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In this installment of Inside Deloitte, the authors summarize the history of P.L. 86-272 and analyze the Multistate Tax Commission's most recent interpretation of P.L. 86-272, examining California's and New York's adoptions of the MTC's position on activities conducted via the internet.

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I. Introduction

Public Law 86-272 was enacted in 1959 to limit the states' authority to impose net income taxes. Since its enactment, technological advances — including the emergence and prevalence of the internet — have changed the way taxpayers conduct business. This change has shifted the tax landscape, causing tax authorities to reconsider and reinterpret principles of law as applied to internet sellers and e-commerce transactions.

One such reinterpretation is the Multistate Tax Commission's¹ recent revision to its Statement of Information Concerning Practices of the Multistate Tax Commission and Supporting States Under P.L. 86-272 (Revised Statement). Through its Revised Statement, the MTC is the first to take the position that for purposes of P.L. 86-272, a business engages in activity *within the customer's state* when the business interacts with the customer via the business's website or app. As a result, states such as California and New York have adopted the same position, leaving taxpayers to wonder whether other states will follow.

This article summarizes the history of P.L. 86-272, discusses the MTC's involvement with the federal statute, analyzes the MTC's most recent interpretation of P.L. 86-272, and examines California's and New York's adoptions of the Revised Statement's position on activities conducted via the internet.

¹The Multistate Tax Commission — an intergovernmental state tax agency created by the Multistate Tax Compact in 1967 — is responsible for promoting consistency and uniformity, facilitating compliance and convenience for taxpayers, and avoiding double taxation. See the MTC website.

II. Background of P.L. 86-272

P.L. 86-272 — codified at 15 U.S.C. sections 381-384 — generally prohibits a state from imposing a net income tax on the income of a person derived from interstate commerce if the only business activities within that state by or on behalf of the person are: (1) the solicitation of orders by the person or the person's representative; (2) for sales of tangible personal property (TPP); (3) the orders are sent outside the state for approval (or rejection); and (4) if approved, are filled by shipment or delivery from a point outside the state.

P.L. 86-272 was adopted by Congress in 1959 and was meant as a stopgap measure addressing the U.S. Supreme Court decision in *Northwestern States*.² The Court upheld the imposition of an apportioned net income tax on an out-of-state manufacturer whose activity in the taxing state, Minnesota, was the regular solicitation of orders for sales of its products. These orders were accepted, filled, and delivered from outside Minnesota and the taxpayer conducted its solicitation activities in Minnesota through a leased office and permanent sales staff. The taxpayer's sales staff also received and transmitted claims against the taxpayer for loss or damage in any shipment made by it. The taxpayer had no bank account, real property, or warehoused merchandise in Minnesota.

The Court's decision in *Northwestern States* and the Court's refusal to review two Louisiana Supreme Court cases involving the imposition of net income taxes on out-of-state companies with in-state activities limited to sales solicitation created uncertainty in the business community, prompting Congress to enact P.L. 86-272.³

After the passage of P.L. 86-272, the scope of the phrase "solicitation of orders" was unclear.⁴ The term "business activities" is also not defined

in the statute. In *Wrigley*, the Court addressed these issues along with whether there is a de minimis exception to the activity (beyond solicitation of orders) that is also protected by P.L. 86-272.

According to the Court in *Wrigley*, "solicitation" includes "not just explicit verbal requests for orders, but also any speech or conduct that implicitly invites an order."⁵ Solicitation also includes 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."⁶ (Emphasis in original.)

The *Wrigley* Court also recognized a de minimis exception for purposes of P.L. 86-272. According to the Court, whether an activity is de minimis enough to avoid loss of P.L. 86-272 immunity depends on whether the "activity establishes a nontrivial additional connection with the taxing State."⁷

The Court also provided guidance on the term "business activities" by stating that it "more naturally connotes courses of conduct."⁸ (Emphasis added.) The *Wrigley* Court also acknowledged that an activity is generally defined as "an occupation, pursuit, or recreation in which a person is active."⁹

Most recently, in interpreting the commerce clause,¹⁰ the Court held in *Wayfair*¹¹ that "physical presence is not necessary to create a substantial nexus."¹² The Court said that "the 'dramatic

⁵ *Id.* at 223.

⁶ *Id.* at 228-229.

⁷ *Id.* at 232.

⁸ The Court said: "One might argue . . . that the phrase 'solicitation of orders' covers only the actual requests for purchases or, at most, the actions absolutely essential to making those requests. We think, however, that would be an unreasonable reading of the text. That the statutory phrase uses the term 'solicitation' in a more general sense that includes not merely the ultimate act of inviting an order but the entire process associated with the invitation is suggested by the fact that §381 describes 'the solicitation of orders' as a subcategory, not of in-state acts, but rather of in-state 'business activities' — a term that more naturally connotes courses of conduct." (Emphasis in original.) *Wrigley*, 505 U.S. at 225-226, citing *Webster's Third New International Dictionary*, 22 (1981) (defining "activity" as "an occupation, pursuit, or recreation in which a person is active — often used in pl. *business activities*"). (Emphasis in original.)

⁹ *Id.*

¹⁰ U.S. Const. Art. I, section 8, cl. 3.

¹¹ *South Dakota v. Wayfair Inc.*, 585 U.S. ___, 138 S. Ct. 2080 (2018).

¹² *Wayfair*, 138 S. Ct. at 2093.

² *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

³ *Wisconsin Department of Revenue v. Wrigley*, 505 U.S. 214, 221-222 (1992), citing *Heublein Inc. v. South Carolina Tax Commission*, 409 U.S. 275 (1972). The Court granted a motion to dismiss *Brown-Forman Distillers Corp. v. Collector of Revenue*, 234 La. 651 (1958), and denied certiorari in *International Shoe Co. v. Fontenot*, 236 La. 279 (1958), which also contributed to the uncertainty in the business community and encouraged Congress to respond by enacting P.L. 86-272.

⁴ *Wrigley*, 505 U.S. at 223.

technological and social changes' of our 'increasingly interconnected economy' mean that buyers are 'closer to most major retailers' than ever before — 'regardless of how close or far the nearest storefront.'" ¹³ Because of the internet, the Court said, "'a business may be present in a State in a meaningful way without'" a physical presence. ¹⁴

Although the Court in *Wayfair* did not interpret P.L. 86-272, the MTC deemed the Court's analysis regarding virtual contacts to be relevant to whether a seller is engaged in business activities in states where customers are located for purposes of P.L. 86-272. ¹⁵

III. The MTC's Guidance on P.L. 86-272

The MTC adopted its original statement regarding P.L.86-272 (Original Statement) on July 11, 1986. It issued the statement "to address the uncertainties arising from the statute and to provide needed guidance to taxpayers."¹⁶ The Original Statement reflected the signatory states' interpretation of the federal statute¹⁷ and set forth those activities that were deemed protected and unprotected by P.L. 86-272.

The MTC has revised the Original Statement four times to address new issues and developments in case law.¹⁸ On August 4, 2021, the MTC adopted the Revised Statement. While the MTC has made various changes in its most recent interpretation of P.L. 86-272, the most notable change in the Revised Statement is the addition of new Section C to Article IV, which provides guidance on the application of P.L. 86-272 to persons who conduct activities via the internet.

According to the Revised Statement, the general analysis that applies to persons who sell TPP by other means also applies to determine whether a person who sells TPP via the internet

is protected from taxation by P.L. 86-272. As such, an internet seller is shielded from taxation in the customer's state if the only business activity it engages in within that state "is the solicitation of orders for sales of [TPP], which orders are sent outside that state for approval or rejection, and if approved, are shipped from a point outside of that state."¹⁹

In newly added Section C, the MTC deems a company's online activities to take place in the customer state. The Revised Statement provides:

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. [Emphasis added.]²⁰

The Revised Statement provides various examples of activities that are deemed protected or unprotected. In each example, the following apply: (1) a business operates a website offering for sale only items of TPP (unless otherwise indicated); (2) customer orders are approved (or rejected) from outside the customer's state; and (3) products are shipped from a location outside the customer's state.

In one example, P.L. 86-272 protection would not be defeated when a business provides post-sale assistance to in-state customers by posting a list of static frequently asked questions with answers on the business's website, because that activity "does not constitute a business activity within the customer's state."²¹

Conversely, P.L. 86-272 would not protect a business that regularly provides post-sale assistance to in-state customers via either electronic chat or e-mail that customers initiate by clicking on an icon on the business's website. According to the Revised Statement, this "*in-*

¹³ *Id.* at 2095, quoting *Direct Marketing Association v. Brohl*, 575 U.S. 1 (2015).

¹⁴ *Id.*

¹⁵ Revised Statement, "Introduction," at 2.

¹⁶ "Submission of Proposed Revisions to the MTC Model Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272," MTC, p. 3 (June 17, 2020).

¹⁷ *Id.* at 4.

¹⁸ *Id.*

¹⁹ Revised Statement, Art. IV, section C, at 8.

²⁰ *Id.*

²¹ Revised Statement, Art. V, section C, Ex. 1, at 8.

*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 [TPP]."*²² (Emphasis added.)

IV. California's and New York's Adoption of the MTC's Position

The California Franchise Tax Board has officially published guidance, TAM 2022-01,²³ that effectively adopts the MTC's interpretation of P.L. 86-272. TAM 2022-01 discusses how P.L. 86-272 applies to 12 different fact patterns that are common to businesses in the current economy because of technological advances (that is, activities conducted via the internet).

Regarding whether the business has exceeded the protections of P.L. 86-272 under each fact pattern in TAM 2022-01, the FTB stated that the analysis generally involves the following two questions: (1) whether the business activities take place in California and (2) whether those activities exceed the protection of P.L. 86-272. In one such fact pattern — which is essentially the same as the first fact pattern/example in the Revised Statement — a business provides post-sale assistance to California customers by posting a list of static FAQs with answers on its website. According to the FTB, that activity does not disqualify the business from immunity under P.L. 86-272 because it does not constitute a business activity within California, since the "viewing of static FAQs through the internet does not provide the requisite interaction between the California customer and [the business] and is similar to reading a pamphlet on a product."²⁴

On the other hand, in another fact pattern — which is also essentially the same as the second fact pattern/example in the Revised Statement — a business regularly provides post-sale assistance to California customers via either electronic chat or e-mail, which customers initiate by clicking on an icon on the business's website. For that example, the FTB concluded:

The activity of [the business] in California disqualifies the business from [P.L.] 86-272 immunity because the activity does not constitute, and is not entirely ancillary to, the in-state solicitation of orders for sales of [TPP]. *There is business activity in California because [the business] is providing live chat and [e-mail] through the website available to customers through computers or other electronic devices in California.*²⁵ [Emphasis added.]

Like the MTC, the FTB — through this example and the others provided in TAM 2022-01 — has determined that when a business interacts with a California customer via the internet or a website, the business is deemed to engage in an activity within California, the customer's state.

Similarly, in April the New York State Department of Taxation and Finance released updates to previously posted proposed draft amendments to parts 1 through 3 of Article 9-A, State Business Corporate Franchise Tax Regulations. According to the department, the revised nexus provisions, which are "largely modeled after the MTC model statute," are added to address P.L. 86-272 and activities conducted via the internet. The department intends to begin the formal adoption process for the draft amendments this year.²⁶

Like the Revised Statement and TAM 2022-01, the proposed draft amendments provide various examples of protected and unprotected activities. Based on those examples, New York has determined that a corporation's activities conducted via the internet with New York customers are deemed to take place in New York.²⁷

There are some instances in which the FTB's interpretation of P.L. 86-272 may be beneficial in California (for example, to avoid throwback to

²² Revised Statement, Art. V, section C, Ex. 2, at 8.

²³ California Franchise Tax Board, TAM 2022-01 (Feb. 14, 2022).

²⁴ *Id.* at Fact Pattern and Conclusion #10.

²⁵ *Id.* at Fact Pattern and Conclusion #2.

²⁶ New York Department of Taxation and Finance, Introduction to "Draft of Parts 1 through 3 of Article 9-A State Business Corporate Franchise Tax Regulations." The draft regulations apply to both C and S corporations.

²⁷ *Id.* at section 1-2.10(i). It should be noted the extent to which a taxpayer has nexus in New York state may affect its ability to claim P.L. 86-272 protection in New York City.

California²⁸). However, many taxpayers may now be required to file and pay taxes in California and New York even though they have historically determined that their sales to those states are not taxable based on the protection of P.L. 86-272.

V. Criticism of the Revised Statement

A. Where Does Business Activity Conducted Through the Internet Take Place?

In its Revised Statement, the MTC takes the position that when a business engages with a customer via the internet, the business engages in activity in the customer's state.²⁹ According to the MTC, the only relevant inquiry is whether the business's internet activities are protected by P.L. 86-272 (that is, whether the internet seller is only soliciting orders for sales of TPP in the customer's state, which orders are sent outside that state for approval (or rejection), and if approved, are shipped from a point outside the customer's state).

Is deeming online business activity to take place in the customer's state a reasonable reading of P.L. 86-272? Is it a reasonable application of P.L. 86-272 to modern online economic activity?

In 1959, when P.L. 86-272 was enacted, the internet did not exist. However, there were other ways to communicate with out-of-state customers (for example, via telephone, advertising in a magazine or newspaper, mail, catalogues, radio, and television). Businesses were able to use these non-online methods of communication to reach customers across the country. And customers could correspond directly with out-of-state businesses using these communication tools without causing the business to be deemed as conducting an activity in the customer's state. A business's call center activities were not deemed to take place in the

customer's state each time a customer called for post-sale assistance. Before the MTC's Revised Statement, correspondence with a customer, even internet-enabled e-mail correspondence, was not considered to be an activity the business was conducting in the customer's state.

One could determine that like other forms of communication, telecommunications were traditionally viewed as having actors engaging in an activity on each end of the communications network. The Revised Statement eliminates this divide and transports the business to the other side of the network when it deems the business's online communications to be business activities taking place in the customer's state. In this way, the Revised Statement may improperly limit the protections of P.L. 86-272 by interpreting the law too narrowly.

Barring unlikely congressional action to revise P.L. 86-272, it is likely that the courts will have to decide the validity of the Revised Statement and whether a business's online activity is taking place on both (all) sides of the internet.³⁰ As support for the Revised Statement, the MTC points to *Wayfair* and its holding that a business's online sales activity may constitute a connection between the business and a state sufficient to satisfy commerce clause nexus concerns.³¹ But arguably, a business can have a substantial connection with a state without conducting business activities in the state. A business can communicate with a customer in another state, and establish connections with the out-of-state customer, without ever conducting a "business activity" in the customer's state within the meaning of P.L. 86-272. Businesses have long been able to do this. The internet makes this process easier and more dynamic. It does not change the fact that the business is on one side of the network and the customer is on the other.

While the *Wrigley* Court did not expressly define "business activities," the Court did state that the term "more naturally connotes courses of

²⁸ See Cal. Rev. & Tax. Code section 25135(a)(2). The TAM expressly states that P.L. 86-272 applies to both of the following: (1) the determination of whether a state into which tangible personal property is delivered may tax the income of the seller and (2) the determination of whether the state from which tangible personal property is shipped may subject the related receipts to the state's throwback rule. However, TAM 2022-01 does not specify whether its guidance applies retroactively or to prospective tax periods only.

²⁹ Revised Statement, Art. IV, section C, at 8.

³⁰ While treating online communications differently could raise issues under the Internet Tax Freedom Act, 47 U.S.C. section 151, note, an analysis of ITFA issues is outside the scope of this article.

³¹ Revised Statement, "Introduction," at 2.

conduct.”³² (Emphasis added.) The *Wrigley* Court then favorably referenced a dictionary definition of activity as “an occupation, pursuit, or recreation in which a person is active.” *Wrigley*’s discussion of business activities supports a traditional limited interpretation of that term consistent with the idea that a business conducts an activity through its physical presence and should not be considered to be conducting business activities in every jurisdiction where a customer accesses its website or interacts with its app.

The implications of the Revised Statement are profound. While it appears to support the idea that some online communications will not be deemed to occur in the customer’s state, the Revised Statement limits that position to static communications that do not allow for customer interaction. Today’s websites and apps are not static. Any business with a modern website or app is essentially left with no P.L. 86-272 protection anywhere because the internet is everywhere. A business no longer has to direct its activity toward a jurisdiction to lose P.L. 86-272 protection. When a business publishes a website, customers can pull the business into their states when they interact with the website. And P.L. 86-272 becomes irrelevant in today’s economy if the MTC’s interpretation is accepted as the law of the land.

The implications of the logic behind the Revised Statement go beyond P.L. 86-272 and may be even more burdensome for businesses. Most state and local regulatory schemes, tax and nontax alike, apply to businesses carrying on business activities in the respective jurisdictions. Municipal business licenses come to mind, many with associated fees or taxes, and each with its own unique compliance challenge. Does a modern website subject the business to every municipal business license? Again, the implications are not limited to tax. The nontax implications are likely more significant but are beyond the scope of this article.

³² *Wrigley*, 505 U.S. at 225-226.

B. Will States Adopt the Revised Statement and If So, How?

MTC uniformity recommendations are not automatically adopted by member states. MTC uniformity projects normally take the form of model regulations or model statutes. A member state adopts a model regulation through its own regulatory promulgation process with notice requirements, opportunity for public comment, and effective dates. Likewise, model state statutes are adopted through the legislative process, which also provides for public notice, an opportunity for input, and effective dates.

The Revised Statement is different. It could be viewed as a recommendation to states that they change their interpretation of an existing federal statute. Generally, states do not have set procedures for announcing changes to their interpretation of federal statutes. There are no rules addressing public notice, public comment, or effective dates. Taxpayers are left to wonder if a state is changing its interpretation of P.L. 86-292. States may, but are not required to, publish guidance announcing the change — as New York and California have done. States could also decide to implement the change prospectively or retroactively — which New York and California have failed to address. The Revised Statement is silent on these issues, but MTC officials have informally suggested that states should issue written guidance and impose the change on a prospective basis only. However, if states do decide to impose the change retroactively, how far back will they go? In most cases the immunity offered by P.L. 86-272 includes protection against a state filing obligation.³³ This means that taxpayers who relied on that protection to not file now cannot rely on state statutes of limitation that begin to run with the filing of a return. Theoretically, states could pursue lookback periods of 20-plus years, to the beginning of the online economy. And they could do so on audit without ever publishing a notice alerting taxpayers to the issue.

³³ Even though a business may not be subject to a net income tax in a state because it is protected by P.L. 86-272, some states may still require the filing of a return to report other non-income-based taxes.

VI. Conclusion

It remains unclear whether other states will adopt the MTC's position. Other than California and New York — which have both adopted official or proposed guidance — states have yet to publicly react to the Revised Statement. The lack of state guidance may create uncertainty for taxpayers.

While state guidance on this subject is needed, it is needed from both states that are adopting the position and states that are not. For states that do adopt the position, that guidance must squarely address the retroactivity issue if it is to provide certainty. Unfortunately, any certainty on this topic may be years away. More to come.³⁴ ■

³⁴ This article contains general information only and Deloitte is not, by means of this article, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This article is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional adviser. Deloitte shall not be responsible for any loss sustained by any person who relies on this article.

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