



MULTISTATE INCOME/FRANCHISE TAX

California Franchise Tax Board guidance on application of P.L. 86-272 to activities conducted via the internet Tax Alert

Overview

On February 14, 2022, the California Franchise Tax Board (“FTB”) issued [Technical Advice Memorandum 2022-01](#) (“TAM 2022-01”) discussing whether the protections of 15 U.S.C. sections 381-384 (“P.L. 86-272”) applied to certain fact patterns now common in businesses due to technological advancements – namely, various activities conducted via the internet.

This Tax Alert summarizes some of the information in TAM 2022-01 and provides some taxpayer considerations.

Summary of TAM 2022-01

Generally, P.L. 86-272 prohibits a state from imposing a net income tax on the income of a person derived within the state from interstate commerce if (1) the only business activities conducted within the state consist of the solicitation of orders for sales of tangible personal property (“TPP”), (2) the orders are sent outside of the state for acceptance or rejection, and (3) if the orders are accepted, the TPP is shipped or delivered from a point outside the state. The FTB is providing this guidance because Congress has not created a federal mechanism to provide administrative guidance to taxpayers or updated the statute to address the manner in which P.L. 86-272 should apply given the significant changes to the manner in which interstate commerce is conducted as a result of technological advancements since P.L. 86-272 was enacted.

Fact Patterns Considered by FTB and Related Conclusions

The FTB considered twelve fact patterns in TAM 2022-01. Each fact pattern presumes that the business makes sales to California customers but is commercially domiciled outside of California and has no other California activities except those mentioned in the fact pattern.

For the following three fact patterns, the FTB concluded that the stated activities are protected under P.L. 86-272:

- Providing post-sale assistance to California customers by posting a list of static FAQs with answers on the business's website.
- Placing internet cookies onto the computers or other devices of California customers, when the cookies only gather customer information for purposes that are entirely ancillary to the solicitation of orders for TPP – for example, 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 electronic devices.
- Offering for sale only items of TPP 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 items.

For the following nine fact patterns, the FTB concluded that the stated activities are not protected under P.L. 86-272:

- Having an employee who telecommutes on a regular basis from within California performing business management and accounting tasks.
- Regularly providing post-sale assistance to California customers via e-mail or electronic chat that customers initiate by clicking on an icon on the business's website;
- Soliciting and receiving online applications from California customers for its branded credit card via the business's website. The issued cards will generate interest income and fees for the business.
- A website that invites viewers in California to apply for non-sales positions with the business. The website enables viewers to fill out and submit an electronic application and upload a cover letter and resume.
- Placing internet cookies onto the computers or electronic devices of California customers and using the cookies to gather customer search information to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale.
- Remotely fixing or upgrading products previously purchased by California customers by transmitting code or other electronic instructions to those products via the Internet.
- Offering and selling extended warranty plans via the business's website to California customers who purchase the business's products.
- Contracting 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 located.
- Contracting with customers to stream videos and music to electronic devices for a charge.

The FTB noted that P.L. 86-272 affects both the determination whether a state into which the TPP is delivered may tax the seller's income and whether the

state from which the TPP is shipped may subject the related receipts to that state's throwback rule. California's throwback rule provides that, if TPP is shipped from an office, store, warehouse, factory, or other place of storage in California, and the taxpayer is not taxable in the purchaser's state, those sales of TPP are treated as California sales for purposes of the sales factor.

Considerations

TAM 2022-01 provides guidance on the FTB's view as to how P.L. 86-272 should apply to various activities conducted via the internet. This guidance could have a significant impact on taxpayers that were previously relying on the protections of P.L. 86-272 to conclude that their sales to California were not taxable in California. However, this guidance may potentially have a more favorable impact on taxpayers that may be subject to California's throwback rule (*see also* FTB Chief Counsel Rulings [2016-03](#) and [2012-03](#), and prior Deloitte Multistate Tax Alerts [here](#) and [here](#)).

The TAM does not specify whether its guidance applies retroactively to prior tax periods or whether it should only be applied prospectively. Given that the TAM is addressing the interpretation of a longstanding federal statute, taxpayers should be aware that the guidance may be applied retroactively to prior periods.

Additionally, it appears that California has effectively adopted the guidance provided in the Multistate Tax Commission ("MTC") [Revisions to the Statement on P.L. 86-272](#) ("Statement"). Previously, the MTC had formed a working group to propose revisions to the Statement to address changes over the past two decades in the economy and the way in which business is conducted. California recently re-joined as a member state of the MTC.

California appears to be the first state to formally adopt the MTC's revised guidance on P.L. 86-272. Other states may follow suit and adopt the MTC guidance either through similar administrative pronouncements or simply through their audit function. Taxpayers relying on P.L. 86-272 should continue to monitor the issue in all applicable jurisdictions.

As the availability of P.L. 86-272 protection turns on a fact-intensive inquiry, taxpayers should consult their tax practitioners to discuss the impact that TAM 2022-01 may have on their California tax liabilities.

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