No. 1103, 86th Cong, 1st Sess. The Willis Committee, which was tasked by Congress following enactment of P.L. 86-272 to study state taxation and evaluate the statute, did engage in additional study and issued a four-volume report in 1964 and 1965. However, no further legislation resulted from its work. *See* Report of the House Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House Rept. No. 1480, 88th Congress, 2d Session (1964); and House Rept. Nos. 565 and 952, 89th Congress, 1st Session (1965) (collectively, the "Willis Committee Report").

[21] 15 U.S.C. section 381(a).

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solicitation of orders for sales of tangible personal property.

4. Job applications: The business's website invites viewers in a customer's state to apply for non-sales positions with the business. The website enables viewers to fill out and submit an electronic application, as well as to upload a cover letter and resume. This in-state business activity defeats the business's P.L. 86-272 immunity in the customer's state because it does not constitute — and is not entirely ancillary to — the in-state solicitation of orders for sales of tangible personal property.

5. Cookies used for purposes other than solicitation: The business places internet cookies onto the computers or other electronic devices of in-state customers. These cookies gather customer search information that will be used to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale. This in-state business activity defeats the business's P.L. 86-272 immunity because it does not constitute — and is not entirely ancillary to — the in-state solicitation of orders for sales of tangible personal property.

6. Cookies used for purposes ancillary to solicitation: The business places internet cookies onto the computers or other devices of in-state customers. These cookies gather customer information that is only used for purposes entirely ancillary to the solicitation of orders for tangible personal property, such as to remember items that customers have placed in their shopping cart during a current web session, to store personal information customers have provided to avoid the need for the customers to re-input the information when they return to the seller's website, and to remind customers what products they have considered during previous sessions. The cookies perform no other function, and these are the only types of cookies delivered by the business to its customers' computers or other devices. This in-state business activity does not defeat the business's P.L. 86-272 immunity because it is entirely ancillary to the in-state solicitation of orders for sales of tangible personal property.

7. Remote repairs and upgrades: The business remotely fixes or upgrades products previously purchased by its in-state customers by transmitting code or other electronic instructions to those products via the internet. This in-state business activity defeats the business's P.L. 86-272 immunity because it does not constitute — and is not entirely ancillary to — the in-state solicitation of orders for sales of tangible personal property.

8. Warranty plans: The business offers and sells extended warranty plans via its website to in-state customers who purchase the business's products. Selling, or offering to sell, a service that is not entirely ancillary to the solicitation of orders for sales of tangible personal property — such as an extended warranty plan — defeats the business's P.L. 86-272 immunity (cross-reference to Article I of the statement).

9. Marketplace facilitators: The business contracts with a marketplace facilitator that facilitates the sale of the business's products on the facilitator's online marketplace. The marketplace facilitator maintains inventory, including some of the business's products, at fulfillment centers in various states where the business's customers are. This maintenance of the business's products defeats its P.L. 86-272 immunity in those states where the fulfillment centers are (cross-reference to Article V of the statement).

10. Streaming: The business contracts with in-state customers to stream videos and music to electronic devices for a charge. This in-state business activity defeats the business's P.L. 86-272 immunity because streaming does not constitute the sale of tangible personal property for purposes of P.L. 86-272 (cross-reference to Article I of the statement).

11. Basic website: The business offers for sale only items of tangible personal property on its website. The website enables customers to search for items, read product descriptions, select items for purchase, choose among delivery options, and pay for the items. The business does not engage in any in-state business activities that are not described in this example, such as the activities described in Examples 2-5 and 7-10 above. This business activity does not defeat the business's P.L. 86-272 immunity because the business engages exclusively in in-state activities that either constitute solicitation of orders for sales of tangible personal property or are entirely ancillary to solicitation.

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Not all members of the work group applied the same reasoning to determine whether activities are protected by the statute (also, members did not always describe their reasoning). Work group discussions indicated, however, that two ideas contributed to members' thinking. First, they found relevant the Supreme Court's observation in *South Dakota v. Wayfair Inc.* that an internet seller "may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term," although they recognized that *Wayfair* did not interpret P.L. 86-272.[22] Second, they found it relevant that when a customer visits a seller's website, the website transmits software to the customer's computer, and that software acts to facilitate the interaction between the customer and the seller.[23] Although these two ideas were widely shared by work group members, they were not always a necessary part of the group's analysis; for example, the work group concluded that music and video streaming are not protected by the statute simply because streaming does not constitute the sale of tangible personal property.

What was perhaps most striking about the work group's deliberations was the broad consensus among members that P.L. 86-272 does not protect business activities conducted via the internet, other than the solicitation of orders for tangible personal property. This is not to say that work group members did not debate the subject matter extensively. For example, they debated whether static, non-interactive presentations of text or photos, and whether activities conducted by telephone, constitute in-state business activities for purposes of the statute. In the end, however, they agreed by large margins that (1) static presentations do not constitute in-state business activities, and (2) telephone calls — hardly a new form of business activity — should not be addressed in the proposed statement. And once these two decisions were made, they debated over the specific verbiage of virtually every scenario before reaching final agreement.

In addition to addressing business activities conducted via the internet, the work group recommended four other substantive updates to the statement — none of which triggered internal dissent. These updates are:

1. Adding to the statement's list of in-state unprotected activities those "activities performed by an employee who telecommutes on a regular basis" (unless the activities are limited to solicitation of orders for tangible personal property). This addition responds to the substantial growth of telecommuting since the statement was last revised two decades ago.[24]
2. Adding to Article V (Independent Contractors) an express statement that an independent contractor's performance of unprotected activities on behalf of a seller, such as performing warranty work or accepting returns of the seller's products, removes the seller's statutory protection. This addition to the statement follows directly from the statute's language and is supported by a growing body of case law.[25]
3. Revising Article VII.A (Application of Statement to Foreign Commerce). The proposed language retains the current

[22] 138 S. Ct. 2080, 2095 (2018). The work group proposed referencing *Wayfair* in the statement's introduction. The introduction, as proposed, states that the Supreme Court's analysis "as to virtual contacts" is "relevant to the question of whether a seller is engaged in business activities in states where its customers are located for purposes of the statute."

[23] There was wide agreement among work group members that P.L. 86-272 does not require a human being to engage in non-solicitation activities within the taxing state to defeat the seller's immunity: If, for example, a seller were to send a robot or a drone into the state, that would be sufficient. Transmission of software to facilitate interaction between the parties has a similar effect. *See* Expert Report prepared by Ashkan Soltani to Ohio Attorney General's Office, p. 20, Sep. 25, 2014 ("When a user visits a website . . ., the website transmits code and images to the user's computer via the user's current internet connection."). The Soltani report and other resources can be found on the project's webpage.

The work group's thinking on this topic is perhaps most clearly reflected in the proposed revision's seventh factual scenario, in which an internet seller remotely fixes or upgrades products it previously sold by transmitting code or other electronic instructions to those products. Scenario 7 states that this activity defeats the business's P.L. 86-272 immunity.

[24] The work group's deliberations ended before the coronavirus pandemic spiked. Since then, many states have announced that temporary work at home necessitated by the pandemic does not defeat a business's P.L. 86-272 immunity.

[25] *See, e.g.*, *Ann Sacks Tile and Stone Inc. v. Department of Revenue*, 20 Or. Tax Ct. 337 (2011) (warranty work performed by in-state independent contractors on behalf of an out-of-state seller/manufacturer); *Cheng Shin Rubber USA Inc. v. Department of Revenue*, TC-MD 156268D (Or. Tax Ct. 2017) (out-of-state tire distributor reimbursed in-state retailer for replacement tires provided to purchasers under the distributor's warranty); and *Santa Fe Natural Tobacco Co. v. Department of Revenue*, TC-MD 170251G (Or. Tax Ct. 2019) (wholesalers accepted returns on behalf of an out-of-state manufacturer under a distributor incentive program).

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statement's observation that P.L. 86-272 applies explicitly only to "interstate commerce" and therefore not to foreign commerce. Unlike the current statement, however, the proposed language does not express that states "will apply" the statute's protections to business activities conducted in foreign commerce — although that appears to be the general practice of states. This change reflects the expressed desire of some work group members to avoid language that appears to mandate conduct by states in an area of great uncertainty. It also reflects the view that neither the Constitution nor U.S. treaties require states to apply the statute to foreign commerce, as long as states apply the statute consistently both to (i) activities of foreign sellers selling into the United States and (ii) activities of U.S. companies selling to foreign purchasers when determining if sales will be thrown back.[26]

4. Deleting Article VII.E (Application of the *Joyce* rule). The current version of the statement endorses the *Joyce* rule,[27] as opposed to the *Finnigan* rule.[28] The work group concluded that this endorsement was no longer appropriate since the majority of combined reporting states have now adopted *Finnigan*. Instead, the proposed revision of the statement takes no position on this subject.

Reactions to the Work Group's Proposal

Although MTC staff encouraged taxpayer representatives to provide input at work group meetings, few did. This is not to say that there has not been feedback outside work group meetings, both supportive and critical. None of the criticisms we have heard or read, however, requires the work group's approach to be revised.

Some observers have asserted that business activities conducted via the internet cannot constitute business activities "within" customers' states for purposes of P.L. 86-272 because internet sellers are not physically present in those states. But as noted earlier, P.L. 86-272 contains no language referring to physical presence.[29] And to construe the language that the statute *does* contain to condition state taxation on a seller's physical presence would violate the rule — repeatedly expressed by the Supreme Court — that state authority is not preempted unless there is a "clear and manifest" congressional intent to do so.[30]

It is also important to note that in the wake of *Northwestern States*, Congress considered four bills that would have expressly preempted state taxation of businesses lacking physical presence — but rejected them all. One bill (S.J.R. 113) would have prohibited a state (or its political subdivisions) from imposing a tax on any business engaged in interstate commerce unless:

> . . . such business has maintained a stock of goods, an office, warehouse, or other place of business in such State or has had an officer, agent, or representative who has maintained an office or other place of business in such State.

Similarly, S. 2218 would have prohibited a state from imposing tax on a person "solely by reason of the solicitation of orders in the State" if the person "maintains no stock of goods, plant, office, warehouse, or other place of business within the State." S. 2281 would have shielded sellers from taxation if they did not

[26] The work group also proposed adding to Article VII.A a citation to *Border Pipe Line Co. v. Federal Power Commission*, 171 F.2d 149 (D.C. Cir. 1948). In that case, the court of appeals explained that Congress may choose to protect or regulate interstate commerce while declining to regulate foreign commerce.

[27] Under the *Joyce* rule, which is named after a California State Board of Equalization decision, members of a unitary group filing a combined return are regarded as separate taxpayers for apportionment purposes in determining if they are subject to a state's tax.

[28] Under the *Finnigan* rule, which is named after another BOE decision, each member of a unitary group filing a combined return is deemed subject to a state's tax for apportionment purposes if the unitary group is subject to tax.

[29] Even if courts were to hold that a seller's physical presence in the taxing state is required to defeat the statute's protection, sellers that conduct non-solicitation activities via the internet would not be immune from tax. *See Wayfair*, 138 S. Ct. at 2095, in which the Court observed that "a company with a website accessible in South Dakota may be said to have a physical presence in the State via the customers' computers."

[30] *Department of Revenue of Oregon v. ACF Industries Inc.*, 510 U.S. 332, 345 (1994); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947). *See also Heublein Inc. v. South Carolina Tax Commission*, 409 U.S. 275, 281-282 (1972) ("unless Congress conveys its purpose clearly, it will not be deemed to have significantly changed the Federal-State balance"); and *Matter of Disney Enterprises Inc. v. Tax Appeals Tribunal*, 888 N.E. 2d 1029, 1036 (N.Y. 2008) (as "the power to tax is such a traditional state power, . . . we will not, absent unambiguous evidence, infer a scope of pre-emption beyond that which clearly is mandated by Congress' language").

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maintain "an office, warehouse, or other place of business in the State" and did not have "an officer, agent, or representative in the State who has an office or other place of business in the State." And another bill (H.J.R. 450) would have prevented any state from taxing a business unless "the business has maintained an office, salable inventory, warehouse, or other place of business in that State or has had an officer, agent, or representative who has maintained an office or other place of business in that State."[31]

Martin Eisenstein and David Bertoni argued that only activities "physically" occurring within a taxing state's geographical area can defeat a seller's immunity, by which I think they meant that employees or representatives who engage in non-solicitation activities on the seller's behalf must be physically present in the taxing state while performing those activities.[32] To support their argument, they invoked *Wisconsin Central Ltd. v. United States*,[33] a 2018 Supreme Court decision that they noted was issued on the same day as *Wayfair*. In that case, the Court considered whether the term "money remuneration" in the Railroad Retirement Tax Act of 1937 includes stock options for purposes of calculating the retirement benefits of railroad employees. To answer this question, Justice Neil Gorsuch wrote: "As usual, our job is to interpret the statute's words consistent with their ordinary meaning at the time Congress enacted the statute." Applying this canon to P.L. 86-272, Eisenstein and Bertoni asserted that "business activities within such State" cannot possibly include activities conducted via the internet because "at the time P.L. 86-272 was enacted, it was inconceivable that Congress intended activities conducted by or on behalf of a taxpayer 'within such State' to embrace a concept of virtual commerce, which would not stir to life until decades later."[34]

Of course, Congress did not have the internet in mind in 1959. But the authors' reliance on *Wisconsin Central* is flawed. Gorsuch recognized that "new applications may arise in light of changes in the world." So the word "money" as used in the Railroad Retirement Act "must always mean a 'medium of exchange,'" he explained, "but what *qualifies* as 'a medium of exchange' may depend on the facts of the day." He then raised the example of electronic transfers of paychecks. "Maybe they weren't common in 1937," he wrote, "but we do not doubt that they would qualify today as 'money remuneration' under the statute's original public meaning."[35] Applying Gorsuch's reasoning to P.L. 86-272, the fact that the internet did not exist in 1959 hardly precludes the phrase "business activities within [the taxing] State" from encompassing business activities or interactions with in-state customers that are conducted via the internet.

More broadly, there is good reason why the Court in *Wisconsin Central* rejected the approach to statutory construction advanced by the authors. The authors' reasoning would mean that statutes, no matter how generally worded, would have to be amended whenever there is a new invention, and those amendments would be required even though the amended law might simply reenact the very same general terms used in the original law. This would be the only way to ensure that any statutory language, no matter how broad or general,

[31] Congress rejected these alternatives, moreover, at a time when it was understood that businesses could have a meaningful presence in a state without physical presence. In the analogous realm of personal jurisdiction, it was settled law in 1959 that a business was not required to have physical presence in a state to be sued there. *See International Shoe Co. v. Washington*, 326 U.S. 310, 316 (1945) ("if he be not present within the territory of the forum, he [must] have certain minimum contacts with it such that the maintenance of the suit does not offend 'traditional notions of fair play and substantial justice'"); and *McGee v. International Life Insurance Co.*, 355 U.S. 220 (1957) (finding that the due process clause did not preclude a court from exercising jurisdiction in a state where the defendant had never been present).

[32] Martin I. Eisenstein and David W. Bertoni, "*Wayfair* Misused: States and Cities Seek to Expand Their Tax Powers," *Tax Notes State*, Dec. 16, 2019, p. 891.

[33] 138 S. Ct. 2067 (2018).

[34] Eisenstein and Bertoni, *supra* note 32, at 896.

[35] 138 S. Ct. at 2074-75.

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would apply to new things. That approach would be no way to run the Wisconsin Central or any other railroad.[36]

Other observers have suggested that state adoption of the work group's proposal would violate the anti-discrimination prohibition of the Internet Tax Freedom Act (ITFA) since states would tax the income of sellers that provide post-sale customer assistance via online chat, but presumably not tax the income of sellers that provide assistance by telephone.[37] This argument (which of course relates to only one of the proposal's 11 scenarios) has at least three problems. First, it is not at all clear that ITFA applies to income taxes in this context, since the law bans discriminatory taxes on electronic commerce — and electronic commerce means any "transaction" conducted over the internet or through internet access.[38] Second, the argument assumes that providing customer service via telephone is a protected activity, a view that the work group decided not to address one way or the other and that is an open question.[39] Third, even if ITFA applies to income taxes in this context and if P.L. 86-272 protects customer assistance provided by telephone, there still would be no ITFA violation because the disparate treatment would be the result of *federal* law (that is, P.L. 86-272), not state law (which imposes tax on the income of sellers regardless of the means sellers may use to convey customer assistance). How could a court reasonably conclude that disparate treatment in effect mandated by one federal statute causes a state to violate another federal statute? In any event, this argument raises a largely academic question — few if any businesses provide customer service only by telephone anymore.

Christopher Lutz argued that an internet seller's use of a website, including the use of cookies, does not defeat the statute's protections, assuming the product being sold is tangible personal property.[40] Analogizing websites to the activities of traditional salespersons, he concluded that activities conducted via a website are ancillary to solicitation and therefore fall "well within the boundaries set in [*Wisconsin Department of Revenue v. William Wrigley Jr. Co.*]."[41] His analogy is a good one — because websites often do perform the role of traditional salespersons. The relevant question is not who or what performs activities; rather, it is whether those activities constitute solicitation (or are ancillary to solicitation). If in-state sales staff engage in activities that extend beyond solicitation, then their employer's P.L. 86-272 immunity is defeated, even if the sales staff primarily engage in solicitation activities.[42] Similarly, if websites or cookies are used for purposes other than solicitation, then their use by a seller also defeats the seller's immunity. And the reality is that websites and cookies often are used for purposes other than solicitation.

In two recent articles, Rick Handel and Brittnee Pool praised many aspects of the work group's proposal — but also raised concerns. In their first article, they argued that the proposal's "general rule for electronic communications with a customer through a website or app, and its specific conclusions on post-sale chat or emails

[36]The Council On State Taxation also has argued that a seller's physical presence in the taxing state is required to defeat P.L. 86-272 protection. COST's logic is as follows: (1) If physical presence were not required, then non-solicitation activities conducted via telephone by an out-of-state seller would defeat the seller's statutory immunity; (2) at the time that the statute was enacted, out-of-state sellers regularly interacted with customers by telephone; (3) the absence of a physical presence requirement therefore would have rendered the statute "meaningless" from the outset; and (4) this is a result that Congress could not have intended. *See* COST Comments to Hearing Officer Robert Desiderio, Aug. 4, 2020.

COST's premise (that is, step 1) disregards the fact that P.L. 86-272 protection turns on whether a seller engages in business activities within the taxing state. Courts have not considered whether activities conducted via telephone constitute in-state activities under the statute — and the work group declined to address this question in the proposed revision. Further, even if activities conducted via telephone were considered in-state business activities, that fact would not render P.L. 86-272 meaningless because the statute would still serve to protect solicitation of orders for tangible personal property — however performed.

[37]ITFA prohibits a state or its political subdivisions from imposing a tax on electronic commerce that is not generally imposed "on transactions involving similar property, goods, services or information accomplished through other means. . . ." ITFA, section 1105 (2)(i), codified as a note to 47 U.S.C. section 151.

[38]ITFA, section 1105 (3).

[39]The work group was not made aware of any state regulation, ruling, or any judicial decision that states that P.L. 86-272 protects non-solicitation activities conducted via telephone.

[40]Christopher T. Lutz, "What to Do With Public Law 86-272," *Tax Notes State*, Dec. 23, 2019, p. 1071.

[41]*Id.* at 1073.

[42]The Supreme Court settled this question in *Wrigley*: "We reject this 'routinely-associated-with-solicitation' or 'customarily-performed-by-salesmen' approach, since it converts a standard embracing only a particular activity ('solicitation') into a standard embracing all activities routinely conducted by those who engage in that particular activity ('salesmen')." *Wrigley*, 505 U.S. at 227.

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initiated from the seller's website" are "too broad."[43] They reached this conclusion in a series of steps. They asserted first that P.L. 86-272 protects non-solicitation activities conducted via telephone (an assertion that is open to debate) and second, that chat and emails initiated through a website serve the same purpose as telephone calls. Therefore, the statute must also protect non-solicitation activities conducted via that chat or email. This logic, however, disregards a key fact: Interactive websites differ from telephones in a relevant way. As discussed earlier, a seller's website — unlike a telephone — inserts software into customers' devices. It is the activities performed by this software that may defeat the seller's statutory immunity.[44]

In their second article, the authors criticized Scenario 9, which states that a marketplace facilitator's storage of a seller's inventory in the taxing state defeats the seller's P.L. 86-272 protection. They acknowledge, however, that their comments are "arguable" and I am happy to accept their invitation.[45] After all, every prior version of the statement has provided that a seller's consignment of goods to a person located in a taxing state, including an independent contractor, constitutes an unprotected activity — and no court has ruled to the contrary.

Handel and Pool offered two arguments to counter Scenario 9. First, they argued that the scenario cannot be correct because sellers may not know where a market facilitator stores their products, and therefore imposing tax based on the products' location would result in a due process violation. This reasoning rests on a faulty premise. It assumes that all or most sellers do not know — or have the ability to determine — where their products are stored, which is not true.[46] In any event, due process clause jurisprudence cannot be read to shield sellers from obligations arising from products they own by transferring possession to another party (in accordance with an ongoing contract) and then turning their head. Interestingly, the authors relied in part on *Burger King Corp. v. Rudzewicz*, a due process case in which the Supreme Court held that Burger King could sue an out-of-state defendant in Florida because the defendant "purposefully availed himself of the benefits and protections of Florida's laws."[47]

Second, the authors argued that Scenario 9 would reduce section 381(c) of the statute "to a nullity." Section 381(c) provides that a person's business activities within a state do not include activities of an independent contractor on behalf of that person if those activities "consist solely of making sales, or soliciting orders for sales, of tangible personal property." In essence, they claim that the protection for "making sales" only has value if it also protects the independent contractor's ability to store its sellers' products in the states where the sellers' customers are located. They further claim that storing a product near customers is "entirely ancillary to selling it" and therefore protected.

These arguments strike me as a very long stretch. There surely is value in protecting in-state sales made by independent contractors on behalf of their third-party sellers — even if that protection does not extend to storing the seller's inventory in the state. And storing sellers' inventory near customers is not "entirely ancillary" to making sales. In *Wrigley*, the Supreme Court held that activities are "entirely ancillary" to solicitation if they "serve no independent business function apart from their connection to the soliciting of orders," as opposed to "those activities that the company would have reason to engage in anyway." Applying this "entirely ancillary" test here, storing sellers' inventory near customers is not ancillary to making sales, since independent contractors may store products at a particular location for any number of reasons — such as to reduce transportation costs, make deliveries more efficient, or take advantage of good transportation infrastructure near population centers. Certainly sellers will not be able to show

[43] Rick Handel and Brittnee L. Pool, "MTC Draft Policy on P.L. 86-272: Electronic Communications Concerns," *Tax Notes State*, Oct. 19, 2020, p. 217.

[44] *See supra* note 23 and related text.

[45] Handel and Pool, "MTC Draft Policy on P.L. 86-272: Marketplace Facilitator Concerns," *Tax Notes State*, Dec. 14, 2020, p. 1151.

[46] For example, sellers that participate in the Fulfillment by Amazon program can access Amazon online inventory reports that indicate where their products are being stored. *See* Amazon Seller Central, "Inventory Reports."

[47] 471 U.S. 462, 482 (1985).

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a "clear and manifest" congressional intent to preempt state tax authority in cases in which an independent contractor operating on their behalf uses what may be a massive in-state warehouse to store their products.[48]

Professor Philip M. Tatarowicz has argued that the proposed revision wrongly seeks to tax "technological tools of efficiency," which he says is contrary to the intent of Congress and presumably contrary to the country's economic self-interest.[49] I respectfully disagree. What the work group did was nothing more than to apply the legal framework Congress adopted in 1959 to the way that business is conducted today. So if a business solicits orders for tangible personal property via a website, or by using some other modern tool never envisioned by Congress, that activity is protected — because solicitation is a protected activity regardless of how it is effectuated. But if a business engages in an activity other than solicitation, then under the plain language of the statute, the business engages in an unprotected activity, whether the activity is performed by a traditional sales force or by some cutting-edge, automated tool.

Rather than adopting the work group's interpretation of the statute, Tatarowicz proposes that the statutory "lines separating permissible from impermissible activities" should be drawn based on whether new "technological based tools . . . allow one to operate more efficiently."[50] So, for example, electronic chat and email are protected because they "represent a process efficiency [compared with] snail mail, telegraphs and telephone calls."[51] Although this test may arguably make good policy sense, at least theoretically, it seems unworkable as a practical matter. And in any event, it does not have a basis in either the statute's language or legislative history.[52]

Finally, Jeffrey Friedman of Eversheds Sutherland (US) LLP called the work group's efforts "a very significant overreach" and "a not-so-thinly veiled attempt to obliterate P.L. 86-272" at an MTC Uniformity Committee meeting.[53] If this is correct, then the work group members were extremely punctilious about hiding their true intent. I cannot recall one comment that suggested a member was pursuing some policy agenda. To the contrary, members dissected the statute's language and history, trying to construct a reasonable approach to applying the statute to modern business activities, and frequently reexamined difficult issues. And at key decision points, the work group elected to adopt a middle-ground approach when there was arguably a more aggressive option available.

One concern expressed by some taxpayer representatives that resonates with me is that P.L. 86-272 fails to provide adequate protection to many small businesses that sell into multiple states.[54] This failing is hardly surprising, since immunity under the statute is based not on the amount of a business's sales into a taxing state, or the magnitude of its other contacts with a state, but rather on whether its activities are limited to solicitation.[55] The impact on these businesses is something that state policymakers should be concerned about, since placing multistate income tax return filing and payment obligations on small businesses can impose excessive burdens (not only on the businesses but also on revenue departments) with little or no revenue benefit to states.

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[48] *See* preemption discussion in note 30 *supra* and related text. It is also noteworthy that Congress included language in section 381(c) stating that persons shall not be considered to have engaged in in-state business activities by reason of their independent contractor maintaining an office in a state — but included no exception for contractors that store inventory or maintain a warehouse in a state.

[49] Comments and slides of Philip M. Tatarowicz at the NYU 38th Institute on State and Local Taxation, Dec. 16. 2019.

[50] Comments of Tatarowicz presented to hearing officer Robert J. Desiderio, Aug. 5, 2020, at 4-5.

[51] *Id.* at 12.

[52] Interestingly, Tatarowicz has also expressed that a physical presence is not required to defeat a seller's statutory immunity. *See id.* at 5; and comments of Tatarowicz at Georgetown Law 2020 Advanced State and Local Tax Institute.

[53] Amy Hamilton, "Inside the P.L. 86-272 Talks: The Draft Internet Section," *Tax Notes State*, Feb. 10, 2020, p. 515.

[54] For example, the statute does not protect the many small businesses that use online marketplaces that store sellers' inventory in warehouses around the country.

[55] The statute's failure to protect many small businesses has been evident for decades. The Willis Committee reached this conclusion in its report in 1964: "Some small companies . . . were left with a broad scope of potential income tax liability even after the enactment of the statute. In this respect, it can be argued that the statute failed to give protection in cases in which protection was appropriate." Willis Committee report, chapter 13 ("Impact of Public Law 86-272"), at 431.

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Work group members recognized that the most effective and targeted way to protect small businesses while preserving state and local revenues is for states to adopt nexus thresholds based on the magnitude of a business's contacts with a state. Consequently, they inserted into the proposal's introduction a reference to the MTC's model factor presence nexus statute and made the model an addendum to the statement.[56] The model shields businesses from income tax obligations if their in-state sales, payroll, and property fall below specified amounts.[57]

Conclusion

It has been more than six decades since Congress enacted P.L. 86-272. Since then, how business is conducted has changed significantly. In light of these changes, Congress is free to update its handiwork. But until it does, states must apply the statute as enacted in 1959. The P.L. 86-272 work group has set forth a compelling framework that states can use to apply the statute to modern business activities. ■

[56]The model statute, titled "Factor Presence Nexus Standard for Business Activity Taxes," was adopted by the MTC in 2002. Professors Walter Hellerstein and John A. Swain identify eight states that have enacted legislation asserting nexus for business activity taxes if a business has in-state sales or receipts above a stated threshold. *See* Jerome R. Hellerstein, Walter Hellerstein, and Swain, *State Taxation* (2001, with updates through May 2020), Part IV, para. 6.11[1].

[57]The Constitution presumably protects small businesses from unduly burdensome income tax compliance obligations, but the courts have yet to determine the precise nature of that protection.

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