Regarding Submission of Proposed Revisions to MTC Model Statement of Information Concerning Practices of Multistate Commission and Supporting States Under Public Law 86-272

Report of Hearing Officer, Robert J. Desiderio
October 30, 2020

A. Introduction

On April 22, 2020, the Uniformity Committee of the Multistate Tax Commission approved its Work Group's Proposed Revisions to MTC's Model Statement of Information on the Practices of the Supporting States under Public Law 86-272 ("Revisions"). On April 23, 2020 the Executive Committee instructed the Executive Director of the MTC to hold a public hearing on the Revisions. Notice of the hearing was issued on June 9, 2020, and the public hearing was held on August 5, 2020. I was appointed the hearing officer pursuant to MTC Bylaw 7(e). As the hearing officer, I am to submit a report to the Executive Committee, which report includes a synopsis of the hearing proceedings and detailed recommendations.[1]

Prior to the hearing, I reviewed P.L. 86-272, the Revisions and the following written submissions:

(1) Suggested modification to the Revisions from Bernard D. Copping, CPA MST, dated May 6, 2020.

(2) A Memorandum to me, dated June 17, 2020, from Brian Hamer, Counsel to the MTC. In his Memorandum, Mr. Hamer described the background and scope of the Work Group's project, and the principles and premises on which the Work Group based its deliberation. ("Hamer Memo"). Mr. Hamer included with his Memorandum the Revisions, both in clean and marked copy.

[1] After the public hearing, the MTC made the following corrections to the Revisions, to which I agree:
1. Revised current title: Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272. Change "Signatory" to "Supporting."
2. Deleted the parenthetical in the first sentence of Article IV.A, on page 4 of the Revisions that parenthetical reads: ("assuming they are de minimis").
3. Corrected the second paragraph of Article IV.C to read: "If the activities of such a seller within a state extend beyond solicitation of orders for sales of tangible personal property and are neither entirely ancillary to solicitation nor de minimis, P.L. 86-272 does not shield the seller from taxation by the customer's state."

(3) Oregon Department of Revenue comments, submitted by Joseph Royston, dated July 30, 2020.
(4) Comments from Professor Darien Shanske, University of California Davis School of Law (King Hall), dated August 2, 2020. ("Professor Shanske")
(5) Comments from COST, submitted by Karl A. Frieden and Nikki E. Dobay, dated August 4, 2020 ("Frieden-Dobay").
(6) Comments from Professor Philip M. Tatarowicz, Georgetown University Law Center, dated August 5, 2020 ("Professor Tatarowicz").
(7) Statement of Support from Geoffrey E. Snyder, Commissioner of Revenue Massachusetts Department of Revenue, dated August 5, 2020.

At the public hearing, oral comments were presented by:

Brian Hamer, who summarized the Revisions and also responded to the oral comments by Professor Tatarowicz and Karl Frieden. ("Frieden"); Professor Tatarowicz, objecting to the Revisions; and Frieden, speaking for COST, objecting to the Revisions.

This report first will review those aspects of the Revisions addressed by the commentator's written and oral comments. The report will then summarize the salient opinions, recommendations, and objections raised by the commentators. The report will provide my reaction and recommendations to each of the commentator's observations, where appropriate. Because Professor Tatarowicz's and Frieden's written and oral statements were similar, I will address them without distinguishing between their oral and written statements.

B. The Revisions

(1) Scope of the Work Group Project

As Brian Hamer explained in his June 17, 2020 Memorandum to me, "the scope of this project was limited to consider how Public Law 86-272 applies to modern business activities." In other words, the Work Group's task was statutory "interpretation, not policy making." Hamer Memo at 2. The objective of the Revisions is "to inform taxpayers of the position that states will take when applying the statute to particular activities," *Id*., and to provide them with the guidance they require "to understand if they are subject to state income tax obligations." *Id.* at 3.

See also Rick Handel and Brittnee L. Pool, *MTC Draft Policy on P.L. 86-272: Electronic Communications Concerns*, State Tax Notes, Oct. 19, 2020 (discussion of importance of taxpayer guidance).

P.L. 86-272 provides that a state may not impose its net income tax on a seller whose only business activity in that state is the solicitation of orders for the sale of tangible personal property, which orders are accepted or rejected from a location without the state and, if approved, the seller delivers the tangible personal property from outside the state. The primary issue the Work Group addressed was the application of P.L. 86-272 to business activity conducted by Internet sellers. *Id.* at 4-7. When is a remote seller's Internet activity business activity in its customer's state? The Work Group accepted that if an Internet seller's activity in the customer's state was merely solicitation, or was ancillary to solicitation (in this report reference to "solicitation," includes activity ancillary to solicitation), the seller was protected under P.L. 86-272. It also concluded that interactive Internet activity that went beyond solicitation was, "unprotected business activity" in the customer's state. The Work Group's decision that interactive Internet activity was business activity in the customer's state was the source of the objections raised by Professor Tatarowicz and COST.

In addition, the Work Group recommended other revisions to the Model Statement:

- Activities performed by an employee are unprotected unless they are only solicitations of orders for tangible personal property. Hamer Memo at 8; see Revisions at 7 (unprotected activity 20).
- Independent contractor performance of unprotected activities removes the seller's P.L. 86-272 protection. Hamer Memo at 8; see Revisions at 10.
- Removing language requiring states to apply P.L. 86-272 to foreign commerce. States, however, that do apply P.L. 86-272 to foreign commerce must do so consistently. Hamer Memo at 8; see Revisions at 11.
- Deleting the endorsement of the Joyce rule with respect to combined filing. The reason is that the majority of combined reporting states have adopted the Finnegan rule. The Revisions take no position with respect to the Joyce or Finnegan rule. Hamer Memo at 8.

These additional revisions raised little or no reaction from the commentators except, perhaps, Professor Tatarowicz's objection to the deletion of the Model Statement's endorsement of the Joyce rule.

The Work Group also adopted the concept of a "Supporting State." Hamer Memo at 8-9. A Supporting State is a state that does not approve the Model Statement by signing it, but adopts the Model Statement in whole or in part by legislation, regulation, or other administrative action. *Id.* at 8-9; see Revisions at 2.

(2) Work Group Principles

The Work Group raised two issues. First, whether activity conducted by means of the Internet "constitutes solicitation for tangible personal property" under P.L. 86-272. Hamer Memo at 4. Second, whether business activities conducted by an Internet seller that extend beyond solicitation are "business activities conducted within [the taxing] state." *Id.* The Work Group gave the first question little attention because P.L. 86-272 protects solicitation for the sale of tangible personal property no matter that it is conducted through the Internet, and solicitation presently is described in the Model Statement. *Id.* The Work Group dedicated the bulk of its work to the second question; it concluded that if the business activities conducted by an Internet seller extend beyond solicitation and are deemed to be in the taxing state, then the Internet seller's activities are not protected by P.L. 86-272. *Id.*

In answering the second question, the Work Group adopted "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." Revisions at 8; Hamer Memo at 4. On the other hand, when a business presents static text or photos on its website, that presentation by itself "does not constitute a business activity" within the customer's state. *Id.* The Work Group was "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." Revisions at 2. (citations omitted). It also considered relevant the Supreme Court's statement in *South Dakota vs. Wayfair, Inc.* that an Internet seller may be present in a state virtually. *Id*; see *South Dakota vs. Wayfair, Inc., _____U.S. _____, 138 S. Ct. 2080, 2095 (2018).*

To illustrate the application, or non-application, of P.L. 86-272 to Internet activity, the Work Group included 11 factual scenarios in the Revisions. Those scenarios assume that an Internet seller operates a website offering for sale only items of tangible personal property, except for one example that involves streaming of videos and music of vendors. Revisions at 10 (scenario 10). All orders are

approved and all products are shipped from location outside the customer's state. In other words, the sellers in the other 10 scenarios are otherwise immune from taxation under P.L. 86-272. Each scenario then builds on that assumed hypothetical with additional facts questioning whether the Internet sellers remain protected by P.L. 86-272. The most controversial of the 11 scenarios are six that involve interactive Internet delivery of services (scenario 2, post-sale assistances; scenario 3, sale of online credit cards; scenario 4, application for non-sales employment; scenario 5, cookies to gather customer information; scenario 7, instructions to fix or upgrade products; scenario 8, sale of extended warranties). *Id.* at 8-11.

C. Commentary

The written comments from Bernard D. Copping CPA, MST, Joseph Royston for the Oregon Department of Revenue, Geoffrey E. Snyder, for the Massachusetts Department of Revenue, and Professor Darien Shanske are generally supportive of the Revisions. The written and oral comments by Professor Tatarowicz and COST oppose the Revisions and recommend the MTC not adopt the Revisions.

(1) Bernard D. Copping, CPA, MST

While not explicitly stating he was in support of the Revisions, Mr. Copping did not object to them but instead submitted suggested enhancements. First, he recommended that the 11 scenarios should be supplemented with illustrations of SaaS, cloud computing, accessing database online, server farms, and purchasing downloadable or hard copies of software operating systems, databases, etc. Second, he suggested that the Revisions should include thresholds, like the MTC Factor Presence Nexus Standard for Business Activity Taxes or the thresholds states have adopted to comply with *Wayfair*.

I have no comment with regard to Mr. Copping's first recommendation. As to his second suggestion, the Revisions do indicate that states may adopt such thresholds, referring specifically to MTC's model factor presence statute, which "recommends that states adopt that statute to shield from taxation small business or businesses that have minimal contracts with the state." Revisions at 2-3.

(2) Joseph Royston

Joseph Royston for the Oregon Department of Revenue expressed general agreement and support for the Revisions. Oregon, however, provided "partial

agreement on the proposed Revisions to Section IV. C." The Department recognized that states may expand the scenarios in that section.

(3) Geoffrey E. Snyder

Geoffrey E. Snyder, Commissioner, Massachusetts Department of Revenue, supported the Revisions, concluding that the Revisions appropriately "modernizes the construction" of P.L. 86-272 and agreed that Internet sellers could be engaged in business activities in the customer's state.

(4) Professor Darien Shanske

Professor Shanske agreed with the Revisions, specifically the 11 scenarios in Section IV.C. The only suggestion he presented concerns the first and second scenarios. Both scenarios involve post-sale assistance to in-state customers. The difference between them is that the first scenario's assistance is by the posting of answers to FAQ's, while the second scenario involves interactive assistance to customers by electronic chat or email. According to the Revisions, the business activity in the first scenario is protected by P. L. 86-272 because the business is not engaging in business activity in the customer's state. The business in the second scenario, however, is not protected by P.L. 86-272 because the business is engaging in business activity in the customer's state and that activity is not entirely solicitation. The two scenarios illustrate the Work Group's general principle that business activity occurs in the customer's state when the Internet activity is interactive, but does not occur in the customer's state when the Internet activity is static.

Professor Shanske agrees that the business in the first scenario is protected while the business in the second scenario is not protected. He differs, however, with the Work Group's reasoning. He believes the Internet seller in the first scenario is immune because the Internet seller's activity is "not beyond" solicitation, and not because the Internet seller is not engaging in business activity in the customer's state, as the Work Group reasoned.

Professor Shanske's position follows from his opinion that a remote seller's communication "through any medium" reaching the customer is business activity in the customer's state. Presumably, he would include telephone communication as business activity, which the Work Group decided was "unnecessary to address." Hamer Memo at 7. Analyzing from that premise, Professor Shanske concludes that the activity in the first scenario is business activity in the customer's state. He then

finds that the post-sale activity in the first scenario is protected because it is not beyond solicitation, while the activity in the second scenario is not protected because it is beyond solicitation.

The Work Group "debated extensively whether the static, non-interactive presentations of text or photos on a website… constitute 'activities within the state' for purposes of the statute." Hamer Memo at 7. Members of the Work Group "agreed by large margins that…static presentations do not constitute activities within the state…" *Id.* Once it had concluded that the presentation was not business activity, the Work Group did not have to face whether the activity was beyond solicitation. Only if the Work Group had concluded that state activity was business activity in the state for purpose of P.L. 86-272, would it have had to answer whether that activity was protected solicitation.

Moreover, Professor Shanske does not explain why the activity in the first scenario is not beyond solicitation, but the activity in the second scenario is beyond solicitation. Both scenarios involve post-sale assistance; their only difference is the medium by which the assistance is communicated. To decide that static web activity is business activity in the customer's state would result, in my opinion, in such activity not being protected, which result the Work Group did not want to reach. The Work Group's line between activity that is, or is not, business activity is based on whether the customer actively engaged with the Internet seller. Although one could opine that even static Internet activity is business activity because it assumes the customer must read, and perhaps take action from, the on-line information, the distinction between static and interactive Internet activity is a reasonable and workable standard. I therefore do not recommend Professor Shanske's alternative reasoning that the first scenario does not involve solicitation.

(5) Professor Philip M. Tatarowicz

While Professor Shanske posits that any medium of communication is business activity, Professor Tatarowicz takes the opposite position. He disagrees with the Revisions' conclusion that interactive Internet communication with customers in the taxing state is business activity in that state for purposes of P.L. 86-272. Professor Tatarowicz's opinion is that such activity is interstate service activity impliedly immune under P.L. 86-272. Professor Tatarowicz at 5 ("there is an argument that P.L. 86-272 implicitly protects services as well where the activities are wholly without the taxing state"). His major issue with the Revisions' position that interactive Internet activity is business activity within the customer's state is that it interferes with "the efficiencies of the digital economy," *Id.* at 3, "narrowing

the marketplace protections of P.L. 86-272." *Id.* at 4. He refers to the Revisions as relying on *deemed* in-state activities. *Id.* (emphasis added).

Professor Tatarowicz concludes that the Revisions are more than an interpretation of P.L. 86-272, but rather they establish new policy that violates P.L. 86-272's explicit and implied intent and purpose. *Id.* In reaching that conclusion, he disagrees with the preemption principle that guided the Revisions: that a federal statute does not preempt state legislation, especially taxation legislation, unless it is the clear and manifest purpose of Congress. *Id*. at 1, 8-9. He also disagrees that *Wayfair* supports the Revisions. *Id.* 2-9. He recommends that the MTC not approve the Revisions and the project be delayed "until 'normality' returns to the marketplace." *Id*. at 15.

Professor Tatarowicz further asserts that the Revisions' deletion of the Joyce rule is inconsistent "with the jurisdictional standard of P.L. 86-272" and the implementation of the Finnegan rule arguably "results in impermissibly frustrating Congressional intent in violation of the Supremacy Clause." *Id*. at 14.[2]

To summarize, Professor Tatarowicz's principal arguments are that;

(1) The Work Group's objective to put Internet activities "on equal footing with other commerce" is at odds with the express and implied mandates of P.L. 86-272." *Id.* at 4. 12.
(2) Interactive Internet activities by an out-of-state seller are not business activity in the customer's state. *Id*. at 1-3.
(3) P.L. 86-272 protects sales of services wholly from without the taxing state. *Id.* at 5.
(4) The Revisions would result in adverse consequences to the market by discriminating against Internet business that produces market efficiencies. *Id*. at 6-8.
(5) P.L. 86-272 would preempt state law that implements the Revisions. *Id.* at 2-3, 8-9.

Professor Tatarowicz is proposing a construction of P.L. 86-272 different from the Work Group, based on a different interpretation of the breadth of P.L. 86-

[2] Professor Tatarowicz also stated, without further explanation, that the Revisions' Article V., "Independent Contractors,", "does not go far enough by its failure to emphasis [sic] how the rule would apply in a digital world where the independent contractor sends the otherwise impermissible activities to one of its locations outside the taxing state." *Id.* at 14.

272 and Congressional intent. Professor Tatarowicz reads P.L. 86-272's immunity beyond its plain meaning and historical purpose.

The plain language of P.L. 86-272 limits its application to in-state business activities that do no more than solicit the sale of the seller's tangible personal property in the taxing state. Congress intended P.L. 86-272 as a temporary fix to a perceived problem following the Supreme Court's *Northwestern States Portland Cement Co. v. Minnesota,* 358 U.S. 450 (1959) decision and its refusal to hear *Brown-Forman Distillers Corp. v Collector of Rev.*, 234 LA. 651, 101 So 2d 70 (1958), *cert. denied.* 359 U.S. 528 (1959) and *International Shoe Co. v. Fontenot, 236* LA. 279, 107 So 2d 640 (1958), *cert. denied,* 359 U.S. 984 (1959). In the latter two cases, Louisiana taxed the companies even though their only activity in Louisiana was solicitation of orders. Business interests were alarmed; they were uncertain that states could impose income taxes when solicitation was their only activity. P.L. 86-272 was Congress's response to that specific concern. *See* Benders State Taxation Principles and Practice §3.03[1] (2020) (Robert J. Desiderio, rewrite Editor).

P.L. 86-272 does not define when or how business activity occurs in the customer's state, nor has any subsequent P.L. 86-272 decision or administrative action done so. The closest is *Wayfair's* language stating that virtual commerce in the taxing state is sufficient to establish substantial nexus for purposes of sales and use taxes. Although *Wayfair* was a dormant commerce clause case, concerning sales and use taxes, in my opinion its equating virtual activity with physical presence is supportive of the Revisions' interpretation of a business activity expressed in P.L. 86-272. Professor Tatarowicz rejects this reading of *Wayfair.* Professor Tatarowicz at 7.

The ultimate question is whether states can define business activity to include interactive Internet activity in the customer's states; that is, whether P.L. 86-272 preempts states from doing such. The Work Group concludes that states are not preempted, Revisions at 2, to which conclusion Professor Tatarowicz rejects. Professor Tatarowicz at 1, 8-9.

Professor Tatarowicz agrees that P.L. 86-272 "does not require an out-of-state seller to have a physical presence within a state." *Id.* at 5. For instance, a seller's sale of tangible personal property by means of the Internet in response to the in-state customer's on-line offer is protected. The seller engaged in business activity in the customer's state but that activity is not beyond solicitation. At the same time, he argues that an interactive Internet seller's delivery of services in the customer's state is not business activity within the customer's state. His position appears inconsistent;

interactive Internet sales of tangible property is business activity in the customer's state, while the interactive Internet sales of services is not business activity.

With respect to whether the Revisions may have an adverse effect on market activity, Congress has the power to cure any possible adverse effect. States are not required to determine whether their taxing power, may or may not, affect national market activity.

I disagree with Professor Tatarowicz's argument that states do not have "sovereign authority to interpret 'business activity' for purposes of P.L. 86-272. Theaccepted preemption principle applicable to P.L. 86-272 is that unless Congress clearly manifests its intent to preempt state's taxing power, states have the sovereign authority to tax. See *Dept. of Rev. v ACF Indus Inc*. 510 U.S. 332, 345 (1994); *Heinlein, Inc. v South Carolina Tax Comm.* 409 U.S.275, 281 282(1972); *Rice v. Santa Fe Elevator Corp.* 331 U.S. 218, 229 (1947). P.L. 86-272 preempts only solicitation, thus, interactive Internet solicitation is immune, but other Interactive Internet activity is not.

(6) COST- Karl A. Frieden and Nikki E. Dobay

COST's position is that P.L. 86-272's protection is lost only by "[a] seller's physical presence in a customer's state." Frieden-Dobay at 2. COST's concern is that "most business with functional websites, but no physical presence in the customer's state, will lose the protections currently afford by P.L. 86-272." *Id.* at 1. COST opines that interactive Internet activity is the in-state customer's activity, not the out-of-state seller's activity. *Id.* at 1-2. Most importantly, COST argues that a remote seller's phone communications with in-state customers have been protected activities under P.L. 86-272. Phone communications are not included in the present Model Statement's list of unprotected activity; yet, phone communication was prevalent in 1959 when Congress enacted P.L. 86-272. COST concludes that Congress "certainty would have been aware of at the time it enacted P.L. 86-272." *Id.* "Clearly, a seller's electronic communications via telephone was an unprotected activity; otherwise, the enactment of P.L. 86-272 would have been meaningless in the first instance." *Id.* Thus, according to COST, Congress and not states have the authority to provide that interactive Internet activity is business activity in the customer's state. *Id*. at 3-4.

The plain meaning of P.L. 86-272 and legislative history do not support COST's position. P.L. 86-272 does not indicate when a remote seller's activities are "business activities" in the customer's state. And as Mr. Hamer stated, Congress in

1959 rejected legislation that would have expressly provided that remote seller's physical presence in the customer's state was a condition to the loss of P.L. 86-272 immunity. Hamer Memo at 13.

Moreover, an interactive Internet seller's activity with a customer is the seller's activity. There is little difference, for example, between the out-of-state seller sending a representative into the state to instruct the customer and the seller's sending instruction through email, website, or app.

D. Conclusion

Because P.L. 86-272 does not define "business activity," the statute is subject to different construction or interpretation. Professor Tatarowicz and COST offer meanings to "business activity" in the customer's state different from the Revisions. The Revisions' interpretation of business activity to include interactive Internet activity is rational; it distinguishes between active communication between the seller and its customer and passive receipt of information by the customer. In that case, the issue is whether P.L. 86-272 preempts states from adopting the Revisions' interpretation of "business activity" to include interactive Internet activity; I think not.