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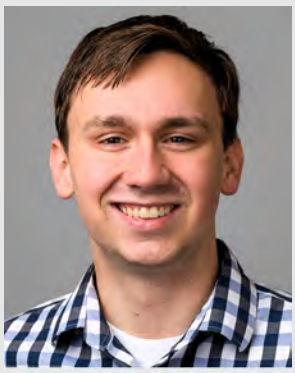

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In this installment of Commerce Crossroads, Wilford examines the federal Interstate Income Act of 1959 (P.L. 86-272), the Multistate Tax Commission's recent efforts to bypass its restrictions, and the ensuing congressional backlash.

Ever since its passage six and a half decades ago, the federal Interstate Income Act of 1959, better known as P.L. 86-272, has been a source of angst for state tax administrators. But while states have long found ways to define business activities as being outside the scope of the law's protections, recent efforts by the Multistate Tax Commission would effectively put the final nail in the coffin, rendering P.L. 86-272 little more than a dead letter. Yet even as the MTC is pushing for the law's final demise, Congress may finally be getting around to giving P.L. 86-272 some teeth.

Background

Back in 1959, the U.S. Supreme Court handed down its decision in *Northwestern Cement Co. v. Minnesota*.[1] In this case, the Court ruled that Minnesota could impose income tax obligations on an Iowa-based business with no activity in the state of Minnesota other than a three-employee sales office that regularly sent sales back to Iowa for fulfillment. States suddenly saw the way forward to extend the reach of their taxing powers over businesses with even the most tangential connection to their state.

Alarmed by the potential consequences of the Court's decision, Congress acted quickly to pass P.L. 86-272 that same year. The most significant element of this law restricted states from imposing income tax on an out-of-state business on the basis of "solicitation of orders" within the state, including by an in-person representative, so long as those orders were then fulfilled by a point outside the state in question.

P.L. 86-272 was initially intended as a temporary measure while Congress studied the issue further. The Willis Commission Report, released in four volumes between 1964 and 1965, provided recommendations for a more comprehensive solution to the issue of state taxation of remote sellers.[2]

The Willis Commission Report ended up putting together recommendations for taxes of all types. The clear theme of the recommendations was federally mandated uniformity — a uniform sales tax base covering just about all retail sales, with states handling any other exemptions they wanted to provide via refunds,[3] a uniform apportionment standard based on two factors of property and payroll within a state (with sales not included),[4] and authority delegated to the Treasury Department to create uniform corporate income tax rules and regulations (and even a uniform state tax return).[5]

[1] *Northwestern Cement Co. v. Minnesota*, 358 U.S. 450 (1959).

[2] H.R. Rep. No. 89-952 (1965).

[3] *Id.* at 1177-1178.

[4] *Id.* at 1144-1145.

[5] *Id.* at 1158-1162.

Other notable recommendations included a direct payment approach of sales and use tax for business customers, freeing remote sellers from the obligation to collect exemption certificates.[6] It also recommended a permanent establishment approach to nexus akin to how most international tax treaties define nexus, essentially requiring a business to have a fixed place of business within the jurisdiction in question before that jurisdiction could impose tax obligations on it.[7]

Not all the recommendations included in the Willis Commission Report translate well to the modern day, but those listed above would greatly ease headaches for smaller remote businesses suddenly expected to handle multistate compliance burdens for which businesses with physical presence nationwide require entire armies of accountants to cope. While states chafe against the few restrictions imposed by P.L. 86-272, those included in the recommendations for a more permanent solution would have gone much further in mandating uniformity and cleaning up the compliance quirks and pitfalls that have only been exacerbated as states seek to expand their tax jurisdictions with no corresponding efforts to reduce burdens.

Ironically, it was the *Northwestern Cement Co.* decision and passage of P.L. 86-272 that spurred the creation of the MTC.[8] Fearing federal preemption, states sought to prove to Congress that they could hash out uniformity issues among themselves, forming the MTC ostensibly to promote uniformity. Six and a half decades later, the MTC is seeking to put an end to the law that caused its inception.

The MTC's Statement of Information

A full accounting of state efforts to bypass the restrictions imposed by P.L. 86-272 could fill a book, but five months after the Supreme Court handed down its decision in *South Dakota v. Wayfair*,[9] the MTC decided the legal landscape was conducive to more aggressive efforts. To that end, the MTC convened a project to "update" its consensus recommendations regarding P.L. 86-272. The final recommendations were adopted by the member states in August 2021.[10] As previously mentioned, the recommendations included in the updated statement of information combine to render P.L. 86-272 all but moot.[11]

Activities outside the scope of P.L. 86-272's protections under the MTC's interpretation included website functions so elementary to a modern business website that it would be difficult for any online business to continue to enjoy the law's protections. Website functions defined by the MTC as being outside P.L. 86-272's protections include offering customer service through virtual chat, enabling prospective employees to submit job applications online, selling extended warranty plans, and even the use of digital "cookies."[12] Throughout, the statement of information uses the most restrictive and limited interpretation of P.L. 86-272 possible, essentially assuming that new technology and ways of doing business counteract the intent of the law.

The States' Turn

Just months after the finalization of the MTC's statement of information, California became the first state to implement the recommendations. However, rather than going through the legislative or traditional regulatory process, California attempted to pass off the significant changes as a mere clarification of existing law.[13] Representatives from the state Franchise Tax Board followed up this minimizing of the significance of the change by stating their intention to apply the technical advice memorandum (TAM) retroactively.[14]

[6] *Id.* at 1185.

[7] *Id.* at 883-885.

[8] Multistate Tax Commission, "MTC History."

[9] *South Dakota v. Wayfair Inc.*, 585 U.S. 162 (2018).

[10] Multistate Tax Commission, "P.L. 86-272 Statement of Information Project."

[11] Multistate Tax Commission, "Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272" (Aug. 4, 2021).

[12] Andrew Wilford, "States Preparing Workaround of P.L. 86-272, A Key Taxpayer Protection for Interstate Businesses," National Taxpayers Union Foundation, May 25, 2022 (while technically the MTC claims only certain "cookie" functions would cause a remote business to lose the protection of P.L. 86-272, the way it defines these functions is so broad and far-reaching that it would be next to impossible for a business to use cookies and be certain of P.L. 86-272's protection under this definition).

[13] Cal. Franchise Tax Board TAM 2022-01. Overruled by *American Catalog Mailers Association v. Franchise Tax Board*, No. CGC-22-601363 (Cal. Super. Ct. Dec. 13, 2023).

[14] Laura Mahoney and Michael J. Bologna, "California's E-Commerce Tax Expansion Vexes Small Online Sellers," *Bloomberg Tax*, Mar. 7, 2022.

California quickly faced a lawsuit from the American Catalog Mailers Association (ACMA), challenging the substance of the TAM under P.L. 86-272 and the Constitution and the implementation of the TAM under the California Administrative Procedure Act. This past December, the Superior Court of California for San Francisco County ruled in favor of ACMA on the implementation question, agreeing with ACMA that the TAM constituted an "underground regulation."[15] Because the court sided with ACMA on these grounds, the case did not progress to the substance of the challenge.

New Jersey had also taken the same path as California, implementing the MTC guidance via a Technical Bulletin in September 2023.[16] With precedent against this path in place, New Jersey's Technical Bulletin may be in jeopardy.

However, the wait for a judgment on the merits may not take long. Unlike California, New York opted to implement the MTC's guidance via the regulatory process,[17] finalizing its corporate tax regulatory changes just days before the court's judgment in favor of ACMA in California. In early April ACMA filed suit against New York, a case more likely to proceed on the merits.[18]

A Federal Solution?

Past efforts to shore up P.L. 86-272 had centered on the Business Activity Tax Simplification Act (BATSA), a proposal that was repeatedly introduced in Congress for years, most recently in 2019.[19] Among other things, BATSA would have codified a physical presence standard for business income taxes, amended P.L. 86-272 to enumerate additional protected activities, and extended nexus protections to digital goods (P.L. 86-272 currently protects only businesses engaged in the sale of tangible personal property).

The House Judiciary Committee approved BATSA in 2015, alongside bills to simplify multistate taxation of mobile workers and digital goods, but the bill hasn't gone any further since. The Supreme Court's decision in *Wayfair* reduced pressure for congressional action on interstate tax issues. So while BATSA continues to offer the potential for enormous simplification improvements, after *Wayfair* it faces far greater political headwinds than it did in the past.

Thus, the latest effort to protect P.L. 86-272 takes the form of H.R. 8021, the Interstate Commerce Simplification Act (ICSA), sponsored by Rep. Scott Fitzgerald, R-Wis., and cosponsored by three other Republican legislators.[20] ICSA is a far shorter bill than BATSA and makes no attempt to revive the physical presence standard or even to amend P.L. 86-272's treatment of digital goods.

Rather, the operative portion of the bill simply clarifies the term "solicitation of orders" to ensure that it is not narrowly defined as the literal act of solicitation and little else. Under ICSA, "solicitation of orders" would be defined as "any business activity that facilitates the solicitation of orders even if that activity may also serve some independently valuable business function apart from solicitation."

That's a minor change in terms of word count, but it smoothly heads off most of the end-arounds states have been doing with the law. It was always unreasonable to interpret P.L. 86-272 as not encompassing activities essential to facilitate solicitation. Post office naming bills aside, Congress rarely passes legislation intended to do nothing at all.

Wayfair appears to have had the unfortunate effect of convincing states that they can assess tax obligations on out-of-state businesses without bothering with the multilateral uniformity and simplification efforts they once used as a carrot. Making this trend particularly ironic is the fact that South Dakota's membership in the Streamlined Sales and Use Tax Agreement was crucial to the Supreme Court's blessing of the state's economic nexus law at issue in *Wayfair*[21] — an agreement no new states have felt compelled to join in the decision's wake.

[15] *American Catalog Mailers Association*, No. CGC-22-601363 (Cal. Super. Ct.) (Order Granting Plaintiff's Motion for Summary Adjudication).

[16] N.J. Div. of Tax. TB-108(R) (Jan. 18, 2024).

[17] 20 NYCRR 1-2.10 (rev. Dec. 11, 2023).

[18] *American Catalog Mailers Association v. Department of Taxation & Finance*, No. 903320-24 (N.Y. Sup. Ct. Apr. 5, 2024) (Verified Complaint).

[19] H.R. 3063, 116th Cong. (1st Sess. 2019).

[20] H.R. 8021, 118th Cong. (2nd Sess. 2024).

[21] *Wayfair*, 585 U.S. 162, 21-23 (2018).

Without congressional or judicial intervention, the incentives are all aligned for states to increase tax obligations on remote businesses that lack legislative recourse. In doing so, they have little reason to concern themselves with the crushing compliance burdens they place on these remote businesses in the process. The need for an empowered federal government to check states' tendency to export tax burdens and import revenues is one of the biggest reasons why judges today concern themselves with the Constitution and not the Articles of Confederation.

Conclusion

While certain to provoke angst at the MTC, ICSA is a badly needed check on states eager to engage in a revenue feeding frenzy on out-of-state businesses. Should states continue to create conditions that require multistate tax expertise as a job prerequisite for small business owners, the inevitable consequence will be more small businesses pushed out of the market.

Even if ICSA does not pass, hopefully it will remind states that they have obligations to taxpayers as well as their own coffers. It is bad enough when tax obligations are so excessive that they push small businesses out of the market — it is far worse when it is the mere compliance burden that does so. ■