taxnotes® state

Volume 101, Number 3 ■ July 19, 2021

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Reprinted from *Tax Notes State*, July 19, 2021, p. 211

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In this installment of Eyes on E-Commerce, Isaacson and Bessey criticize the Multistate Tax Commission's proposed revision to its Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272, arguing that the proposed revision is an invitation to states to ignore the clear protections of the law, and that state efforts to tax the net income of out-of-state businesses based on the revised statement will inevitably lead to a court challenge and should be struck down under the supremacy and commerce clauses of the U.S. Constitution.

For more than 60 years, Public Law 86-272 has protected multistate businesses from overburdensome state taxation. The Constitution reserves for Congress the power to regulate interstate commerce, and P.L. 86-272 is as clear an exercise of Congress's commerce clause power as exists in the area of tax law. A number of state revenue departments, through the Multistate Tax Commission, are now poised to adopt an "interpretation" of P.L. 86-272 that would exempt from the protection of the law essentially any business with an interactive website, a category that would include almost all e-commerce companies. Such a move is less an act of interpretation than it is an attempted nullification of a duly enacted federal statute. While the MTC may believe that P.L. 86-272 is outdated and should be repealed or replaced, the Constitution reserves that decision for Congress and Congress alone.

P.L. 86-272

P.L. 86-272 was enacted by Congress as a reaction to the 1959 Supreme Court decision in *Northwestern States Portland Cement Co. v. Minnesota*.[1] In *Northwestern States*, the Court considered an income tax assessment imposed by Minnesota on an Iowa cement company that engaged in "a regular and systematic course of solicitation of orders for the sale of its products" in neighboring Minnesota. The Court upheld Minnesota's imposition of its net income tax on the Iowa company's income against a constitutional challenge, noting that the tax was imposed on the company's income "earned from and fairly apportioned to business activities within the taxing State."[2]

In the wake of the *Northwestern States* decision, Congress acted swiftly, enacting P.L. 86-

[1] 358 U.S. 450 (1959).

[2] There was no dispute on the proper apportionment of the taxpayer's income to business activities conducted within the taxing state. *Northwestern States*, 358 U.S. at 452.

272 that same year, for the express purpose of reversing the effect of the Court's decision and protecting companies whose business activities in a taxing state are limited to the solicitation of orders in interstate commerce.[3]

P.L. 86-272 is a straightforward and affirmative exercise of Congress's authority to regulate commerce under the commerce clause. After the Court determined that the commerce clause did not prohibit Minnesota's tax in the absence of congressional action, Congress acted. P.L. 86-272 has been the law of the land ever since.

The MTC and P.L. 86-272

It is only a slight exaggeration to say that the MTC was established, at least in part, to help its member states push back against the protections of interstate commerce enacted by Congress (in the form of limitations on the imposition of certain state taxes) and enshrined in P.L. 86-272. As the MTC notes on its website, the events that "sparked its formation" began with the Supreme Court's *Northwestern States* decision, and the swift congressional action taken in that decision's wake — both the passage of P.L. 86-272 and the creation of the Willis Committee to study state business income taxes and consider comprehensive federal legislation in the area.[4] The creation of the MTC in 1967 was "an effort by states to protect their tax authority,"[5] including in the area of interstate commerce, and to limit any restrictions on state taxing authority imposed by either the commerce clause itself or by federal legislation in accordance with Congress's commerce clause authority.

Over the years, the interpretation of P.L. 86-272 has focused on whether a company's "business activities" within a given state consist of mere solicitation (in which case the company is protected by P.L. 86-272 from the state's net income tax) or if the in-state activities go beyond solicitation, in which case the state may impose a tax on the company's net income derived from its activities in the taxing state.[6] The MTC itself has made meaningful contributions to the uniform interpretation of P.L. 86-272, most prominently through its Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272. The MTC statement, first drafted in 1986 and revised again in 1993, 1994, and 2001, is a policy statement describing MTC member states' interpretation of P.L. 86-272 and, particularly, whether some "business activities" within a state will be considered "protected" solicitation or "unprotected" activities that would subject a company to the state's income tax.

Although previous versions of the MTC statement provided useful guidance to taxpayers, the MTC's current proposal to revise the MTC statement goes far beyond interpretation of a federal statute and attempts to read the law's protections out of existence entirely. As justification for the most recent proposed revision, the MTC laments that P.L. 86-272 is ambiguous and that Congress has failed to update the law to keep up with changing times.[7] Of course, Congress may at any time amend the law, but to date has chosen not to. Complaints by the MTC of congressional

[3] The law provides:

> No State, or political subdivision thereof, shall have power to impose . . . a net income tax on the income derived within such State by any person from interstate commerce if the only business activities within such State by or on behalf of such person during such taxable year are either, or both, of the following:
>
> (1) the solicitation of orders by such person, or his representative, in such State for sales of tangible personal property, which orders are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State; and
>
> (2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph.

15 U.S.C. section 381.

[4] *See* Multistate Tax Commission, "MTC History."

[5] *Id.*

[6] *See Wisconsin Department of Revenue v. William Wrigley Jr. Co.*, 505 U.S. 214, 228, 232 (1992) (P.L. 86-272 protection for "solicitation" attaches to those activities that are "entirely ancillary to requests for purchases — those that serve no independent business function apart from their connection to the soliciting of orders"). The test for whether in-state activity other than "solicitation of orders" will be considered more than de minimis, sufficient to forfeit P.L. 86-272's immunity, is whether the in-state activity "establishes a nontrivial additional connection with the taxing State."

[7] In the introduction to the proposed revision, dated Feb. 20, 2020, the MTC's P.L. 86-272 work group writes, "In the decades since P.L. 86-272 was enacted, the way in which interstate business is conducted has changed significantly. Congress, however, has neither created a federal mechanism to provide administrative guidance to taxpayers nor has it updated the statute to indicate how it applies to new business activities."

inaction ring somewhat hollow against the backdrop of the MTC's founding purpose to push back against the very sort of comprehensive federal regulation of taxation of interstate commerce whose absence the MTC now uses to justify its extralegislative attempt to hollow out the law's protections. On the question of the law's ambiguity, it has always been understood that the borders between protected solicitation activities and unprotected business activities can be "somewhat less than entirely clear,"[8] but there has never been any ambiguity regarding the meaning of the word "within," as used in P.L. 86-272. From the date the law was enacted until the MTC commenced its current effort at interpretive obliteration, the statutory reference to "business activities within such State" has been understood to refer to business activities occurring inside the physical boundaries of a state.

Nevertheless, the MTC set out in 2018 with the apparent goal of changing the very meaning of P.L. 86-272 and eliminating the protections Congress provided for out-of-state businesses engaged in interstate commerce, including by effectively removing the word "within" from the statutory text. That process is now nearly complete — a draft revision to the MTC statement was approved by the MTC Executive Committee in November 2020, and, following a survey of MTC member states,[9] the proposal will be presented for consideration at the MTC's summer meeting.[10]

The most significant revision to the policy is the addition of a new section on "Activities conducted via the Internet," which provides 11 separate examples of activities conducted via the internet that will be considered either protected solicitation or unprotected activities. These additions would defeat the core protection of P.L. 86-272. They are based on the unsupportable conclusion that if a business's interactive website is accessible via the internet to customers located in a taxing state, that company's interactions with customers via its website should be deemed business activities occurring "within" the taxing state. Thus under the revised MTC statement, an out-of-state company whose website includes a clickable link by which an in-state customer can email a question or comment to the company would result in that company being treated as engaged in unprotected customer services activities within the taxing state, and thereby subject to the state's net income tax, *even though no employee or agent of the company has ever set foot in the taxing state*.[11] Equally extreme, if an out-of-state company's website uses cookies for analytics purposes (as essentially every commercial website does), and the website is accessible by in-state customers (as any website on the internet would be), an MTC member state adopting the revised statement as policy would conclude that the company had engaged in non-solicitation activities within the state.[12]

The 11 separate examples in the revised statement have been discussed at some length in these pages,[13] and an itemized discussion of each example is beyond the scope of this article. For our purposes, we will focus more broadly on a core conceptual error made by the MTC in developing the revised statement, and a discussion of the ways in which we believe the revised statement improperly impinges on Congress's constitutional role under the commerce clause. As discussed below, the proposed revision of the MTC statement is premised on an indefensible reading of both the statutory language and the Supreme Court's decision in *South Dakota v. Wayfair*.

[8] *Wrigley*, 505 U.S. at 223.

[9] The MTC's bylaws call for a survey of compact and sovereignty members to determine if a majority of the states would consider adopting a model statute or regulation. If so, the commission will consider the proposal, and will adopt it if at least 60 percent of the compact members and 60 percent of the sovereignty members approve. *See* MTC, "Uniformity Process." Under the MTC bylaws, the "member" is "the head of the State agency charged with the administration of the types of taxes to which this compact applies."

[10] Amy Hamilton, "MTC Projects on P.L. 86-272, *Finnigan* Set for Final Adoption," *Tax Notes State*, Apr. 26, 2021, p. 433.

[11] Revised MTC Statement, Article IV, section C(2) ("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.").

[12] *Id.*, section C(5).

[13] *See, e.g.*, Brian Hamer, "An Insider's View of the MTC's P.L. 86-272 Project," *Tax Notes State*, Mar. 22, 2021, p. 1213; and Marty Dakeesian and Michael Penza, "A Failure in Statutory Interpretation: The MTC and P.L. 86-272," *Tax Notes State*, Apr. 12, 2021, p. 175.

The MTC's Reliance on *Wayfair* Is Misplaced Because P.L. 86-272 Is Affirmative Legislation Enacted Under the Commerce Clause

The MTC's entire revision project hangs on a single sentence from Justice Anthony M. Kennedy's majority opinion in *Wayfair*: "A business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term."[14] Only by assuming permission to ignore the distinction between an out-of-state company's business activities conducted within a state and its activities outside a state — the very heart of the protection of P.L. 86-272 — could the MTC proceed with its goal of sweeping away what it considers the inconvenient protections that Congress provided when it enacted the statute. The MTC's reliance on *Wayfair* is wrong, however, because that decision does not apply in the P.L. 86-272 context, and because Kennedy's statement is not consistent with the MTC's strained interpretation and misapplication of his words.

To the first point, *Wayfair* involved a decision under the Supreme Court's dormant commerce clause jurisdiction, which over the years has defined the zones in which state taxes will be held unconstitutional under the commerce clause *even absent any congressional action or regulation*. The bright-line physical presence rule of *Quill Corp. v. North Dakota*,[15] which the Court overruled in *Wayfair*, was, of course, never enacted by Congress — it was invented by the Supreme Court. P.L. 86-272, however, is an affirmative exercise of Congress's commerce clause authority. The more relevant language from the *Wayfair* decision, then, is the majority opinion's multiple acknowledgements of the supremacy of congressional authority, when affirmatively exercised, to regulate commerce.[16]

Moreover, Kennedy's statement is misapplied by the MTC on its own terms. The *Wayfair* decision overruled *Quill* and *National Bellas Hess Inc. v. Department of Revenue of Illinois*,[17] which had established, as a Court-made doctrine, the bright-line principle that under the dormant commerce clause, states could not compel an out-of-state company to collect and remit the state's sales tax on sales to in-state residents, unless the out-of-state company had a physical presence in the state. In his majority opinion in *Wayfair*, Kennedy concluded that the bright-line physical presence nexus standard was not an appropriate proxy for determining whether a company had the required "substantial nexus with the taxing state"[18] to enable the state to impose a sales tax collection obligation on the out-of-state company.

The statement quoted by the MTC was not intended in the context of the *Wayfair* decision to change the meaning of any words in a federal statute — or even to change the meaning of any words in earlier Supreme Court precedent. It is totally lacking in authority for the revised MTC statement to rely on Kennedy's statement to support the conclusion that the actual words of the statute — "business activities *within* such state" — no longer mean what they say and should be understood differently from how they have consistently been interpreted for decades. Under the revised statement, a business located in State A, whose website may be accessed from anywhere on Earth with an internet connection, would be deemed to be conducting business activities *within* State B merely because a resident of State B may click on a link on the website and send an email to the company in State A. This conclusion finds no basis in *Wayfair*.

The MTC Ignores the Important Differences Between Sales Taxes and Income Taxes

The MTC's reliance on *Wayfair* is particularly misplaced given the inherent differences between a sales tax — a tax imposed on a particular transaction, easily sourced to a single state — and a tax on net income. A sales tax is generally imposed by a state on its own citizens. In *Wayfair*,

[14] *South Dakota v. Wayfair*, 585 U.S. ___, 138 S. Ct. 2080, 2095 (2018) (quoting *Direct Marketing Association v. Brohl*, 575 U.S. 1, 18 (2015) (Kennedy, J., concurring)).

[15] 504 U.S. 298 (1992).

[16] 138 S. Ct. at 2089 ("of course, when Congress exercises its power to regulate commerce by enacting legislation, the legislation controls") (*citing Southern Pacific Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 769 (1945)); *Id.* at 2096 ("While *it can be conceded that Congress has the authority to change the physical presence rule*, Congress cannot change the constitutional default rule." (emphasis added)); *Id.* at 2098 ("And in all events, Congress may legislate to address these problems if it deems it necessary and fit to do so.").

[17] 386 U.S. 753 (1967).

[18] *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274, 279 (1977).

there was no question about whether the tax was correctly applied to the transactions — consumers in South Dakota were responsible for the payment of South Dakota sales and use tax on their purchases of taxable products, regardless of whether the retailer collected the tax at the time of sale. Rather, *Wayfair* addressed the manner of collection of an admittedly valid tax. Because it is difficult to collect sales and use tax from individual consumers, and arguably easier to require sellers to collect and remit the tax on the state's behalf, states understandably have sought to compel *any* seller making taxable sales to residents of the state to collect the sales tax. If out-of-state sellers do not collect the tax, the practical effect may be that taxable transactions go untaxed and tax revenue simply vanishes.

An income tax is different. No more than 100 percent of a business's income can be subject to taxation.[19] Thus, any state asserting the authority to tax a portion of an out-of-state business's net income may effectively be denying another state's authority to tax that same portion of the business's net income. In some circumstances, apportionment of net income among the states may be uncontroversial — in *Northwestern States*, the Court emphasized that there was no challenge to the appropriateness of the apportionment of the taxpayer's income — but in many cases apportionment issues can be extremely thorny, and there is no uniformity among the states on apportionment methods.[20] This means that the burden of complying with disparate income tax requirements is potentially greater — and may present more traps for the unwary — than requiring out-of-state businesses with in-state sales in excess of specific thresholds to collect and remit the state's sales tax.[21]

Finally, the imposition of state income taxes on out-of-state businesses merely on the basis of the "virtual contacts," described in the revised MTC statement, raises significant constitutional concerns in its own right. In *Complete Auto v. Brady*,[22] the Supreme Court held that a state tax will be upheld as constitutional "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State." In *Complete Auto*, the Court approvingly noted the many state-provided benefits enjoyed by the business bringing the challenge.[23] Certainly the same could be said of the services provided by Minnesota to the Iowa cement company whose sales representatives traveled Minnesota's roads in *Northwestern States*.[24] What services does a state provide to the out-of-state business whose business activities "within such state" are limited to maintaining, on an out-of-state server, an internet-accessible website that uses analytics cookies or has a clickable email link or chat function? And how is the state's income tax fairly related to those services?

These concerns point to both the wisdom of Congress's action to protect interstate commerce from arbitrary and unfair burdens of state income tax when it passed P.L. 86-272 and the folly of looking to the Supreme Court's sales tax jurisprudence, specifically the *Wayfair* decision, as support for the MTC's effort to eviscerate the statute.

[19] *See, e.g.*, *Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. 542, 563 (2015); and *Northwestern States*, 358 U.S. at 458 (a state tax discriminates against interstate commerce in violation of the commerce clause if it "subject[s] interstate commerce to the burden of 'multiple taxation'").

[20] Consider a small start-up company consisting of a single software engineer in State A who develops a successful mobile gaming app that generates revenue through in-app purchases. The app uses servers located in State B. A smartphone user downloads the app and periodically makes in-app purchases. The user's telephone number has an area code from State C, the user resides in State D, and he is traveling in State E when he makes an in-app purchase. Under the revised MTC statement, the app developer was conducting business activities through an interactive app "within" multiple states as the user traveled around the country. Which states are entitled to tax the income of the app developer, who has never left State A, and how should that income be apportioned among the states?

[21] This points to another concern: When one state's income tax revenue can only come at the expense of another state's, the risk of conflict between the states increases — the very economic "Balkanization" that the commerce clause was intended to protect against.

[22] 430 U.S. 274 (1977).

[23] The Court cited the Mississippi Supreme Court's statement that "the Taxpayer has a large operation in this State. It is dependent upon the State for police protection and other State services the same as other citizens. It should pay its fair share of taxes so long, but only so long, as the tax does not discriminate against interstate commerce, and there is no danger of interstate commerce being smothered by cumulative taxes of several states. There is no possibility of any other state duplicating the tax involved in this case." 430 U.S. at 277.

[24] 358 U.S. 450 (1959).

Congress Is the Appropriate Body to Make Determinations About a Changing Economy

The revised MTC statement attempts to justify its interpretive nullification of P.L. 86-272 simply by referencing the passage of time, and, specifically, the development of the internet, which did not exist in 1959 when the statute was enacted.[25] When it makes the blanket statement that "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,"[26] the MTC is concluding that although P.L. 86-272 may have protected an out-of-state business with a telephone number in 1959, it could not possibly have been intended to protect an out-of-state business with an email address in 2021. Of course, the MTC's self-serving conclusion is far from obvious, and in any case, it is for Congress, not the MTC, to decide whether and how to update a federal statute to reflect changing times.

It is true that many new technologies have emerged in the six decades since the enactment of P.L. 86-272, and in that time Congress has not chosen to amend or repeal the statute. To the extent MTC members are sincere in lamenting the lack of congressional action in this area, they should perhaps be careful what they wish for. The regulation of interstate commerce is a foundational concern of the Constitution,[27] and it is at least as likely that Congress, if and when it chooses to act in this area, might act to create greater protections for interstate commerce rather than choosing to eliminate the limited protections already provided by P.L. 86-272.

When advocates of the MTC's revised statement comment that P.L. 86-272 was intended as a "temporary" measure when it was enacted in 1959, they often neglect to mention that Congress considered P.L. 86-272 to be temporary because it anticipated even more comprehensive legislation on the horizon, which would have resulted in further curtailment of individual state taxing authority in favor of greater uniformity of state tax regimes. In 1959 an out-of-state company typically had to undertake activities purposefully directed at a specific state in order to sell to in-state customers — in *Northwestern States*, the out-of-state company employed teams of salespeople to visit customers in the neighboring state in person. Yet Congress determined that the needs of interstate commerce required that the out-of-state company be protected from the imposition of state taxes on its net income in those circumstances. In 2021 a single individual with a website can sell to customers in all 50 states more easily than ever before. If the member states of the MTC have their way, that same individual could suddenly find herself subject to a dizzying array of income tax obligations in dozens of states, including significant compliance costs and the risk of multiple taxation, subject only perhaps to a de minimis sales threshold. These burdens are much greater than the burdens Congress sought to remove when it passed P.L. 86-272, and they arguably call for more robust action from Congress, not less.

Furthermore, the flourishing of interstate commerce in the internet age — which the MTC points to as grounds for greater and more intrusive state taxation of out-of-state companies whose only connections to the taxing state are virtual — may be due in no small part to the economic conditions Congress created when it enacted P.L. 86-272. Entrepreneurs can grow their businesses, to the benefit of the national economy, safe in the knowledge that the next sale is not necessarily a ticket to mysterious and burdensome tax and compliance obligations in faraway jurisdictions.[28] Ultimately, the question whether the protections of P.L. 86-272 are too much, too little, or just right is a question that Congress, and only Congress, has the authority and the expertise to decide. The U.S. Constitution specifically dedicates to Congress the power "to regulate Commerce . . . among the several States."

[25] MTC revised statement, Introduction ("In the decades since P.L. 86-272 was enacted, the way in which interstate business is conducted has changed significantly.").

[26] MTC revised statement, Art. IV, section C.

[27] As the Supreme Court has noted, the commerce clause "reflect[s] a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Wayfair*, 138 S. Ct. at 2089 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979)).

[28] Of course, companies that do conduct business activities beyond solicitation within a taxing state will be subject to that state's net income tax, if applicable.

In a complex area, with disparate interests at stake, Congress has the capacity to investigate and analyze facts affecting interstate commerce across the entire nation,[29] and, moreover, it has the democratic legitimacy to do so. The MTC represents the interests of a handful of state revenue departments, while Congress represents the citizens of every state.

Conclusion

It is not surprising that the MTC — an organization founded to oppose federal legislation that limits state taxing authority — would chafe under P.L. 86-272, a law that does just that. But the MTC's misguided revision of its P.L. 86-272 statement of information leads not to greater clarity in statutory interpretation, but to the courthouse. Because the revised statement flies in the face of the statutory text of P.L. 86-272, and of the Constitution itself, any state law, regulation, or policy statement enacting the revised MTC statement as state policy ought to be struck down when the inevitable court challenge comes. ■

[29] *See Wayfair*, 138 S. Ct. at 2104 (Roberts, J., dissenting).