

**IMA's 9th Annual Tax Conference:
Helping You Succeed With Key Tax Strategies
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MITIGATING RISK

**Presented by David A. Hughes
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ILLINOIS
MANUFACTURERS'

P.L. 86-272 – A TEMPORARY LAW TURNS 63



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David advises Fortune 500 companies, privately-held companies, middle-market businesses and individuals on strategies to minimize their state and local tax exposure, maintain compliance and reduce the risk of audit problems. This includes income tax, sales/use tax, franchise tax, gross receipts tax, and unclaimed property matters involving nexus, apportionment, business income, unitary business groups, credits, losses and exemptions.

In addition to helping clients all over the country structure their businesses to reduce state and local tax liabilities, David represents them in audits, administrative proceedings, litigation and appeals. He has argued cases for clients at the Illinois Supreme Court, the Illinois Appellate Court and the New York Supreme Court (Appellate Division). In addition to Illinois, David is licensed to practice in Wisconsin.

Agenda & Learning Outcomes

- **History of Public Law (“P.L.”) 86-272**
 - Learning outcome: understand the background and historic application of P.L. 86-272.
- **Multistate Tax Commission’s (“MTC”) Uniformity Committee’s Actions**
 - Learning outcome: understand the MTC’s recent changes to its interpretation of P.L. 86-272.
- **Who Does P.L. 86-272 Protect in 2022?**
 - Learning outcome: understand recent state-level caselaw interpreting P.L. 86-272; understand open questions on P.L. 86-272 that may affect businesses.
- **The Anti-Commandeering Act Doctrine**
 - Learning outcome: understand certain states’ argument that the anti-commandeering doctrine nullifies P.L. 86-272.

THE HISTORY OF P.L. 86-272

The History of P.L. 86-272

- *Northwestern Cement Co. v. Minnesota*, 358 U.S. (1959).
 - Taxpayers challenged a Minnesota and a Georgia statute levying a tax on a fairly apportioned amount of those taxpayers' income when the only activities conducted within the states was "exclusively in furtherance of interstate commerce."
 - Both challenges were premised on the argument that the imposition of tax violated the Due Process and Commerce Clauses of the U.S. Constitution.
 - Neither taxpayer maintained facilities in their destination states. However, they did conduct selling activities and deliver tangible personal property into each state.
 - Because the taxes were not levied directly on interstate commerce and were directed at activities that were regular and systematically conducted in the state, both states' imposition of tax survived scrutiny.
 - "It has long been established doctrine that the Commerce Clause gives exclusive power to the Congress to regulate interstate commerce, and tis failure to act on the subject in the area of taxation nevertheless requires that interstate commerce shall be free from any direct restrictions or impositions by the States."
 - See *Miller Bros. Co. v. Maryland*, 347 US 340 (1954) (Maryland did not have sufficient nexus with a company in DE even though "Some [of the goods were] delivered to [the purchasers] in Maryland by common carrier, and others by appellant's own truck.").

The History of P.L. 86-272

- *Northwestern Cement Co. v. Minnesota*, 358 U.S. (1959).
 - Justice Frankfurter's dissent:
 - The problem calls for solution by devising a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power. Congressional committees can make studies and give the claims of the individual States adequate hearing before the ultimate legislative formulation of policy is made by the representatives of all the States. The solution to these problems ought not to rest on the self-serving determination of the States of what they are entitled to out of the Nation's resources. Congress alone can formulate policies founded upon economic realities, perhaps to be applied to the myriad situation involved by a properly constituted and duly informed administrative agency.

The History of P.L. 86-272

- Public Law 86-272:
- 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).

Polling Question 1

Should Congress update P.L. 86-272 to explicitly address the broad changes to the U.S. economy that have occurred over the last 63 years?

1. Yes, federal preemption on this issue would be great!
2. No, the law is fine as it is.

MULTISTATE TAX COMMISSION'S UNIFORMITY COMMITTEE'S ACTIONS

Multistate Tax Commission Statements



- Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States under Public Law 86-272
 - Originally adopted in 1986
 - Subsequently revised in 1993, 1994, 2001, and 2021.
 - Provides a list of “unprotected activities,” including:
 - Making repairs or providing maintenance;
 - Collecting on delinquent accounts;
 - Investigating credit worthiness;
 - Installation;
 - Training for non-sales personnel;
 - Providing technical assistances;
 - Investigating complaints;
 - Approving or accepting orders;
 - Repossessing property;
 - The list goes on...

Multistate Tax Commission's Uniformity Committee



- The MTC Uniformity Committee undertook an initiative to update its Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272 as it applied to modern business activities. The focus was the interaction of the concept of solicitation and the internet.
 - The Working Group of the Committee applied a two-part analysis to determine if the statute provided immunity:
 - Did the business activities conducted by the business constitute the solicitation of orders of tangible personal property?
 - If the business's activities extend beyond solicitation, do they take place within the taxing state?
- The Working Group used *Wayfair* language as support for the concepts set forth in the revised statement:
 - 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.”
- The proposed revisions to the statement were approved on August 4, 2021.

MTC Uniformity Committee



- The revised statement added eleven factual scenarios to illustrate whether business activities involving Internet sellers were protected.
- Examples of unprotected activities are:
 - A business has an employee that telecommutes on a regular basis unless the activities are limited to the solicitation of orders for tangible personal property.
 - The company provides post-sale assistance to customers via either electronic chat or email that is accessed through a link on the company's website.
 - The company solicits and receives on-line applications for its branded credit cards via the company's website.
 - The company contracts with a marketplace facilitator, whose marketplace offers for sale the company's products via a website. The marketplace maintains inventory, including the company's products, at fulfillment centers around the country.
 - The company (a) inserts Internet "cookies" into the computers or other electronic devices of customers who access the company's website and (b) uses customer search information gathered by its cookies to adjust production schedules and inventory amounts, develop new products, or identify new items to offer for sale.
 - The company remotely fixes products via the Internet and WiFi.

Multistate Tax Commission Uniformity Committee



- Examples of unprotected activities cont.:
 - The business sells extended warranty plans via a website to customers who purchase the company's products.
 - The company streams videos and music to electronic devices for a charge.
- Examples of protected activities:
 - The company provides post –sale assistance by posting a list of FAQ with answers on its website.
 - The business places Internet “cookies” on to customer’s computers for the purpose of gathering information that is entirely ancillary to the solicitation of orders for tangible personal property, ex. store personal information of the customer, remind the customer of what is in their shopping cart.
 - The company website only offers for sale items of tangible personal property and does no engage in any in-state business activities.

Recent State Developments



- California
 - California issued guidance for twelve fact patterns applying the MTC's updated statement for purposes of determining whether P.L. 86-272 protections apply.
 - ❖ California FTB Tech. Advice Memorandum 2022-01 (Feb. 2022)
 - ❖ *American Catalog Mailers Association v. California Franchise Tax Board*
- New York
 - The New York Department of Taxation and Finance released draft regulations that provide guidance on, and examples of, internet activities that are no longer protected by P.L. 86-272. The department's draft regulations generally follow the MTC's statement.
- Oregon
 - Considered adopting the MTC statement...until the taxpayer community objected

Open Questions Resulting from the Adoption of the Statement

- Considerations following the adoption of the Statement:
 - Will there be litigation?
 - Yes!
 - *American Catalog Mailers Association v. California Franchise Tax Board*
 - What is the impact on apportionment?
 - Throwback?
 - What about combined reporting states?
 - New Jersey TB-100 (Jan. 25, 2021)
 - Addresses the applicability of P.L. 86-272 to combined groups and clarifies that “if one member of the combined group exceeds the protections of P.L. 86-272, the entire combined group exceeds P.L. 86-272.”
 - **NOTE:** After reviewing concerns raised by New Jersey taxpayers, the Tax Division announced on April 12, 2022, that it has decided to reverse its policy and will apply P.L. 86-272 protection on a member-by-member basis. The Technical Bulletin will be revised.

Polling Question 2

How do you plan to approach the MTC's revised P.L. 86-272 statement?

1. Proactively discussing changes to filing position in multiple states.
2. Planning to change California filing position but taking no action in other states.
3. Taking no action until states amend statutes and/or regulations.

WHO DOES P.L. 86-272 PROTECT IN 2022?

Recent Cases & Developments

- California FTB Tech. Advice Memorandum 2018-03
 - Issue: “Is delivery of tangible personal property via private vehicles, instead of a common carrier, considered a protected activity under P.L. 86-272?”
 - Yes, delivery in a private vehicle is protected
 - What about backhauling?
 - Not generally protected.
- Indiana DOR 02-20181344.LOF (Jan. 30, 2019)
 - Was taxpayer subject to tax in Alabama, Georgia, Illinois, Kentucky, Michigan, South Carolina, Tennessee, and Canada? Otherwise, subject to throwback.
 - Canada - “During the protest, Taxpayer was able to provide additional information including emails between Taxpayer and Canadian customers. These emails include discussions regarding shipment of product, quality assurance issues, and planning a trip with a plant tour... The emails provided by Taxpayer do discuss shipping and quality assurance. In addition, there were emails to discuss ways to improve the produce and shipping.”
 - US Jurisdictions - Without any evidence, the taxpayer “provided its returns for the protested U.S. jurisdictions to show that they were taxable in those jurisdictions.”

Recent Cases & Developments

- *Santa Fe Natural Tobacco Co. v. Dep't. of Rev.*, No. TC-MD 170251G (OR Tax Court Magistrate Div. February. 26, 2019) (Pending Tax Court, Regular Division).
 - Taxpayer made sales primarily to in-state wholesalers. The wholesalers accepted returns from retailers pursuant to a “distributor incentive program” where taxpayer made cash payments/credits to wholesalers accepting returns. Wholesalers, in some instances, accepted and processed orders pursuant to the distributor incentive program.
 - The wholesaler’s acceptance of returns caused the taxpayer to lose its P.L.86-272 immunity.
- *Stanislaus Food Products Co. v. Div. of Tax’n*, Dkt. No. 011050-2017 (N.J. Tax Court June 28, 2019) (Motion for Reconsideration denied April 22, 2021).
 - State alternative minimum assessment applied only to P.L. 86-272 protected entities.
 - Tax was not measured by “net income.”
 - “The Legislature cannot create a special tax, whether it be a gross receipts, gross profits or some other tax, that only applies to entities protected by P.L. 86-272 in a transparent attempt to garner lost net income tax.”

Recent Cases & Developments

- *Procacci Brothers Sales Corp. v. Division of Taxation*, Dkt. No. 015626-2014 (N.J. Tax Ct. May 25, 2021).
 - The New Jersey Tax Court ruled that the in-state activities of an out-of-state wholesale produce distributor were protected from the corporation business tax under P.L. 86-272.
 - The Taxpayer had no offices, property, or employees in New Jersey and delivered produce to in-state customers primarily using third-party trucks.
 - The court found that the produce deliveries and returns before produce acceptance were “ancillary to solicitation of sales” and protected under P.L. 86-272.
 - However, the Taxpayer’s practice of sending its own trucks into the state to pick up returned produce after delivery and the customer’s acceptance was not protected unless de minimis.

Questions on the Horizon

- What is the impact on foreign commerce?
 - Public Law 86-272 applies only to interstate commerce.
 - A number of states specifically extend protection to foreign commerce. See 86 Ill. Admin. Code 100.9720(c)(8); Michigan Rev. Admin. Bull. 2014-5 (Jan. 29, 2014); Mont. Admin. R. 42.26.508; and Utah Admin. R. R865-6F-6(14).
 - Other states specifically explain that protection is limited to interstate commerce. California Franchise Tax Board Informational Publication No. 1050 (June 1, 2017) (stating P.L. 86-272 protection only applies to the United States and Puerto Rico); and New Mexico Taxation and Revenue Department, “Corporate Income Tax Audit Manual” (May 1, 2007) (“P.L. 86-272 only applies to interstate commerce and not to foreign commerce.”).
 - MTC Statement specifically states that the law does not apply to foreign commerce but provides language for states choosing to extend protection to foreign commerce and appears to encourage same.
 - Other arguments?
 - When does foreign commerce become interstate commerce?
 - State “subject to tax” rules for throwback or throwout with respect to foreign-destined sales.

Questions on the Horizon

- Will states use other aspects of *Wayfair* to undermine P.L. 86-272 protection?
 - Is economic nexus enough to kill protection for sellers of tangible personal property?
 - Has the analytical framework changed?

ANTI-COMMANDEERING ACT DOCTRINE

Anti-commandeering Doctrine

- *Murphy v. NCAA*, 138 S. Ct. 1461(2018).
 - “In sum, regardless of the language sometimes used by Congress and this Court, every form of preemption is based on a federal law that regulates the conduct of private actors, not the States.”
 - The federal statute did not confer any federal right on private actors nor did it impose any federal restrictions on private actors; instead, the law prevented states from passing a law allowing a particular activity. “Thus, there is simply no way to understand the provision prohibiting state authorization as anything other than a direct command to the States. And that is exactly what the anticommandeering rule does not allow.”
- A number of states and the MTC have raised the question of whether this doctrine should nullify P.L. 86-272.
 - “While there is no dispute that Congress has the constitutional power to regulate interstate commerce, the three cases raise the issue of whether Congress can use that power to regulate state conduct with respect to tax policy. At present, the answer to that question is unknown. Given the possible impact on many other federal statutes that command states to refrain from taxing instrumentalities used in interstate commerce and other interstate commercial activities, unless and until P.L. 86-272 is challenged on the basis that it violates the anti-commandeering principle, the answer to that question will never be known.” Bland, R., The Anti-Commandeering Principle and P.L. 86-272, Tax Notes (Aug. 12, 2019).



Questions?

Thank you!

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