MULTISTATE TAX COMMISSION

COMMENTS OF PHILIP M. TATAROWICZ
PUBLIC HEARING ON PROPOSED REVISIONS TO

STATEMENT OF INFORMATON CONCERNING PRACTICES OF
MULTISTATE TAX COMMISSION AND SIGNATORY STATES
UNDER PUBLIC LAW 86-272[1]

Robert J. Desiderio, Hearing Officer
August 5, 2020, 2:00 P.M. Eastern
https://global.gotomeeting.com/join/947297813

My name is Philip M. Tatarowicz. I am a Professor in the Graduate Tax Department of the Georgetown University Law Center, and Of Counsel with Blank Rome LLC in Washington, D.C. I appear here today in my individual capacity and the views I express are strictly my own.

I start by wishing to thank the Executive Committee for this opportunity to speak on this matter of global importance. Also, to acknowledge the Uniformity Committee and the dedicated individuals of its Work Group who were delegated the preparation of these proposed revisions of the Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272 ("Statement") (2/20/2020).

<u>Summary</u>

The MTC should not approve the Statement until further critical data is gathered, analyzed, and disclosed to all stakeholders before seeking adoption by "Supporting States"[2]. Further, outside the Work Group, the project to update the PL 86-272 Statement should be delayed until "normality" returns to the marketplace and it can receive the attention warranted by those too preoccupied with COVID-19 matters.

The Statement wanders from its stated purpose of providing how "PL 86-272 nexus" applies to modern business activities without engaging in tax policy. It espouses a novel interpretive rule of where a business is deemed to be engaging in a business activity when it interacts with a customer via the business's website or app (while unfairly seeking a self-serving presumption against preemption absent a clear statement of Congress) that goes beyond the pale of PL 86-272 nexus. Also, it goes beyond the question of state income tax jurisdiction and implicates issues involving sourcing and federalism.

---

[1] 15 U.S.C. §§ 381-384.

[2] The Statement's Introduction, p. 2, defines Supporting State to mean "a State that adopts or otherwise expressly indicates support for this Statement by legislation, regulation or other administrative action. Other states may adopt or otherwise indicate support for individual sections of this Statement".

Concerns With Statement

In the interest of brevity, following are illustrative concerns raised within me by the Statement. After detailing these points, I will be pleased to answer questions.

1. The Statement Works at Odds With The Congressional Goals of PL 86-272

Congress enacted PL 86-272 to stop a growing gap between interstate businesses and the U.S. Supreme Court over what activities under the Commerce Clause should constitute a taxable nexus ("Stop Gap" or "The Gap").

Based on vacillating national-local federalist conceptions, U.S. Supreme Court ("SCOTUS") standards evolved from the time of Chief Justice Marshall[3] from a virtual prohibition of state taxation of interstate commerce to, leading up to the *Northwestern-Stockham* decisions,[4] a position that the States were prohibited from imposing taxes on the privilege (and at times, *on* the income) of corporations engaging exclusively in interstate commerce.[5]

As SCOTUS started to move away from its initial views that widely prohibited state taxation of interstate commerce, so too was there an increase in the frustrations of the business community desiring greater marketplace protections.[6]

PL 86-272 addressed The Gap, in part, by *increasing* the essential connection/nexus for a tax *on* income by prohibiting state and local governments from levying a net income tax where the out-

[3] In the Court's first case striking down a State tax on CC grounds, Justice Marshall all but committed the Court to view the implied aspect of the CC as prohibiting state taxation of interstate commerce. *See*, e.g., *Brown v. Maryland*, 25 U.S. 419 (1827) (MD privilege tax on importers as impermissible regulation of commerce).

[4] Chief Justice Marshall was not absolute in his view, for he recognized the need for coexisting powers in select instances, e.g., State taxes for support of their own government that did not violate national marketplace interests except in limited instances such as those addressing local matters of safety, health and morals. *See*, e.g., *Willson v. Black-Bird Creek Marsh, Co*., 27 U.S. 247 (1829) (State act authorizing Black Bird Creek Marsh Company to place a dam across the creek not considered repugnant to the federal power to regulate commerce where Congress silent)

Even after the *Cooley* Doctrine took hold expanding the parceling of commerce into subjects local and national, the Court's opinions started adding reference to inaction of Congress. *See*, e.g., *Robbins v. Shelby County Taxing District,* 120 U.S. 489 (1887) (struck down TN tax on drummers; where Congress not spoken it was interpreted as an exercise of its will that the subject of the tax be left free from State restrictions or impositions).

[5] *See*, e.g., *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307 (1938) (invalidated an Indiana GRT imposed on an Indiana manufacturer's unapportioned gross receipts from manufactured products shipped to out-of-state purchasers). Distinguishing, *American Mfg. Co., v. City of St. Louis*, 250 U.S. 459 (1919) (upholding an excise tax on manufacturing, measured by the total gross proceeds on interstate sales of the manufactured goods). Note, shortly after *J.D. Adams Mfg. Co.*, the Court in *Gwinn, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939), struck down a WA tax for the privilege of engaging in business, measured by the total gross receipts from sales made by taxpayers who were a marketing agency for fruit growers in the taxing State.

[6] Since at least 1917, a strong belief exists that Federal legislation is needed. *See,* Philip M. Tatarowicz, *A History of the State and Local Taxes Committee and Its Most Recent Quarter Century of Work,* 68 The Tax Lawyer 595 (2015).

of-state seller's only activities within the state are soliciting orders for sale of tangible personal property. Moreover, it was careful not to contribute to The Gap by disturbing the dormant commerce clause ("DCC") prohibition of an income tax imposed on the privilege of conducting an interstate business.[7] Further, the SCOTUS distinction that had waxed and waned over time concerning the permissibility of imposing a state income tax *on* versus *measured by* interstate income was resolved by Congress when it extended the safe harbor of PL 86-272 to "net income taxes", which includes taxes imposed *on* and *measured by* income.[8]

The Statement is at odds with the goals that galvanized Congress to enact PL 86-272; and, consequently, many of its interpretive recommendations fail to harmonize with the express and implied Congressional mandates of PL 86-272.

The Statement implies that the failed achievement of uniform federal legislation somehow works like a deemed sunset rule imbuing it and the States with the power to reallocate legislative authority and narrow the protections of PL 86-272 in the silence of Congress.[9] If accepted, the efficiencies of the digital economy become the long-desired weapon of the States for significantly disemboweling PL 86-272.

2. **New Section IV.C. Is Analytically Incomplete; Neither MTC Nor States Have Sovereign Authority to Narrow PL 86-272; and, Statement Not Entitled to Interpretive Deference**

---

[7] Important to understanding The Gap is the base line of protections that were retained by Congress. In this regard, Congress did not strike marketplace protections from taxes imposed on the privilege of operating in interstate commerce. While some may be inclined to dismiss this as a token concession to days of formalism, realities are that there can be no clearer expression of State legislative intent of regulating interstate commerce than by taxing its privilege to conduct such.

It took 18-years after enactment of PL 86-272 for SCOTUS to eliminate its ban on the state income taxation of the privilege of conducting an interstate business. *See, Spector Motor Serv. v. O'Connor,* 340 U.S. 602 (1951), *overruled by Complete Auto Transit, Inc. v. Brady*, 430 US 274 (1977). (On CC grounds, the *Spector* Court struck down a CT franchise tax even though it was fairly apportioned and did not discriminate), reaffirming *Freeman v. Hewitt,* 329 U.S. 249 (1946) (condemned an Indiana GRT on the sale of stock by an Indiana stockholder (trustee) through brokers on the NYSE), which re-established, as a per se violation of the CC, the tax imposed directly on interstate transactions. The U.S. Supreme Court repealed its "Spector Rule" in *Complete Auto Transit, Inc. v. Brady, 430 US 274 (1977).*

[8] *See, Northwestern States Portland Cement Co. v. Minnesota* 358 U.S. 450 (1959) (upholding a MN <u>net income tax</u> imposed *on* an interstate entity). This resolution would not have impacted the *Northwestern* decision, because the taxpayer leased an office in MN, which exceeds the minimum activities permitted under PL 86-272. For a fuller discussion of *Northwestern-Stockham*, as well as relevant State cases, legislative history and other issues related to statutory interpretation reviewed on a state-by-state basis, *see* Philip M. Tatarowicz, *State Judicial and Administrative Interpretations of U.S. Public Law 86-272*, 38-2 The Tax Lawyer 293 (1985) (hereafter, Tatarowicz Interpretation of PL 86-272 article).

[9] The proposed revisions reference the stopgap (non-enforceable) aspect of PL 86-272 as if it is an implied authority for the Work Group to create interpretive guidelines that dramatically narrow the marketplace protections of PL 86-272. The Statement ignores The Gap (enforceable) aspect of PL 86-272 thereby substituting Congressional supremacy with its own policy judgments.

The stated intent of Section IV.C. is to put "internet activities on equal footing with other commerce" via a general rule that relies on a deemed in-state activities component ("Equal Footing Framework Rule" or "EFFR")[10]. To begin, this objective is at odds with the express and implied mandates of PL 86-272 that divides marketplace and federalist interests without intent to put activities on equal footing with other commerce.

By operation of law, the Supremacy Clause[11] works to preempt State laws that are contrary to the language or purpose of a federal statute. The EFFR attempts an end run around legislative supremacy and judicial review by adopting a rule that deems out-of-state activities to constitute in-state activities to diminish marketplace interests. The EFFR does not "give effect to the intent of Congress" and introduces its own policy views with the obvious intent of significantly narrowing the marketplace protections of PL 86-272.[12] The courts rely upon the constitutional-avoidance-canon, among other interpretive tools, to avoid constitutional issues where there are two reasonable constructions of a statute.[13]

It is generally accepted that PL 86-272 was constitutionally enacted[14] and that within wide parameters Congress has authority to restrict and expand a State's powers to tax[15]. To avoid the tendencies toward economic Balkanization, the Constitution places responsibility for balancing marketplace and federalist interests with Congress.[16]

In my view, a non-constitutionally suspect and harmonized framework for addressing internet activities in line with the goals of PL 86-272 should parcel permissible from non-permissible activities pursuant to the express and implied[17] mandates of PL 86-272. Accordingly, when addressing technological based tools, lines separating permissible from impermissible activities should be drawn based on where those tools allow one to operate more efficiently (as it does for

---

[10] **<u>The EFFR states</u>: "**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 <u>within the customer's state</u>. 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)

[11] U.S. Const., art. VI, cl. 2 ("*This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding").*

[12] *See, e.g., United States v. Am. Trucking Ass'ns, Inc*. 310 U.S. 534, 542 (1940). ("In the interpretation of statutes, the function of the courts is easily stated. It is to construe the language so as to give effect to the intent of Congress").

[13] *See, e.g., Legal Servs. Corp. v. Velazquez*, 531 U.S. 533, 545 (2001) ("It is well understood that when there are two reasonable constructions for a statute, yet one raises a constitutional question, the Court should prefer the interpretation which avoids the constitutional issue.")

[14] For a minority view, *passim*, Michael T. Fatale, *Federalism and State Busines Activity Tax Nexus: Revisiting Public Law 86-272*, 21-4 Virginia Tax Review 435, (2002)

[15] *See, e.g.,* David Gamage and Darien Shanske, *The Federal Government's Power to Restrict State Taxation,* State Tax Notes, August 15, 2016 at 547.

[16] The Commerce Clause was intended to "avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Hughes v. Oklahoma,* 441 U.S. 322, 325–26 (1979), and The Federalist No. 42 (James Madison), Nos. 7, 11 (Alexander Hamilton).

[17] *See, e.g.,* fn. 18 and related text, *infra*.

everyone) but not create new lines of business as it does for relatively few, without application of a deemed in-state activities component that trespasses The Gap. ("Proffered Alternative Framework Rule" or "PAFR")

PL 86-272 deals with The Gap by expressly addressing when a State can impose its net income tax on an interstate business that has in-state <u>activities</u>. It does not define what types of interstate <u>income</u> earned in interstate commerce that is taxable if earned from activities wholly outside the State. This is important, because while it is generally accepted that PL 86-272 only protects sales of tangible personal property where in-state activities are involved, there is an argument that PL 86-272 implicitly protects sales of services as well where the activities are wholly without the taxing State.[18] A plain word reading of PL 86-272 does not require an out-of-state seller to have a physical presence within a State.

It would be a *post hoc* fallacy to assert that by not defining permissible <u>in-state</u> activities to include sale of services, PL 86-272 immunity is disallowed a seller of services whose permissible activities are <u>wholly without</u> the State. Also, it would be a *non sequitur* to assert that by limiting in-state <u>activities</u> to sales of tangible personal property, PL 86-272 does not protect interstate <u>income</u> from sale of services where the activities are wholly without the State. The minimum nexus standard of PL 86-272 is constructed on the characterization of instate activities, not the characterization of interstate income.

Against this backdrop, arguably an intended purpose of the EFFR deemed in-state activities component is to deny marketplace protection in situations that might include an out-of-state company selling cloud services that is not engaged in activities within a State.

For instance, assume Taxpayer ("Seller") operates with all its capital and labor (but one employee who lives and exclusively solicits sales in State B) a software as a service ("SaaS") business in State A, and its business's website and app includes "cookies" where its customers can opt to provide (non-binding) notice of their anticipated future ordering needs of goods and services, as well as make optional notations regarding whatever is on their minds regarding matters ranging from new business opportunities they are exploring to questions of the company concerning add-on products they can leverage with what they currently purchase.[19]

---

[18] If in-state activities are greater (above) permitted PL 86-272 activities, then federalist interests are deemed stronger than those of the marketplace; inversely, if the in-state activities of a seller are less than (below) the permitted activities, then marketplace interests are deemed to outweigh federalist interests. Obviously, notwithstanding some contrived fiction such as the deemed in-state activities component of the EFFR, activities wholly outside a State are less than (below) then permitted activities within a State.

[19] A discussion of computer cookies is beyond the scope of this paper. Like the human mind, cookies can address various matters ancillary to solicitation, albeit much more efficiently. Simplistically, a cookie is technology that store "identifiers" in computers used by persons visiting websites. They are "used" by computers to make websites work more efficiently, as well as to provide information to the owners of the website and their independent contractors. Cookies can be categorized, e.g., required, analytics and enhanced experience cookies, among others. Required cookies enable you to navigate the Site and to use its services and features; analytics Cookies allow one to analyze your use of their Site to evaluate and improve their performance; enhanced experience cookies aim to

Assume further that one of Seller's Buyers ("Customer") is headquartered in State B and operates in States B, C, D and E. State B characterizes SaaS transactions as the sale of TPP and services; State C as TPP; State D as services; and, State E as a mixture of TPP and services. Seller's sales representative solicits a sales offer to provide SaaS product to all the Customer's employees. Payment under the contract will be based on the number of users. Under this scenario, the question arises as to which states may tax Seller's net income under PL 86-272?

One view is that Taxpayer is only subject to a net income tax in States A and B: State A where it operates its SaaS business; and, State B, because it has a physical presence and it activities include the solicitation of the sales of services.[20]

In contrast, albeit not entirely clear given the skeletal guidance provided in the Statement, it appears the Work Group would view Seller taxable in all the States: A and B for the same reasons stated above; and, C, D and E, because it has a deemed in-state presence and its prohibited in-state activities do not care if the type of information the "cookies" gather have functional equivalents and simply enhance the process without creating new lines of businesses that have existed virtually since the beginning via competent, thinking sales people.[21]

Of course, the States with the tax rights would divide the full taxable base of Seller according to their laws, so but for nonuniformity between the laws of these States, nowhere income should not be a problem. Under the first view where only States A and B have tax rights, the least burden on interstate commerce exists, which more faithfully aligns with the Congressional express and implied mandates and goals of PL 86-272.

By taxing process efficiencies, it appears clear that the Statement wants to create "equal treatment" by weaponizing human interactions via a reincarnated form of "garbage [deemed location of activities] nexus" [22] argument.

---

enhance the experience of consumers visiting the website; cookies can remain on one's computer or mobile device for different time periods; pursuant to privacy laws of various countries, cookies provide various options to website visitors, e.g., the right to accept or reject any or all of the cookies.

[20] *See, e.g.,* Martin I. Eisenstein and Nathaniel A. Bessey, *Public Law 86-272: Sunlight for a Cloud Service*, State Tax Notes (May 21, 2018), p. 769, 773.

[21] *See, passim,* Richard L. Cram, *No Shade for Cloud Computing Income Under P.L. 86-272*, State Tax Notes (Sept. 24, 2018), p. 1237.

[22] In *Quill*, the Court rejected the North Dakota argument that the Company had economic nexus because, among other things, ND had to dispose of 24 tons of catalogs and flyers ("garbage") mailed by Quill into the State every year. Like cookies of new, the garbage of old too frequently invited information that the Work Group would now use to narrow Congressional protection. Ironically, in *Wayfair*, the MTC/States generally argued to repeal the DCC physical presence rule to increase their revenues. In contrast, here the MTC/States would be arguing to repeal the express CC non-physical presence rule to increase their tax revenues.

That the legislative history of PL 86-272 does not address the distinction between Sellers with and without a physical presence in the taxing State is not amazing, because it would have been superfluous given that Congress opted to write its Stop Gap legislation as a qualitatively based, minimal activities net income tax nexus standard not tied to a physical presence within the State. It would be criticized a *post hoc* fallacy and/or *non-sequitur* to suggest a tie between the non-taxability of an in-state taxpayer whose activities fall at or below the minimum permitted in-state activities and the taxability of interstate income earned by an out-of-state taxpayer wholly without in-state activities.

Given its reference to *Wayfair*, the Statement seeks to bootstrap dicta from the decision as its authority for the deemed in-state activities component found within the EFFR.[23] This reliance is misplaced.

The recent battles concerning physical presence that culminated in the *Wayfair* decision pertain to sales and use taxes and the duties of an out-of-seller to collect and remit use taxes. Only tangentially, at best, does *Wayfair,* decided pursuant to the Court's implied CC powers, bear any relevance to the interpretation of PL 86-272 enacted by Congress pursuant to its express CC powers.

The EFFR reflects the Work Group's iconoclasm for Congressional authority, as well as the judgment of the founding fathers who enacted the Commerce Clause as a needed instrument of federalism. For those inclined to dismiss or assign lighter weights to these issues, I would respond that current global events prove otherwise. The Stop Gap nature of PL 86-272 was needed just as much in the 20th Century as it remains today in the 21st.[24]

[23] Also, see quoted reference to *Wayfair* by Brian Hamer, MTC General Counsel and member of the Work Group, speaking on his own behalf at the 2020 Georgetown Law Advance Institute on State and Local Taxes: ("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") Copy of Mr. Hamer's conference outline on file within the Georgetown Law Office of Continuing Legal Education.

[24] In my view, enactment of the EFFR and other non-uniform steps governments of the world are taking with regard to the taxation of digital/digitized commerce may if left unchecked warrant need for another Congressional Committee to analyze and propose, as necessary, uniform federal legislation addressing state income taxation of interstate commerce. While written some 55 years ago, I find the following quote from Vol. I, p. 599, of the Willis Report remain true.

> *Fifty years ago, as the first of the States adopted the income tax, forward-looking tax men warned of the dangers of each State taxing interstate commerce in its own way. For 50 years, State tax administrators have been discussing ways of achieving simplicity and uniformity. One proposal after another has been formulated, discussed, revised, and in spite of the expenditure of enormous efforts, discarded. And, today, the States appear to be as far from a solution as they have ever been. In short, the history of 50 years of State income taxation leaves no room for optimism that the States will be any more successful in the future than they have been in the past.*

The EFFR in combination with other components of the Statement take the product of the Work Group beyond jurisdiction and implicate policy[25] matters. It seems clear that the intended work of the EFFR is to circumvent the protection of PL 86-272; source receipts to a market state even if, for instance, all hardware, personnel, and prohibited activities are located outside the taxing state; and, rebalance marketplace and federalist interests contrary to the Congressional mandate of PL 86-272.

(i) The States Do Not Have Sovereign Authority to Narrow PL 86-272

The Statement asserts that its EFFR, among other things, is entitled to the benefit of a discretionary federalist canon (i.e., a sort of judicially granted rebuttable presumption against altering federal-state powers) that can tip the scale in favor of the States where more than one interpretation exists.[26]

The States were previously rebuked in their attempt to tip the scale in their favor while narrowing PL 86-272 in *Wisconsin Department of Revenue v. William Wrigley Jr. Co*., 505 U.S. 214, 224 (1992), where Justice Scalia ruled (citations and internal quotes omitted):

> *We reject the proposition put forward by Wisconsin and its amici that we must construe § 381 narrowly because we said in Heublein that unless Congress conveys its purpose clearly, it will not be deemed to have significantly changed the Federal-State balance. That principle—which we applied in Heublein to reject a suggested inference from § 381 that States cannot regulate solicitation in a manner that might cause an out-of-state company to forfeit its tax immunity —has no application in the present case. Because § 381 unquestionably does limit the power of States to tax companies whose only in-state activity is the solicitation of orders, our task is simply to ascertain the fair meaning of that term.*

As reviewed above, the EFFR deemed in-state activities component was written without reference to the legal consequences raised by its application to the interstate income earned by an out-of-state seller wholly without activities in the taxing State. When a plausible reading of a federal statute raises constitutional problems, such as exposed here by the EFFR, the substantive canons do not call for application of presumptive sovereign immunity absent a clear statement of Congress to the contrary. Rather, the canon of constitutional avoidance is warranted that recommends that the court explore if another reading of the statute would avoid the constitutional issue.

To suggest that evolving notions of fiscal federalism have surrendered historic judicial decisions favoring a level-field-marketplace for the States' desires of rules favoring their collectively non-

[25] See, transmittal letter of June 17, 2020, from Brian Hamer, Counsel to the Commission, to Robert Desiderio, Hearing Officer, of proposed revisions, p. 2, addressing Scope of Project ("Work Group's task was statutory interpretation, not policy making").
[26] "This Statement is guided by the principle that sovereign authority of states to impose tax will not be preempted unless it is the 'clear and manifest purpose of Congress' to do so". Statement Introduction, p. 2, para. 4.

uniform and interstate burdensome interests is misguided. It is hard to imagine a more deeply rooted area where the DCC quelled State attempts to promote their federalist interests over those of the marketplace.

(ii) The Statement is Not Entitled to Interpretive Deference

Today, deference doctrines[27] are under attack with many judges calling for their narrowed use if not outright repeal due to constitutional separation of power concerns. In a nutshell, the argument (and the reason why fewer judges now use the rules) is that they effectively preclude judges from exercising constitutionally mandated independent judgment (judicial review).

In *Wrigley*, Justice Scalia wrote: "**our task** is … to ascertain the fair meaning of [the] term [solicitation]" . *Id* at 224. (Emphasis added).

Significantly, jurisprudence interpreting PL 86-272 makes clear that courts have retained judicial review to interpret the scope of Congressional protection afforded multijurisdictional entities under PL 86-272.[28]

It is anticipated by many that the business disruptions attributable to intersecting technological forces of digitalization, disintermediation, and decentralization will not end soon, requiring nuanced adjustments better suited to judicial review than regulatory guidelines. It is fundamentally unfair and not a prudent exercise of independent judgment that a court should defer to an agency who has clearly demonstrated hostility and a policy agenda to narrow/negotiate away/eliminate PL 86-272.

3. **The Combined Workings of the EFFR and Revenue Rule Will Disadvantage U.S. Companies and Encourage Some to Invert, Because the Statement Does Not Address How Enforcement Jurisdiction Will be Assured Globally**

Pursuant to the "Revenue Rule" most countries decline to enforce tax judgments of other countries against their citizens.[29] This reality cautions warning that the Statement not overreach by narrowing the protections against state taxation of interstate income, particularly where the out-of-state taxpayer's activities are wholly without the taxing State. While to a degree steps to mitigate evasion and abusive tax planning may be available, the Statement currently is blind to moral hazard costs that will be shifted to in-state taxpayers by out-of-state taxpayers who cease

[27] *See, e.g., Auer v. Robbins,* 519 U.S. 452 (1997) (deference to an agency's construction of its own regulations); *Chevron U.S.A., Inc v. Natural Resources Defense Council, Inc*, 467 U.S. 837 (1984) (deference to an agency's construction of a statute); and, *Skidmore v. Swift & Co.,* 323 U.S. 134 (1944) (interpretations of less formal agency documents that lack force of law, e.g., policy statements).
[28] *See* Tatarowicz Interpretation of PL 86-272 article, fn. 8, *supra*.
[29] *See, e.g., Holman v. Johnson*, 98 Eng. Rep. 1120, 1121 (1775) ("no country ever takes notice of the revenue laws of another").

their in-state activities, as well as foreign and alien corporations that invert to “arbitrage” foreign country nonuniform nexus and sourcing laws whose interstate income is earned based on activities wholly outside the taxing State.

Example. Assume 2-companies, a foreign and alien corporation[30] sell digital products via the internet from State A and a foreign country, respectively, into State B. Both fail to pay taxes due and State B secures a tax judgment against both. Assuming both have available assets in their home jurisdictions: State B will be able to seek enforcement of its judgment in State A under the U.S. Constitution’s Full Faith and Credit Clause[31]; and, State B will not be able to seek enforcement of its judgment in the foreign country against the alien corporation due to operation of the Revenue Rule.

Another way of thinking about this is that while State B has substantive nexus over both the U.S. and alien corporation, it lacks enforcement/collection nexus over the alien corp.

While the root laws at play were different, in effect this is what existed under *National Bellas Hess/Quill* prior to *Wayfair.*

It is well understood that a cornerstone of a self-assessment tax system rests in the confidence of the taxpayer that everyone will pay their fair share. The EFFR will negatively impact global taxpayer confidence given its overreaching and inconsistent goals and operations with the Congressional mandates of PL 86-272.

It is not unreasonable that taxpayers will want reassuring answers concerning questions such as the following:

- How will States be able to enforce collection of the tax outside the U.S.?
- What legal and/or policy justifications exist for expanding the (substantive) jurisdiction of a State beyond what it may be able to collect from an alien v. foreign corporation?
- Will adoption of the Work Group’s recommendation lead to another SUT quagmire, i.e., State has a valid use tax, but could not enforce its collection by out-of-state vendors?
- What constitutional issues are implicated, if any, by the differing DCC standards applicable to interstate and foreign commerce?
- How would adoption of the EFFR impact the current debate concerning *Kraft* violations?
- Are cookies protected from state taxation, in part, if characterized as 1st Amendment protected speech?

---

[30] For our purposes, a “foreign” corporation is a U.S. corporation that is not legally incorporated under the laws of the taxing state; and, an “alien” corporation is a non-U.S. corporation. In both instances, different steps might reasonably be expected to be taken by either of these types of entities depending on whether they had a physical presence and PL 86-272 protected activities within the taxing state, or interstate income wholly attributable to activities outside the taxing state.

[31] U.S. Const., art. IV, § 1 (“Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof”).

4. The Statement Reflects No Consideration Given To What Will Be Its Economic And Tax Policy Consequences: ***Who Will Be Winners and Losers Among Supporting States and Other Government and Non-Government Stakeholders?***

It is unfair to ask for adoption and support of the Statement given it is devoid of critical information of what its financial and tax policy impact will be on key stakeholders, e.g., individual states, taxpayers operating in intrastate, interstate, and international commerce (from both an inbound and outbound perspective).

For instance, focusing on the impact that the Statement may have in any one particular State, one can reasonably anticipate that it will increase the income tax reporting obligations of small-to-midsize business operating in the digital economy everywhere, while resulting in a net increase of revenues in some states and decrease in others. Further, the costs of tax administration and litigation will more likely than not rise in many States.

States on the revenue losing side of these dynamics may find themselves needing to increase the tax rates of preexisting taxes or enacting new taxes to maintain balanced budgets. Like individual States, the impact on individual taxpayers will be affected by degree depending on factors such as the industry in which they operate, their geographical footprint and topology. Also, given the tax collection powers of the States do not apply equally between U.S. and non-U.S. entities, adoption of the Statement may induce U.S. companies to invert, as well as dissuade non-U.S. companies from investing in the U.S.

From a national perspective, i.e., the collective impact on all states, additional issues come into focus. For instance, unlike the lost sales and use tax revenues to the States that resulted under the pre-*/Wayfair* standard, the Statement does not result in any "new" collective tax revenues for the States by trespassing PL 86-272 nexus. If you assume, for example, 100% taxation of all income pre-Statement, post-Statement results reflect a reallocation of taxing rights.

From a tax policy perspective the Statement would move the States closer to adoption of a minimum tax that alone raises an out-of-scope issue for stakeholders concerning what this impact would have on the intersection of expanding tax rights and reliance interests of the use of tax incentives by the States.

Narrowing the safe harbor of PL 86-272 will thwart the economic development goals of those States that adopted, as an intended tax incentive, single-factor (or heavily dependent) sales factor apportionment formulas without corresponding throwback rules. For taxpayers realizing tax benefit losses, it is certainly possible that some may forego current expansion plans or relocate.

By putting its finger on political, legal and economic dynamics that impact the use of income tax incentives, the Statement will create budgetary consequences, among other things.

5. **The Factual Scenarios Of IV.C., As Well As The Four Additional Substantive Revisions To The Statement Do Not Reflect A Principled, Internally Consistent Set of Guidelines**

Other Than Allowing States to Adopt Nonuniform Laws to Maximize Their Own Revenues, At The Cost of Other States

The Internally Inconsistent Scenarios of IV.C

While the need to develop reasonable definitions among other matters remain, the Proffered Alternative Framework Rule (PAFR) without a deemed in-state activities component reflects the Congressional goals, as well as the express and implicit mandates of PL 86-272. It is principled and does not require the patchwork of rationales that were required to build a less than unanimous consensus among the Work Group members,.[32] Importantly, it also does not deny other interpretations based on a plain word reading of PL 86-272.

The EFFR invites litigation and if not found fatally flawed by a court may require application of the constitutional-avoidance-canon, or other interpretive guidelines, to sever its deemed physical in-state activities component.

Comparing the EFFR against the PAFR brings into focus various issues covered within this Statement. For example:

- In Scenario 2, which deals with post-sale assistance provided via electronic chat or website email with the vendor outside the State, the EFFR would find those out-of-state activities exceed the protections of PL 86-272, because they are deemed to have occurred within the State. Pursuant to the PAFR these activities would not result in loss of the safe-harbor of PL 86-272, because the technology tool represent a process efficiency of decade long activities via snail mail, telegraphs and telephone calls, among other means of communicating interstate commerce that do not result in new lines of business for their users.

  Here the deemed activities within the state component of the EFFR is effectively a putative levy on efficiency and a trap to the unwary that is easily circumvented by sophisticated taxpayers. Can the State assure competitive neutrality, e.g., how will it enforce collection actions against alien corporations? The MTC should not endorse an interpretation non-aligned with The Gap, as well as the express and implied mandates of PL 86-272 that will thwart efficiencies unrelated to the creation of new businesses.

- Scenario 4 would *per se* deny PL 86-272 immunity as being outside permissible solicitation and involving the sale of tangible personal property where the facts involve a business's website that invites viewers in a customer's State to apply for non-sales position with the business and enables viewers to fill out and submit an electronic application as well as

[32] Among the principles relied upon in interpreting PL 86-272 was dicta from *Wayfair* 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'"; without distinguishing if requested or not, that websites insert cookies into the customer's computer to facilitate interaction; and, streaming does not constitute the sale of TPP; static presentations do not constitute activities with the state; and, because telephone calls were not address in the previous Statement, it was not necessary to address that issue now. *Wayfair,* 138 S. Ct. 2080 at 2096 (citing *Direct Mktg. Ass'n v. Brohl,* 575 U.S.1, 18 (2015)).

upload a cover letter and resume. In contrast, the PAFR would not jump to this conclusion but require the gathering and analysis of additional information that may be relevant, e.g., are the job postings purposely directed to specific individuals and, if not, constitutionally protected DPC nexus? Are website applications protected 1st Amendment communications outside Commerce Clause analysis?

The Four Additional Substantive Revisions To The Statement

Providing detailed comments regarding each of these four additional substantive revisions is beyond the scope of my Statement but warrant brief re-emphasis because they either: should not be entitled to any interpretive deference; leave optional choices to the States without noting constitutional infirmities that may militate against one choice over another; or leave unstated implicit protections that may exist for out-of-state seller whose interstate income is related to activities wholly without the taxing State.

(i) Article IV. B. (Unprotected Activities), adds example 20, which interprets PL 86-272 as offering no immunity for "an employee who telecommutes on a regular basis from within the State unless the activities constitute the solicitation of orders for sales of tangible personal property or are entirely ancillary to such solicitation". No surprises here. So why did the Work Group feel it prudent to state a generally conceded point, particularly at a time when policy questions concerning a broad range of matters involving telecommuters outside net income taxes[33] are currently being debated within State capitols and Congress?

For me, the most plausible answer is that the Work Group, while directed not to allow its interpretations to be influenced by policy, saw value for indirectly putting its finger on the scales to the benefit of the States.

If the proposed revisions are adopted, given the undefined latitude provided to become a Supporting State (i.e., "other administrative action" [34]), little may be needed to shift critical tax policy decisions from legislatures to tax administrators, clouding transparency and accountability. In effect, legislators and/or tax administrators may be tempted to hide an elephant within a mouse hole for various reasons. Even the possibility of this outcome should not be condoned by the MTC.[35]

[33] For instance, currently being debated from a policy perspective are the degree telecommuters should influence sourcing for payroll (e.g., unemployment) taxes, withholding of income taxes for residents and nonresidents, and related tax relief during times of crisis, such as global pandemic.

[34] See, fn. 2, *supra*.

[35] *See, e.g.*, *Gonzales v. Oregon*, 546 U.S. 243, 263 (2006) ("'Congress, we have held, does not alter the fundamental details of a regulatory scheme in vague terms or ancillary provisions–it does not, one might say, hide elephants in mouseholes."'). (Citing *Whitman v. American Trucking Assns., Inc.*, 531 U.S. 157, 468 (2000).) Also, the Court has not assumed that the legislative branch tacitly defers interpretations of major economic and politically significant tax credits to agencies. *See, e.g.*, *King v. Burwell*, 135 S. Ct. 2480 (2015) (if Congress had wished to assign questions of deep economic and political significance to an agency, it surely would have done so expressly).

(ii) The Statement deletes Article VII.E, which endorsed the Joyce[36] rule that is consistent with the jurisdictional standard of PL 86-272, which is widely understood to be determined on an entity-by-entity basis, and without relation to methods used to source the tax base.[37]

Where application of the Finnigan[38] rule results in a greater tax burden than would result by application of PL 86-272 on an entity-by-entity basis, the State's law arguably results in impermissibly frustrating Congressional intent in violation of the Supremacy Clause.

Conflicting statements have been advanced by the MTC for its movement away from the Joyce rule, arguably all to the effect of washing its hands to allow States to pick and choose the methodology that maximizes their revenues.[39]

(iii) Article V intends to clarify the scope of protection afforded under PL 86-272 when independent contractors are involved. However, the Statement does not go far enough by its failure to emphasis how the rule would apply in a digital world where the in-state independent contractor sends the otherwise impermissible activities to one of its locations outside the taxing State.

(iv) Prior to revision, the Statement recommended extending PL 86-272 to foreign commerce to avoid "the necessity of expensive and difficult efforts in the identification and application of the varied jurisdictional laws and rules existing in foreign countries". While this rationale was misleading, because some States opted simply to apply U.S. Constitutional law or PL 86-272 standards,[40] it was at least principled and favored marketplace interests.[41]

---

[36] *Appeal of Joyce, Inc*., Cal. State Bd. Of Equal., No. 66-SBE-069 (Nov. 23, 1966) (In the context of an inbound transaction, held that individual members of a group return are the taxpayers)

[37] *See, e.g.,* Paul J. Hartman, *A Compilation of Views, Divergent and Otherwise, on Current Important Problems in State and Local Taxation of Multistate Business, p.3 (January 1962), Section of Taxation, American Bar Association ("jurisdiction is concerned only with connection of corporation with taxing state"). Also, ("Jurisdiction to tax is a question to be decided without any relation to methods used to divide the tax base among a number of states.")*

[38] *Appeal of Finnigan Corp*., Cal. State Bd of Equal., No. 88-SBE-022A (Aug. 25, 1988), *reh'g denied* (Jan. 24, 1990) (In the context of an outbound transaction, held that the combined group is the taxpayer)

[39] See, e.g., "The most significant reason the Commission had for adopting the Joyce approach was to avoid litigation. The risks that litigation may have posed have not materialized, however." Finnigan Briefing Book Provided to Phil Skinner, Idaho, prepared by MTC Legal Staff Date at p. 1 (June 8, 2018). C.f., "The Work Group concluded that it was no longer appropriate for the Statement to recommend Joyce, since the majority of combined reporting states have now adopted Finnegan. Instead, the proposed revision of the Statement takes no position." Transmittal letter of Statement, from Brian Hamer, Counsel to the Commission, to Robert Desiderio, Hearing Officer, at p. 8 (June 17, 2020).

[40] See Tatarowicz Interpretation of PL 86-272 article, fn. 8, *supra*, at 322-323. In *Scott & Williams, Inc v. Board of Taxation*, 117 N.H. 189 (1977), the Supreme Court of New Hampshire took the position that taxpayer must prove that it was subject to that country's jurisdiction. In *Appeal of Dresser Industries*, [New Matters] St. Tax Rpt. (CCH) ¶ 400-376 (Cal. Bd. Eq. 1983), *reh'g denied*, St. Tax Rpt. (CCH) ¶ 400-488 (Cal. Bd. Eq. 1983), the California State Board of Equalization held taxpayer must apply U.S. jurisdictional standards. And, in *Coors Porcelain Co. v. State*, 517 P.2d 838 (1973), *cert. denied*, 419 U.S. 874 (1974), the Colorado Supreme Court denied taxpayer the right to apportion its activities outside the taxing State, which the court deemed were no more than solicitation.

[41] *See*, *Id*. at fn. 239 for a discussion of various pre-Kraft consequences that need be considered from adoption of a broad U.S. jurisdictional standard for determining when a corporation is subject to a foreign country's tax. This analysis has become even more complex since SCOTUS decided *Kraft General Foods Inc. v. Iowa Department of Revenue and Finance*, 505 U.S. 71(1992) and *South Dakota v. Wayfair Inc.*, 138 S. Ct. 2080 (2018). *See, passim.*

> Now the proposed revision to the Statement leaves application of PL 86-272 to the election of the States, opting to rebalance federalist interest over marketplace interest.

Concluding Remarks

The Statement ignores an alternate interpretation that PL 86-272 implicitly preempts a State from taxing interstate service income earned by an out-of-state company whose activities are wholly without the taxing State.

The U.S. Constitution is not a tax shelter; and changes narrowing or expanding the protections of marketplace interest are the responsibility of Congress.

In my view, given the EFFR disconnects from the Congressional goals of PL 86-272, adoption of it will result in extensive, repetitive litigation in various States, resulting in yet more nonuniform decisions, complexity, and related SALT costs for the marketplace to absorb. Opponents of PL 86-272 want to see the States litigate against Congressional legislative supremacy, because they want revenues redirected to them, even at the cost of sister States. On the other hand, proponents have seen how history has proven that Stop Gap concerns are real and remain.

The Statement reflects a tax policy intended to weaponize process efficiencies to undercut Congressionally protected activities. Process efficiencies gained with technology tools do not change the fundamental nature of an activity, although they may create new lines of business for some. Currently, the Statement makes no serious effort to distinguish these outcomes.

The MTC should not approve the Statement until further critical data is gathered, analyzed, and disclosed to all stakeholders before seeking adoption by Supporting States. Outside the Work Group, the project to update the PL 86-272 Statement should be delayed until "normality" returns to the marketplace and it can receive the attention warranted by those too preoccupied with COVID-19 matters.

Michael T. Fatale, *Foreign Commerce Clause Discriminating: Revisiting Kraft After Wayfai*r, State Tax Notes, (April 20, 2020).