

Public Law 86-272 – Nexus and Sourcing in the Digital Age

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AGENDA

- Background of P.L. 86-272
- MTC Developments
- Impact to Sales Factor Sourcing
- What Does the Future Hold?

★ BACK IN 1959 ★

🇺🇸 USA population: 177.8 million
🇺🇸 President: Dwight D. Eisenhower
💰 Household income: \$5,400



Queen Elizabeth II and U.S. President Dwight Eisenhower

NEWS STORIES

- ★ Alaska is admitted as the 49th U.S. state
- ★ The U.S. launches the Vanguard II weather satellite
- ★ Queen Elizabeth II and U.S. President Dwight Eisenhower open the Saint Lawrence Seaway
- ★ Hawaii is admitted as the 50th U.S. state
- ★ USS Barbero and U.S. Postal Service attempt the delivery of mail via Missile Mail

SPORT

- 🏆 World Series Champions Los Angeles Dodgers
- 🏈 NFL Champions Baltimore Colts
- 🏀 NBA Champions Boston Celtics
- 🏒 Stanley Cup Champions Montreal Canadiens

MOVIE

- 🎬 Ben-Hur
- 🐶 The Shaggy Dog
- 👗 Operation Petticoat
- 🔥 Some Like It Hot
- 🗣️ Pillow Talk

BORN IN 1959

- 🌟 Simon Cowell - talent manager
- 🌟 Cathy Nesbitt-Stein - reality star
- 🌟 Magic Johnson - basketball player
- 🌟 Weird Al Yankovic - pop singer
- 🌟 Rachal Renee Russell - children's author

INVENTIONS

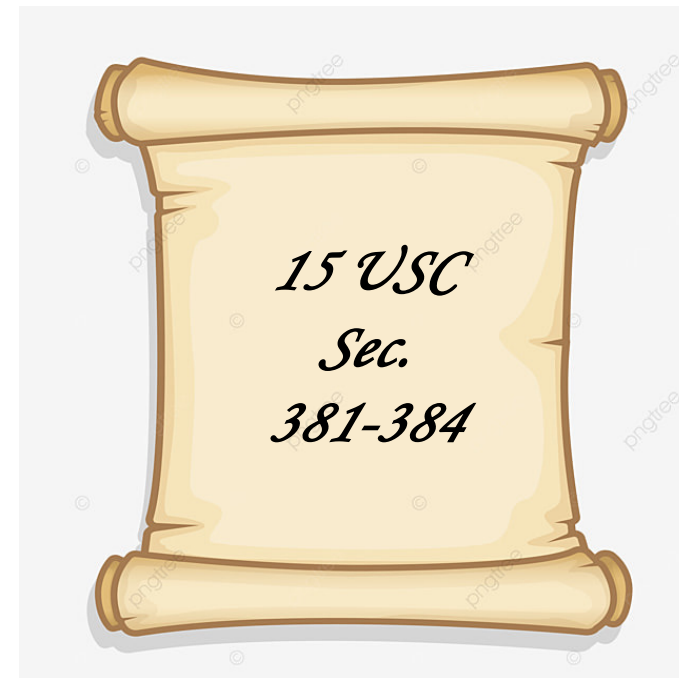
- 🔧 MOS transistor
- 🔧 Xerox
- 💡 Halogen Lamp
- 🌐 Weather Satellite
- 👙 Spandex

Music

- 🎵 The Battle of New Orleans - Johnny Horton
- 🎵 Mack the Knife - Bobby Darin
- 🎵 Personality - Lloyd Price
- 🎵 Venus - Frankie Avalon
- 🎵 Lonely Boy - Paul Anka

SLANG

- 🗣️ Maggy ann - Margarine
- 🗣️ Flake - A boring, unappealing
- 🗣️ Bazoosie - The nose
- 🗣️ Tough shit - So what? See if I care!
- 🗣️ Wig out - To lose control



*Northwestern Cement Co. v. Minnesota and
Williams v. Stockham Valves and Fittings, Inc.,
358 U.S. 450 (1959)*

- Facts:
 - Two contemporaneous corporate net income tax decisions involving the same facts (separately briefed and argued but consolidated for decision)
 - Taxpayer maintained an office;
 - District manager, two sales people and a secretary worked in Minnesota, leased office contained furniture and fixtures, company cars were provided to salespeople
 - Taxpayer has one or more salesperson who actively solicited within the State orders for the purchase of the corporation's products;
 - 48% of sales were made in Minnesota
 - Orders were accepted at, and filled from, the corporation's head office in another State.
 - Minnesota Supreme Court upheld the constitutionality of the tax
 - Georgia Supreme Court struck down the tax as violating the Due Process and Commerce Clauses

Northwestern States/Stockham Valves (cont.)

- US Supreme Court granted review because:
 - “The importance of the question in the field of state taxation is indicated by the fact that thirty-five States impose direct net income taxes on corporations.”
- Holding:
 - “[N]et income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same.”
 - Court not concerned with an undue burden:
 - “There is nothing to show that multiple taxation is present. We cannot deal in abstractions. In this type of case the taxpayers must show that the formula places a burden upon interstate commerce in a constitutional sense. This they have failed to do.”
 - Due Process was satisfied resulting from the significant amount of in-state sales, both taxpayers engaged in “substantial income-producing activity in the taxing States.”
 - Justice Frankfurter Dissented:
 - “The Court sustains the taxing power of the States in these two cases essentially on the basis of precedents. For me, the result of today's decisions is to break new ground. I say this because, among all the hundreds of cases dealing with the power of the States to tax commerce, there is not a single decision adjudicating the precise situation now before us.”

Public Law 86-272 (codified at 15 U.S.C section 381 et. seq.)

- Enacted in 1959
- States cannot impose a net income tax if:
 - the taxpayer confined its business within the State to 'the **solicitation** of orders . . . 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.'
- A number of questions have arisen, including the definition of “solicitation” and “tangible personal property”

Heublein, Inc. v. South Carolina, **409 U.S. 275 (1972)**

- Taxpayer, a seller of alcoholic beverages, was required to store inventory in the state for sale to retailers. The question before the Court was whether the South Carolina regulatory scheme – requiring in-state inventory – deprived the taxpayer of the benefit of P.L. 86-272.
- Court held for the State. The taxpayer’s compliance with the regulatory scheme was not designed to require taxpayers to forfeit P.L. 86-272
 - “Section 381 was designed to define clearly a lower limit for the exercise of that power. Clarity that would remove uncertainty was Congress' primary goal. By establishing such a limit, Congress did, of course, implicitly determine that the State's interest in taxing business activities below that limit was weaker than the national interest in promoting an open economy.”

Wisconsin Dep't of Revenue v. Wrigley, **505 US 214 (1992)**

- Taxpayer, manufacturer of chewing gum, sold its products through sales representatives who resided in and sold in Wisconsin. Taxpayer did not have any offices or warehouses in Wisconsin.
- The sales representatives performed a variety of tasks in association with their job and the Department of Revenue determined that these activities were sufficient to impose the franchise tax on the taxpayer and that the taxpayer was not protected by P.L. 86-272.
- After a series of reversals, the Wisconsin Supreme Court finally disallowed the tax. The Supreme Court of the United States granted certiorari and reversed.

Wisconsin Dep't of Revenue v. Wrigley (cont.)

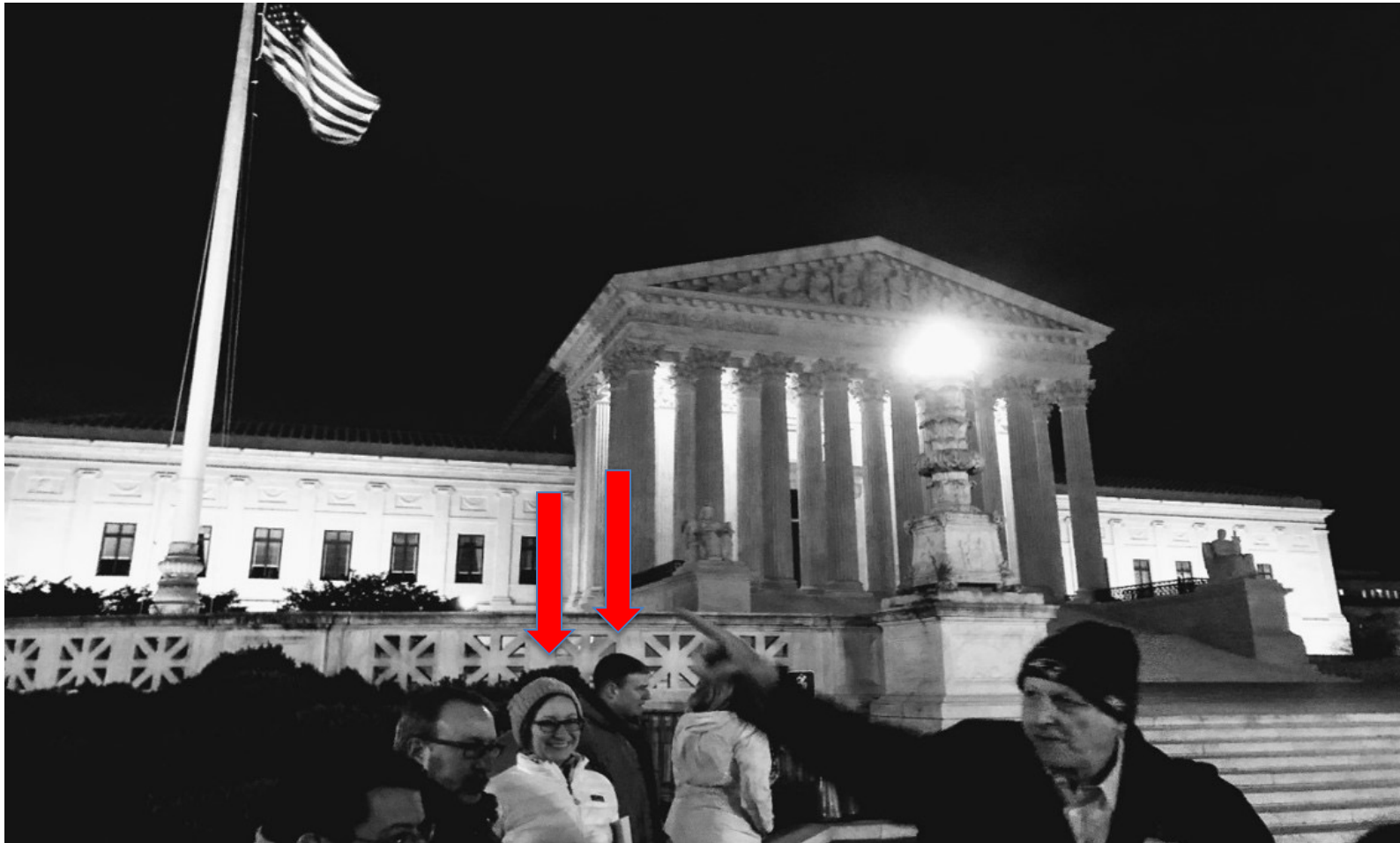
- The Court determined that some of the tasks performed fell within the definition of a “solicitation” or “ancillary to solicitation” and others were unprotected activities.
- Three Categories of Activities:
 1. Solicitation: verbal requests for orders or any speech or conduct that implicitly invites an order.
 2. Ancillary to solicitation: providing a car and stock of free samples, recruitment/training/evaluation of sales representatives, use of hotels and homes for sales-related meetings, and communication with the Chicago office about credit disputes.
 3. Unprotected activities: sales representatives repairing or servicing the company’s products, replacing stale gum, supplying gum through agency stock checks, and storing gum.

ASAP Cruises, Inc. v. Wisconsin Department of Revenue

- The Taxpayer sold travel services utilizing independent travel consultants (ITCs)
- The ITCs earned a commission from the Taxpayer for sales of cruises and travel related services
- The Taxpayer claimed P.L. 86-272 protection because it sold software as a service (SAAS) which should be treated as sales of tangible personal property
- The Wisconsin Tax Appeals Commission held that the Taxpayer sold services, not tangible personal property
 - The Dare County Circuit Court remanded the case because it found that the Wisconsin Tax Appeals Commission improperly granted summary judgment and did not give proper weight to an affidavit filed by the Taxpayer
 - The case is on appeal at the Wisconsin Court of Appeals

Nexus Developments and PL 86-272

To the extent *Wayfair* broadened or clarified nexus for corporate income tax, in addition to addressing sales tax, it increased focus on P.L. 86-272 for both states and taxpayers



15 USC. 381, et seq. (P.L.86-272)

(a) 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;

(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 (1).

MTC Model Interpretation

- In 2021, the Multistate Tax Commission (MTC) adopted revisions to its “Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272”
 - “... 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.’ 138 S. Ct. 2080, 2095 (2018). Although the Wayfair Court was not interpreting P.L. 86-272, the Supporting States consider the Court’s analysis as to virtual contacts to be relevant ... for purposes of [PL 86-272].”
- Primary purpose is to address business activity of an Internet seller
 - **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; and if that activity exceeds the thresholds of PL 86-272, the business loses protection
 - To be effective in a state, the state must first adopt the MTC model into its own law, guidance, practice, or policy
 - MTC recommends adoption “prospective only”

MTC Model Interpretation

Protected

- The business's website allows customers to search for items, read product descriptions, select items for purchase, pay for items, and choose delivery options
- The business has static FAQs on its website
- The business places Internet cookies onto customer devices that gather customer information that is only used:
 - 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
 - To remind customers what products they have considered during previous sessions

Not Protected

- The business offers post-sale assistance via electronic chat or email that is accessed by clicking an icon on a website
- The business solicits applications for branded credit cards via the website
- The business offers and sells extended warranty plans via its website to in-state customers who purchase the business's product
- The business places Internet cookies onto customer devices that gather customer search information to adjust production schedules and inventory, or develop/identify new products for sale
- The business website invites viewers to fill out an online application for a non-sales job opening.
- The business remotely fixes or upgrades products previously purchased by transmitting code or other electronic instruction to the products.

MTC Model Interpretation

- ***Joyce or Finnigan.*** Language that had invoked a Joyce apportionment rule was removed.
 - *Disney Enterprises, Inc. v. Tax Appeals Trib.*, 888 N.E.2d 1029 (NY 2008)
 - *Airborne Navigation Corp. v. Arizona Dep't of Rev.*, 1987 WL 50031 (Ariz. Bd. Tax App. Feb. 5, 1987)
 - New Jersey Revised Bulletin TB-86(R) adopted 2019, later retracted
- ***Foreign sales.*** P.L. 86-272 and throwback should be invoked consistently, including with respect to foreign sales.
- ***Telecommuters.*** Telecommuting added to the list of unprotected activities, unless telecommuter's activities are within the statutory protection.

State Adoption

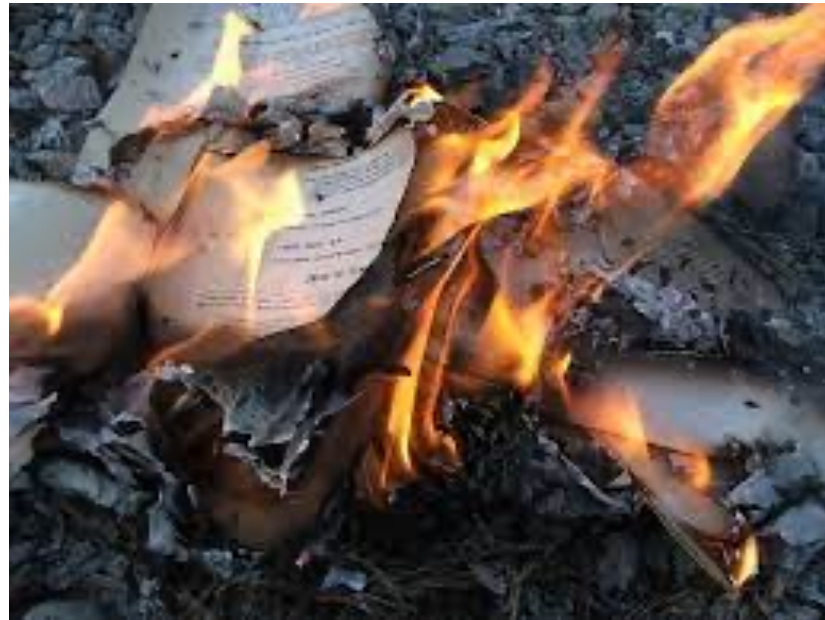
- Two states adopted at least in part, three considering
 - California TAM 2022-01 (Feb., 2022), updated its Pub 1050 (May 2022) adopts aspects of MTC model; but see *American Catalog Mailers Association*
 - New Jersey Technical Bulletin – 108 (Sept 2023) departs in some ways
 - New York proposed regulations Article 9-A, Part I, Section 1-2.10 (July 2023; Comments due October 10, 2023) includes aspects of MTC model
 - Oregon considering adoption by regulation
 - Minnesota circulated draft guidance (April 2023) closely tracking the MTC model
 - Other states on audit, without published guidance

- “Unprotected Activities....
 22. Making sales that equal or exceed \$100,000 during the current or preceding calendar year; and
 23. Engaging in 200 or more business transactions with persons within Hawaii during the current or preceding calendar year.”
 - Is this statement supportable?
 - If so, is it retroactive . . .

Some Taxpayer Reactions to MTC Model

- It's a federal statute
- Is the MTC interpretation “in accord with the ordinary public meaning of [PL 86-272's] terms at the time of its enactment”? See *Bostock v. Clayton County, Georgia*, 140 S.Ct. 1731 (2020). E.g., Is the 2021 internet more “interactive” than a 1959 telephone, or is it just a new and better communication technology?
- New Interpretations should (must?) be communicated
- New Interpretations should (must?) be prospective only
- If retroactive, does that cut both ways (e.g. amended throwback adjustments?)
- What about state “signatories” to older MTC interpretations?

This is what the new guidance does...



*American Catalogue Mailers Association v. Calif.
FTB, Case No. CGC-22-601363 (Aug. 24, 2023)*

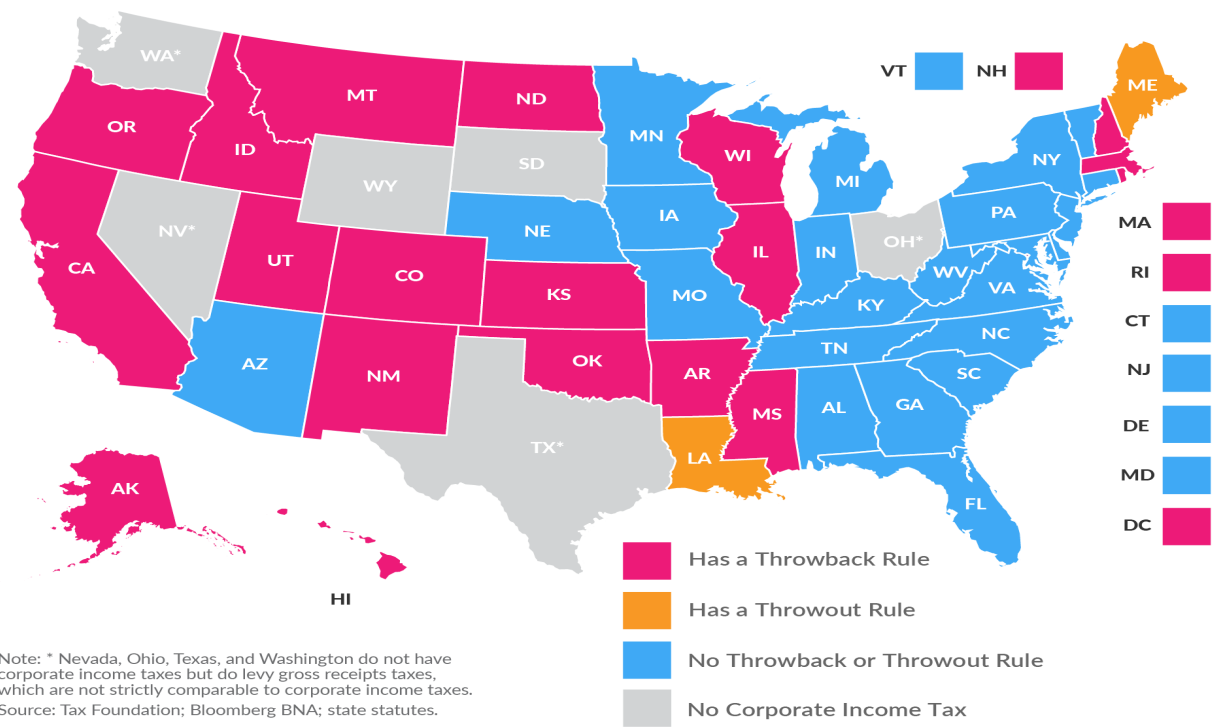
- ACMA challenged California TAM No. 2022-01 and FTB Publication 1050
- ACMA's Motion for Summary Judgement was Denied
 - Discusses at length whether "within the state" requires more than remote contact
 - The Court could not conclude on summary judgement that the TAM and Publication 1050 are invalid in their entirety – but expressed "significant concerns as to FTB's interpretation and application of PL 86-272"
 - Court states that the TAM and Publication are void as regulations not in compliance with the APA, but does not invalidate them because the ACMA did not move for summary judgment on the issue

Impact of Digital Activity on Throwback

- Business may have taxable **nexus** based upon physical presence or economic presence
- Sellers of TPP may not be subject to a net income tax if PL 86-272 applies
- What does this have to do with throwback?
 - Sales from a state with throwback rule may not require throwback if company is subject to tax in the destination state – no increase in origin state numerator
 - “Subject to” tax may be in reference to PL 86-272 (e.g., California)
 - As more states adopt MTC interpretation throwback may be affected

States with a Throwback or Throwout Rule

Does Your State Have a Throwback or Throwout Rule?
State Throwback and Throwout Rules as of January 1, 2023



Note: * Nevada, Ohio, Texas, and Washington do not have corporate income taxes but do levy gross receipts taxes, which are not strictly comparable to corporate income taxes.
Source: Tax Foundation; Bloomberg BNA; state statutes.

Impact to Throwback – E.g., California

Example – corporation ships from California has chat function on website

Throwback originally reported to CA	10,000,000
Total Sales	100,000,000
Reduction in sales factor removing TB	10%
Taxable income	20,000,000
Reduction in apportioned income	2,000,000
Tax Rate	8.84%
Reduction in Tax	176,800

Consider how *American Catalog Mailers Association* lawsuit impacts claims in CA

Where are we headed with PL 86-272?

CASE STUDY #1:

Nevada Mining Corp. provides a job application portal on its website for metallurgists to work in Fallon, NV. No one in New York even applies due to the specialized nature of the business and location. The company solicits sales of silver in New York within the parameters of *Wrigley*. **Is the company protected by PL 86-272?**

Where are we headed with PL 86-272?

CASE STUDY #2:

Banana Co. sells its fruit in California. The company has a program that may be accessed in a VR headset where buyers can take a virtual tour of the farm and production facility. California buyers have taken the virtual tour. **Does access to this experience go beyond the protection of PL 86-272?**

Where are we headed with PL 86-272?

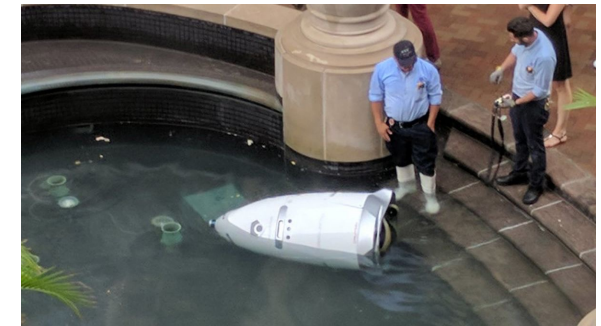
CASE STUDY #3:

Music Co. in Nashville, TN sells vintage vinyl across the USA. The company does nothing that falls within the new MTC guidelines – it merely sells through its reputation and on the website. The company hires an accountant in Illinois who can work remotely given technology-enabled work solutions. **Does this employee cause Music Co. to lose its protection? Are there any other issues to consider?**

Where are we headed with PL 86-272?

CASE STUDY #4:

Security Corp. sells a robot that roams around malls and takes video for security surveillance. Security partners with a spinoff company that sells cloud hosted software that enables security teams to do surveillance real time. Security Corp. sells only the robot, which can function without the added software, but the software is usually the big selling point. [When Security Corp. provides information for the software, which is not their product, does this exceed the protection of PL 86-272?](#)



30th ANNUAL

PAUL J. HARTMAN
STATE AND LOCAL TAX FORUM

QUESTIONS?