

## Thoughts on Public Law 86-272 After *Wayfair*

Ray Langenberg

### I. Text of 15 U.S.C. § 381(a) (emphasis added)

§381. Imposition of net income tax.

(a) Minimum Standards.

No state or political subdivision thereof, shall have power to impose, for any taxable year ending after September 14, 1959, a net income tax on the income derived within such State by any person from interstate commerce if the **only business activities within such State** by or on behalf of such person during such taxable year are either, or both, of the following:

(1) **the solicitation of orders by such person, or his representative, in such State** for sales of tangible personal property, which orders are sent outside the State for approval or rejection and, if approved, are filled by shipment or delivery from a point outside the State; and

(2) the solicitation of orders by such person, or his representative, in such State in the name of or for the benefit of a prospective customer of such person, if orders by such customer to such person to enable such customer to fill orders resulting from such solicitation are orders described in paragraph (1).

### II. When is a “business activity within such State”?

A. *Heublein, Inc. v. South Carolina Tax Comm'n*, 409 U.S. 275 (1972).

1. “The **impetus behind the enactment of § 381 was** this Court's opinion in ***Northwestern States Portland Cement Co. v. Minnesota***, 358 U.S. 450, 79 S. Ct. 357, 3 L.Ed.2d 421 (1959). There we held that ‘net income from the interstate operations of a foreign corporation may be subjected to state taxation provided the levy is not discriminatory and is properly apportioned to local activities within the taxing State forming sufficient nexus to support the same.’ 358 U.S., at 452, 79 S. Ct., at 359. Congress promptly responded to the ‘considerable concern and uncertainty’ and the ‘serious apprehension in the commercial community’ generated by this decision by enacting Pub.L. 86—272, 73 Stat. 555, 15 U.S.C. § 381, within seven months.” *Id.* at 279-80 (emphasis added).
2. “In this statute, Congress attempted to allay the apprehension of businessmen that ‘mere solicitation’ would subject them to state taxation. Such apprehension arose because, as businessmen who sought relief from Congress viewed the situation, *Northwestern States Portland Cement* did not adequately specify what local activities were enough to create a ‘sufficient nexus’ for the exercise of the State's power to tax.” *Id.* at 280.

B. *Quill v. North Dakota*, 504 U.S. 298, 307 (1992).

1. “**In response to** this Court's indication in ***Northwestern States Portland Cement Co. v. Minnesota***, 358 U.S. 450, 452, 79 S.Ct. 357, 359, 3 L.Ed.2d 421 (1959), that, so long as the taxpayer has an adequate nexus with the taxing State, “net income from the interstate

operations of a foreign corporation may be subjected to state taxation,” ***Congress enacted Pub.L. 86–272***, codified at 15 U.S.C. § 381. That statute provides that a State may not impose a net income tax on any person if that person’s “only business activities within such State [involve] the solicitation of orders [approved] outside the State [and] filled ... outside the State.” *Ibid.* As we noted in *Heublein, Inc. v. South Carolina Tax Comm’n*, 409 U.S. 275, 280, 93 S.Ct. 483, 487, 34 L.Ed.2d 472 (1972), in enacting § 381, “Congress attempted to allay the apprehension of businessmen that ‘mere solicitation’ would subject them to state taxation.... Section 381 was designed to define clearly a lower limit for the exercise of [the State’s power to tax]. *Clarity that would remove uncertainty was Congress’ primary goal.*” (Emphasis supplied.)” *Id.* at n. 9(emphasis added)

C. *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214 (1992).

1. “Section 381 was designed to ***increase-beyond what Northwestern States suggested was required by the Constitution***-the connection that a company could have with a State before subjecting itself to tax.” *Id.* at 232 (emphasis added).

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

1. “Nor will the argument that the exactions contravene the Due Process Clause bear scrutiny. The taxes imposed are levied only on that portion of the taxpayer’s net income which arises from its activities within the taxing State.” *Id.* at 464.
2. “It strains reality to say, in terms of our decisions, that each of the corporations here was not sufficiently involved in local events to forge ‘some definite link, some minimum connection’ sufficient to satisfy due process requirements. *Miller Bros. Co. v. State of Maryland*, 1954, 347 U.S. 340, 344—345, 74 S. Ct. 535, 539, 98 L. Ed. 744.” *Id.* at 464.
3. The *Northwestern States* opinion cited *Miller Brothers* in the discussion of due process. *Miller Brothers* required more than a transient physical presence in the state. The mere delivery of sales to purchasers in the state was not enough to create nexus.

E. *Miller Bros. Co. v. Maryland*, 347 U.S. 340 (1954).

1. “(1) the vendor’s advertising with Delaware papers and radio stations, though not especially directed to Maryland inhabitants, reached, and was known to reach, their notice; (2) its occasional sales circulars mailed to all former customers included customers in Maryland; (3) it delivered some purchases to common carriers consigned to Maryland addresses; (4) it delivered other purchases by its own vehicles to Maryland locations.” *Id.* at 341-42.
2. “We do not understand the State to contend that it could lay a use tax upon mere possession of goods in transit by a carrier or vendor upon entering the State, nor do we see how such a tax could be consistent with the Commerce Clause.” *Id.* at 344.

F. Observations

1. *Miller Brothers* held that due process required more than transient physical presence in the state.
2. If delivery in company trucks was protected by due process, wouldn't Congress also assume that remote telephone calls were also protected by due process?
3. Codification of the physical presence requirement was not the impetus for 86-272.
4. Public Law 86-272 did not protect any particular form of activity; it protected a type of activity – solicitation.
5. Accordingly, the “solicitation of orders by such person, or his representative, in such State for sales of tangible personal property” should be interpreted to mean the solicitation of customers in the state, regardless of the location of the solicitor.

G. *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214 (1992).

1. *Wrigley* would allow this interpretation, suggesting that solicitation does not have to be in person. Shouldn't the solicitation occur where the customer is located, rather than where the solicitor is located?
2. “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. See 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>”). Moreover, limiting “solicitation of orders” to actual requests for purchases would reduce § 381(a)(1) to a nullity. (It is obviously impossible to make a request without some accompanying action, such as **placing a phone call** or driving a car to the customer's location.) And limiting it to acts “essential” for making requests would engender endless uncertainty, contrary to the whole purpose of the statute. (Is it “essential” to use a company car, or to take a taxi, in order to conduct in-person solicitation? **For that matter, is it “essential” to solicit in person?**)” *Id.* at 226 (emphasis added).

H. Ideas for consideration.

1. Activity is not the same as physical presence.
2. The April 25, 2019 Report to the Uniformity Committee seems to be differentiating activities based on the amount of physical presence in the state:

As to this second step, a consensus has developed among Work Group members--if an instate customer interacts with the remote business's website (i.e., does more than just view a presentation on the website),

the business has engaged in activities in the state. This thinking is based in key part on the following considerations:

(1) When a customer engages a seller's website, the website transmits software or code to the user's computer, which is stored in the user's computer for some period of time. The code serves to facilitate the interaction between the customer and seller.

(2) The interaction between the customer and the seller's website is substantial in nature.

(3) The analysis in *South Dakota v. Wayfair, Inc.* speaks to the "continuous and pervasive virtual presence of retailers" in the states where their customers are located.

Applying these considerations, a majority of Work Group members draw a distinction between business activities conducted by remote sellers via the telephone and business activities conducted via the seller's website. In the case of the former, the seller does not engage in activities within the customer's state; in the case of the latter, the seller does.

3. After *Wayfair*, perhaps this way of thinking is obsolete for the reasons stated in *Wayfair*. This way of thinking results in arbitrary distinctions – telephone communications and Internet communications may have the same business purpose.
4. I think the committee should reconsider what constitutes "business activities within such State." My idea is that any communication directed to a state constitutes a business activity within the state.
  - a. "Today buyers have almost instant access to most retailers via cell phones, tablets, and laptops. As a result a business may be present in a State in a meaningful way without that presence being physical in the traditional sense of the term." *Direct Marketing Ass'n v. Brohl*, 135 S. Ct. 1124, 1135 (2014) (Kennedy concurring).
5. When a person speaks on a telephone, or a website is visited, encoded electromagnetic impulses are being directed to the location of the recipient in a state.
  - a. That activity constitutes a physical activity within the recipient's state regardless of the location of personnel and property of the transmitting entity.
  - b. That activity should constitute a business activity within the recipient's state if it has a business purpose.
  - c. And that business activity is protected under 86-272 only if it is a solicitation activity or activity ancillary to solicitation.
6. Put another way, 86-272 never protected telephone calls; it protected solicitation calls and other solicitation activities. Therefore, finding that non-solicitation calls are not protected is not an undermining of 86-272. Rather it is an acknowledgment that traditional physical presence in the taxing state is no longer required for nexus.

7. If this analysis is correct, then every proposed scenario considered by the committee constitutes business activity within the state.
8. The issue then becomes the extent to which the non-solicitation activities should be considered de minimis.

### III. What is de minimis?

- A. *Wisconsin Department of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214 (1992).
  1. "... the venerable maxim *de minimis non curat lex* ("the law cares not for trifles") is part of the established background of legal principles against which all enactments are adopted, and which all enactments (absent contrary indication) are deemed to accept." *Id.* at 231.
  2. "Whether a particular activity is a *de minimis* deviation from a prescribed standard must, of course, be determined with reference to the purpose of the standard." *Id.* at 232.
  3. "...whether in-state activity other than "solicitation of orders" is sufficiently *de minimis* to avoid loss of the tax immunity conferred by § 381 depends upon whether that activity establishes a nontrivial additional connection with the taxing State." *Id.* at 232.
  4. "...we have little difficulty concluding that they [Wrigley's 'various nonimmune activities'] constituted a nontrivial additional connection with the State." *Id.* at 235.
- B. *South Dakota v. Wayfair, Inc.*, 138 S. Ct. 2080 (2019).
  1. "And, if some small businesses with only *de minimis* contacts seek relief from collection systems thought to be a burden, those entities may still do so under other theories." *Id.* at 2099.
- C. Ideas for consideration.
  1. Isn't the de minimis standard a determination of whether an entity has substantial nexus from unprotected activities (excluding protected activities)?
  2. Non-solicitation communications and other unprotected activities directed to a state will disqualify the taxpayer if the activities are more than de minimis, i.e., they amount to substantial nexus.
  3. The description in the MTC "Statement of Information" is a proxy for substantial nexus:  
  
De minimis activities are those that, when taken together, establish only a trivial connection with the taxing State. An activity conducted within a taxing State on a regular or systematic basis or pursuant to a company policy (whether such policy is in writing or not) shall normally not be considered trivial. Whether or not an activity consists of a trivial or non-trivial connection with the State is to be measured on both a qualitative and quantitative basis. If such activity either qualitatively or quantitatively creates a non-trivial connection with the taxing State, then such activity exceeds the protection of P.L. 86-272. Establishing that the

disqualifying activities only account for a relatively small part of the business conducted within the taxing State is not determinative of whether a de minimis level of activity exists. The relative economic importance of the disqualifying in-state activities, as compared to the protected activities, does not determine whether the conduct of the disqualifying activities within the taxing State is inconsistent with the limited protection afforded by P.L. 86-272.

4. In the 21<sup>st</sup> Century, post-*Wayfair* era, the qualitative measurement of activities should also include an evaluation of the extent to which the activities are purposefully directed to a state.
5. When Congress adopted 86-272, and for a time thereafter, the nexus inquiry focused on the presence of property or personnel in a state.
  - a. “In order to uphold the power of Illinois to impose use tax burdens on National in this case, we would have to repudiate totally the sharp distinction which these and other decisions have drawn between mail order sellers with retail outlets, solicitors, or property within a State, and those who do no more than communicate with customers in the State by mail or common carrier as part of a general interstate business.” *National Bellas Hess, Inc. v. Illinois Department of Revenue*, 386 U.S. 753, 758 (1967).
6. No attention was given to purposeful availment because it could be assumed that taxpayers purposefully placed their assets in a state.
7. The Supreme Court then began to recognize that modern commercial life was rendering the traditional physical presence standard obsolete, and that activities “purposefully directed” towards residents of another state may be enough for nexus – in the context of in personam jurisdiction.
  - a. “[I]t is an inescapable fact of modern commercial life that a substantial amount of business is transacted solely by mail and wire communications across state lines, thus obviating the need for physical presence within a State in which business is conducted. So long as a commercial actor's efforts are “**purposefully directed**” toward residents of another State, we have consistently rejected the notion that an absence of physical contacts can defeat personal jurisdiction there.” *Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 476 (1985) (emphasis added).
8. However, for state tax purposes, the importance of physical presence lingered on, as exemplified by *Quill*.
  - a. “In sum, although in our cases subsequent to *Bellas Hess* and concerning other types of taxes we have not adopted a similar bright-line, physical-presence requirement, our reasoning in those cases does not compel that we now reject the rule that *Bellas Hess* established in the area of sales and use taxes.” *Quill*, 504 U.S. at 317.
  - b. “Although constitutional limits on personal and tax jurisdiction evolved in parallel, an important twist involving the Commerce

Clause complicates analysis of the sales taxes... *Quill's* preservation of the presence test under the Commerce Clause was a stubbornly persistent relic of territorial reasoning.” A. Erbsen, “Wayfair Undermines *Nicastro*: the Constitutional Connection Between State Tax Authority and Personal Jurisdiction,” 128 Yale L.J. Forum 724, 733-34 (2019).

9. Thus, the discussion of unprotected activities under 86-272 naturally focused on activities resulting from physical presence in the taxing state.
  - a. While *Wrigley* was being litigated, *Bellas Hess* was the law of the land. Therefore it is understandable that the only activities identified by the state’s attorneys in the *Wrigley* litigation involved personnel physically in the state. *Wrigley*, 505 U.S. at 232.
10. *Wayfair* has now confirmed that activities conducted by electromagnetic methods may also constitute substantial nexus:
  - a. “Between targeted advertising and instant access to most consumers via any internet-enabled device, ‘a business may be present in a State in a meaningful way without’ that presence ‘being physical in the traditional sense of the term.’ *Id.* [Direct Marketing], at —, 135 S. Ct., at 1135. ... This Court should not maintain a rule that ignores these substantial virtual connections to the State.” *Wayfair*, 138 S. Ct. at 2095.
11. Activities conducted by electromagnetic methods include activities conducted by telephone, email, Internet, and radio.
12. Although activities resulting from the presence of property or personnel in a state may be presumed to be purposefully directed at the state, that presumption may not be appropriate for activities in a state conducted by electromagnetic methods. The degree of purposeful direction may vary.
  - a. An entity may call a client that has a known service address in a particular state.
  - b. But an entity might also make or receive a cold call from a cellular telephone and the area code of the telephone may not reflect its location.
13. So, an additional analysis is appropriate for electromagnetic activities. Judging by the proposed scenarios, I think that is the committee’s intuition.
14. But instead of trying to differentiate based on the medium or the degree of physical presence at the recipient’s location, differentiate based on the extent to which the activity is purposefully directed to the state.
15. For non-solicitation business communications in which the location of the recipient is known, the communication is qualitatively more significant than a similar communication in which the location of the recipient is not known.

16. If a customer with a known service address logs on to a web site, that communication is qualitatively more significant than an Internet interaction with an unidentified surfer.
17. Instead of trying to determine where an activity takes place based on physical presence, I kinda like the idea of making qualitative and quantitative assessments under the MTC *de minimis* standard.
  - a. I don't like the idea of making all-or-nothing decisions based on small distinctions.
  - b. Leaves room for the possibility that large quantities of low-quality activities might constitute substantial nexus.
  - c. "*De minimis* activities are those that, **when taken together**, establish only a trivial connection with the taxing State." MTC Statement of Information (emphasis added).
  - d. "We need not decide whether any of the nonimmune activities was *de minimis* in isolation; **taken together**, they clearly are not." *Wrigley*, 505 U.S. at 235 (emphasis added).
18. Factors in determining purposeful direction might include:
  - a. The participant that initiated the activity.
  - b. The extent of interaction.
  - c. The extent to which the location of the participants is known.