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Report No. 1471
December 19, 2022

Amanda Hiller
Acting Commissioner and General Counsel
New York State Department of Taxation and Finance
W.A. Harriman Campus
Albany, NY 12227

Re: *Report No. 1471- Report on Draft Regulations Regarding P.L. 86-272*

Dear Acting Commissioner Hiller:

I am pleased to submit Report No. 1471 of the Tax Section of the New York State Bar Association discussing Section 1-2.10 of the Article 9-A draft regulations regarding P.L. 86-272.

We appreciate your consideration of our Report. If you have any questions, please feel free to contact us and we would be happy to assist.

Respectfully Submitted,

Robert Cassanos
Chair

Enclosure

CC:

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Report No. 1471

New York State Bar Association Tax Section

REPORT ON DRAFT REGULATIONS REGARDING P.L. 86-272

December 19, 2022

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A. Introduction

In April 2022, the New York State Department of Taxation and Finance (the "Department") released draft regulations (the "Draft Regulations") essentially adopting model regulations promulgated by the Multistate Tax Commission (the "MTC"), which deal with the scope of P.L. 86-272 insofar as it applies to Internet-based interstate commerce.[1] This report (the "Report")[2] reviews and offers comments on the Draft Regulations and the MTC proposal on which they are based in light of the history and purpose of P.L. 86-272.

B. Summary and Recommendation

A substantial majority of the Executive Committee is of the view that portions of the Draft Regulations which treat a business's non-solicitation Internet communications with persons in New York State as "business activities within such State [*i.e.*, New York]" which can defeat P.L 86-272 protections are not easily reconciled with established rules of statutory interpretation. In particular, the majority believes that additional consideration should be given to two longstanding principles of statutory interpretation applied by the United States Supreme Court. First, in evaluating Congressional intent, a statute's words must be interpreted consistent with their ordinary meaning at the time Congress enacted the statute. Second, an interpretation that would render a statute a virtual nullity upon its enactment — which would have been the case for P.L. 86-272 if Congress believed that the prevalent forms of customer communications in 1959 (via telephone and mail) constituted an in-state business activity — is looked upon by the courts with disfavor because it means the legislation left unchanged the law that existed before its enactment.

The reason given by the MTC, and relied upon by the Department, for treating Internet communications as an in-state business activity is the 2018 Supreme Court decision in *South Dakota v. Wayfair, Inc.* 138 S. Ct. 2080 (2018). That decision overruled longstanding Court precedent, and held that under the dormant Commerce Clause an out-of-state seller need not be physically present in the taxing state in order to be required to collect sales tax from in-state customers. However, this Report does not address whether the Commerce Clause allows a state constitutionally to tax a business based on its Internet communications with persons in that state. Here, where Congress has exercised its authority to regulate commerce by enacting P.L. 86-272 to

[1] Article 9-A Business Corporation Franchise Tax Draft Regulations, Part 1 § 1-2.10 (N.Y.S. Department of Taxation & Finance, April 2022). While not defined therein, the term "Internet" is used herein with the same meaning as in the Draft Regulations, and is therefore capitalized throughout in the same manner as in the Draft Regulations.

[2] The principal author of this Report was Irwin M. Slomka. Helpful comments were received from Robert Cassanos, Peter L. Faber, Stephen B. Land, Alysse McLoughlin, Richard M. Nugent, Yaron Z. Reich, Stuart L. Rosow, Michael L. Schler, and Jack Trachtenberg. This Report reflects solely the views of the New York State Bar Association Tax Section and not those of the New York State Bar Association's Executive Committee or its House of Delegates.

restrict state taxation, it is necessary to ascertain the scope of that enactment. This approach looks to Congressional intent upon enactment in 1959 as the most important factor.

The question thus becomes what Congress meant by the phrase "business activities within such State." P.L. 86-272 was designed to protect businesses that were physically conducting business activities in the taxing state, and was in direct response to the 1959 Supreme Court decision in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959). Since there was no Internet, we looked to whether Congress considered the then prevailing forms of interstate customer communications in 1959 — telephone and mail — as constituting an in-State business activity. If it did, then P.L. 86-272 would have been a virtual nullity at inception. Although there is no direct authority on point that we were able to discover, the majority felt they had to assume that in enacting P.L. 86-272 Congress intended to provide protection to businesses that engaged in such then-prevailing ordinary course non-solicitation communications with customers and other counterparties for this very reason (that is, that any other interpretation would have rendered the statute a virtual nullity at inception). While one could argue that only such means of communication in existence in 1959 were within the intended penumbra of protection, there is no evidence to support this view that we were able to discover and the majority does not believe that is the better view for the reasons discussed below. Similarly, although arguments can be made that software such as cookies and apps constitute in-state physical presence, we did not find any authority supporting such treatment, although there is one case in the area holding that they do not, which is currently on appeal.

A minority of the Executive Committee takes the view that there is no "clear and manifest" evidence of Congressional intent to preempt the Department from taxing businesses that engage in interstate non-solicitation Internet communications. Therefore, the minority believes the Department should be allowed to promulgate regulations that narrowly interpret the P.L. 86-272 protections, and leave it to the courts to decide whether its interpretation is correct. The minority also believes that if Congress did not intend for then-prevalent means of interstate communications to run afoul of P.L. 86-272 protections, 86-272 would not have been a nullity in 1959, and Congress could reasonably have limited that protection to those then-existing means of communication. The fact that the Department's interpretation would likely render P.L. 86-272 a nullity under current business practices is therefore not relevant. Finally, the minority views the placement of Internet "cookies" on customer computers as being meaningfully different than the types of customer communications in 1959, and as representing a type of physical in-state "presence."

C. Foreign Corporations – Public Law 86-272

1. Background

15 U.S.C. §§ 381-384 ("P.L. 86-272") prohibits a state or political subdivision from imposing on a corporation formed under the laws of another state:

> [A] net income tax on the income derived within such State . . . if the only business activities within such State by or on behalf of such person . . . [are] the solicitation of orders . . . for sales of tangible personal property, which . . . are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State.[3]

P.L. 86-272 was enacted by Congress in 1959 in direct response to a Supreme Court decision upholding the imposition of Minnesota's corporation income tax on an out-of-state cement company that leased a small sales office in Minnesota principally for its sales representatives to solicit sales orders.[4] P.L. 86-272 generally exempts corporations from state and local net income tax where the corporation's in-state business activities do not exceed the solicitation of orders for sales of tangible personal property.

The Supreme Court has interpreted the scope of P.L. 86-272 in only a few cases. In *Heublein, Inc. v. South Carolina Tax Comm'n*, 490 U.S. 275 (1972), the Supreme Court addressed the narrow question whether the in-state non-solicitation activities engaged in by an out-of-state producer of alcoholic beverages — carried out solely to comply with state liquor regulations — should be disregarded for P.L 86-272 purposes. Not surprisingly, the Court held that the non-solicitation activities removed the protections of 86-272, finding that by taxing the out-of-state producer, South Carolina was "pursuing permissible ends in a manner that Congress did not address." *Heublein* at 282.

More significant to the question of statutory interpretation of P.L. 86-272 was the Supreme Court decision in *Wisconsin Dep't of Revenue v. William Wrigley, Jr. Co.*, 505 U.S. 214 (1992). In *Wrigley*, the Supreme Court clarified the scope of P.L. 86-272, regarding the phrase "solicitation of orders," holding that it encompassed activities that were "entirely ancillary" to such solicitation, such as providing cars and a stock of free samples to sales representatives but did not include, for example, the in-state "repair or service" of the seller's products by those representatives. Writing for the majority, Justice Scalia found that an extremely narrow interpretation of the phrase "solicitation of orders" adopted by the State of Wisconsin had to be rejected because it "would

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[3] *See Northwestern States Portland Cement Co.* at 450; 15 U.S.C. § 381(a)(1).

[4] The Supreme Court 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." *Northwestern States* at 452.

reduce [P.L. 86-272] to a nullity" and "would cause [86-272] to leave virtually unchanged the law that existed before its enactment." *Wrigley* at 226. The Court also noted that the in-state conduct of a *de minimis* level of non-protected activities would not cause a corporation to run afoul of P.L. 86-272 protections. While the Court addressed these two "primary sources of confusion," inasmuch as the case involved actual in-state activities physically carried out by Wrigley in Wisconsin, the meaning of the term "business activities within such State" was not in issue. *Wrigley* at 222.

For tax years beginning after 2014, the nexus standards under Article 9-A of the New York Tax Law ("Article 9-A") were expanded to include a corporation deriving at least $1 million of receipts for the tax year from activity in New York State, generally known as "bright-line economic nexus." For 2022, this annual threshold was increased to $1,138,000. The economic nexus standard based on in-state receipts ascribes greater significance to customer location rather than to a corporation's in-state physical presence for nexus purposes, making a clear delineation of protected and unprotected activities for purposes P.L. 86-272 even more important.

Although P.L. 86-272 is a federal law, the Department, like many state taxing authorities, has for many years interpreted its scope principally by regulation. Since its enactment in 1959, Congress has not amended the law to define the phrase "business activities within such State." However, at the time the statute was enacted, it was generally understood that jurisdiction to tax a corporation was based on its actual physical presence within the state. Accordingly, the term "business activities" was believed to have referred to in-state *physical* activities and not to include, for example, mailing a letter, making a long-distance phone call, or broadcasting an advertisement from one state to another. In other words, there was little if any controversy over the scope of the term "business activities" other than with respect to in-state physical business activities that were alleged to be *de minimis*, as opposed to, for example, the scope of the term "solicitation of orders."[5]

In late 2018, the MTC convened a working group to consider how P.L. 86-272 applied to modern business practices, specifically business activities conducted through the Internet. The triggering event for its reevaluation was the ground-breaking Supreme Court decision earlier that year in *South Dakota v. Wayfair, Inc.*, which, as the MTC has acknowledged, involved the constitutionality of a sales tax vendor collection statute and not the scope of P.L. 86-272. In *Wayfair*, the Supreme Court overruled two earlier decisions – one going back more than 50 years

[5] See Scalia's opinion in *Wrigley* at 223:

> Although we have stated that § 381 was "designed to define clearly a lower limit" for the exercise of state taxing power, and that "Congress' primary goal" was to provide "clarity that would remove [the] uncertainty" created by *Northwestern States* [citation omitted], experience has proved § 381's "minimum standard" to be somewhat less than entirely clear. The primary sources of confusion, in this case as in others, have been two questions: (1) what is the scope of the crucial term "solicitation of orders"; and (2) whether there is a de minimis exception to the activity (beyond "solicitation of orders") that forfeits § 381 immunity.

– that imposed an in-state "physical presence" requirement for nexus in order for a state to require an out-of-state seller to collect sales tax from customers in the taxing state.[6] In particular, the MTC considered the statement in *Wayfair* that an Internet seller "may be present in a State in meaningful way without that presence being physical in the traditional sense" as being relevant in applying P.L. 86-272.[7]

On August 4, 2021, the MTC revised its "Statement of Information Concerning Practices of the Multistate Tax Commission and Supporting States Under Public Law 86-272" (the "Statement"). This Statement set out a new principle that "when a business interacts with a customer via the business's web site or app, the business engages in a business activity within the customer's state." The MTC proceeded to set out examples of what it considered to be business activities conducted in a customer's state via the Internet, and identified those that it identified as exceeding solicitation and therefore as defeating P.L 86-272 protections.[8]

The Draft Regulations largely adopt the MTC's approach.[9]

2. <u>The Draft Regulations</u>

The Department posted the Draft Regulations on its web site as part of revisions to Parts 1 through 3 of the Article 9A draft regulations, dated April 2022. Draft Regulation Section 1-2.10

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[6] In *Wayfair*, the Supreme Court overturned its decisions in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992) and *National Bell Hess Inc. v. Dep't of Revenue of Ill*., 386 U.S. 753 (1967).

[7] *Wayfair* at 2095 (internal quotations omitted).

[8] An article appearing in State Tax Notes, authored by Brian Hamer, counsel to the MTC (and one of the architects of the Statement), contains a thoughtful analysis of the history leading to the Statement, the approach taken by the MTC work group in evaluating various factual interactions between an Internet seller and its customers, and the author's responses to comments made by practitioners to the work group's deliberations that resulted in the final Statement. Brian Hamer, "An Insider's View of the MTC's P.L. 86-272 Project," *State Tax Notes*, Vol. 99, Mar. 22, 2021, p. 1213–1225 ("Hamer Article").

[9] The California Franchise Tax Board has conformed to the MTC approach. *Technical Advice Memorandum*, California Franchise Tax Board, No. 2022-01, dated February 14, 2022. The TAM does not state that it is to be applied only prospectively. *See also*, Franchise Tax Board Publication 1050, "Application and Interpretation of Public Law 86-272 (revised May 2022). An action was brought in California Superior Court challenging the TAM as being in direct contravention of P.L. 86-272 and the U.S. Constitution. *American Catalog Mailers Assoc. v. Franchise Tax Board*, Case No.: CGC-22-601363 (California Superior Court, San Francisco County, Aug. 19, 2022). At this time, we are aware of no other states having adopted the MTC approach regarding the effect on P.L. 86-272 protections for activities engaged in via the Internet. It has been reported that in August 2022, the Acting Director for the New Jersey Division of Taxation stated that the Division of Taxation would be proposing regulations based on the MTC Statement in the coming months. Paul Williams, "MTC Urges States To Protect Small Online Sellers From Tax", LAW360 (Aug. 3, 2022), available at https://www.law360.com/tax-authority/articles/1517022/mtc-urges-states-to-protect-small-online-sellers-from-tax. The Oregon Department of Revenue, after initially announcing that it was considering adopting the MTC approach, later announced that it had put its deliberations on hold. *See* Amy Hamilton, "Oregon Holds Off on Following MTC's P.L. 86-272 Revisions," TAX NOTES (Sept. 26, 2022), available at https://www.taxnotes.com/tax-notes-state/nexus/oregon-holds-following-mtcs-pl-86-272-revisions/2022/09/26/7f5xj.

contains new provisions addressing the effect of a corporation's "activities engaged in via the Internet" on the exemption from tax under P.L. 86-272.[10] The Department describes the new provisions as being "largely modeled after the [MTC] model statute," for the stated purpose of better reflecting modern business practices conducted via the Internet.

Section 1-2.10(d) of the Draft Regulations specifies that the exemption from tax under P.L. 86-272 is limited to the solicitation of orders for the sale of tangible personal property, or activities which are entirely ancillary to such solicitation, but now also includes a specific reference to "activities engaged in via the Internet." The revisions regarding Internet activities are largely set out through examples involving activities conducted through an out-of-state seller's website.

Section 1-2.10(i) introduces three new examples of activities engaged in via the Internet which the Department considers entirely ancillary to the solicitation of orders for the sale of tangible personal property ("solicitation of sales"), and therefore as not exceeding the protected activities under P.L. 86-272.[11] Section 1-2.10 also provides eight new examples of Internet activities, presumably performed from outside New York State, which the Department considers to cause the business to lose its P.L. 86-272 protections because they constitute "business activities in [New York] State" that exceed solicitation or activities ancillary to solicitation that it considers to be business activities in the state.[12] These 11 examples, which are substantially the same as the example in the MTC's Statement, are summarized as follows:

> Protected Internet Activities.
>
> - Example 6: Selling tangible personal property on the seller's website and the listing of "static" frequently asked questions and answers (FAQs) on the website.
>
> - Example 11: Placing Internet "cookies" onto the customer's computers or other electronic devices through the website that will be used for purposes entirely ancillary to the solicitation of sales, such as remembering items in the customer's online "shopping cart."

[10] While the scope of P.L. 86-272 had previously been the subject of several earlier Article 9-A draft regulations going back to 2015, none of these earlier drafts addressed "activities engaged in via the Internet." Parts 1 through 3 of the Draft Regulations were further revised in August 2022, but not with respect to P.L. 86-272.

[11] *See* Examples (6), (11) and (16).

[12] *See* Examples (7)–(10) and (12)–(15).

- Example 16: Selling tangible personal property on the seller's website where, for instance, the website enables customers to search for items to purchase, read product descriptions, and select and pay for the items.

Unprotected Internet Activities Resulting in the Loss of P.L. 86-272 Protection.

- Example 7: "Regularly" providing post-sale assistance by e-mail or through an online electronic "chat" service on the seller's website, such as by regularly advising customers on how to use purchased products.

- Example 8: Soliciting and receiving branded credit card applications from customers via the seller's website, for credit cards that will generate interest and fees to the seller.

- Example 9: Inviting viewers of the seller's website to apply for non-sales positions with the corporation, including enabling viewers to fill out and submit electronic employment applications through the website.

- Example 10: Placing Internet "cookies" onto the customer's computers or other electronic devices through the seller's website that will be used to gather customer search information that will be used to adjust production schedules, develop new products, or identify new items to offer for sale.

- Example 12: Remotely fixing or upgrading products previously purchased by customers by transmitting code or other electronic instructions via the Internet.

- Example 13: Offering and selling extended warranty plans through the seller's website for products previously purchased by customers.

- Example 14: Contracting with a marketplace provider that facilitates the sale of the corporation's products on the provider's online marketplace, in instances where the provider maintains inventory, "including some of the corporation's products," at fulfillment centers in New York State.

- Example 15. For sellers of tangible personal property via the Internet, also contracting with customers to stream video and music to electronic devices for a fee.[13]

If adopted, these new examples would represent a significant change from the Department's longstanding interpretation of P.L. 86-272 and would substantially remove the protections of the law for most businesses.

The Department states on its web site that it intends to begin the formal promulgation process, for this and other Article 9-A draft regulations, by the end of 2022. The Draft Regulations do not indicate the tax years to which they would apply if promulgated.

3. Comments

The Tax Section commends the Department for seeking to provide additional guidance — which will be effectuated through the State regulatory promulgation process — concerning the scope of P.L. 86-272 in light of modern business practices regarding the Internet. As has been its practice with all of its draft regulations relating to Article 9-A corporate tax reform, the Department has published the Draft Regulations on its web site before beginning the formal promulgation process, thereby giving the public a broad and welcome opportunity to offer comments throughout the process.

At the outset, it must be acknowledged that when Congress enacted P.L. 86-272 in 1959, not only was there no Internet, but except for telephone, broadcast and mail communications, businesses generally conducted their affairs with customers in person through their employees and independent contractors. The case law makes clear that in enacting P.L. 86-272, Congress was addressing the tax consequences of physical in-state business activities, principally through the in-state presence of sales representatives.[14] This appears to have been the Department's long-standing view as well, as evidenced by the fact that the existing Article 9-A regulations interpreting P.L. 86-272 currently contain examples of business activities considered as exceeding solicitation, all of which involve activities *physically* conducted in the State.[15]

[13] This example involves both the sale of tangible goods as well as the provision of services which go beyond the customary "customer support" activities described in some of the other examples. A full analysis of this and similar fact patterns is beyond the scope of this Report.

[14] Both *Heublein* and *Wrigley* involved activities physically engaged in by sales representatives in the state. In *Wrigley*, the Court noted that "Wrigley engaged in print, radio, and television advertising in Wisconsin," but did not discuss the significance of those advertising activities, other than to note that the purchase and placement of advertising was managed by an independent advertising agency in Chicago, *i.e.*, activities conducted outside the state.

[15] 20 NYCRR 1-3.4(9)(v).

Although the Internet has played an increasingly essential role in modern business practices for many years, it was not until the Supreme Court's decision in *Wayfair* — specifically, the reference to a statement in Justice Kennedy's concurring opinion in another case decided three years earlier[16] (that an Internet seller "may be present in a State in meaningful way without that presence being physical in the traditional sense of the term") — that the impact of a corporation's non-solicitation activities not physically conducted in the taxing state was first considered by the MTC and, more recently, by the Department.

We note that as a matter of constitutional law, we believe *Wayfair* is of questionable relevance to the scope of P.L. 86-272 inasmuch as it was decided under "dormant" Commerce Clause precedent, while 86-272 represents a direct Congressional action authorized under the Commerce Clause to restrict state taxation. In the case of the former, the courts must rule on whether state actions unconstitutionally discriminate or excessively burden interstate commerce in the absence of any Congressional action. But where Congress has affirmatively acted, as it has in this case by enacting P.L. 86-272, the threshold question is instead the scope of the Congressional limitation rather than the constitutionality of state action. Through enacting P.L. 86-272, Congress has struck the balance that it considers appropriate under its Commerce Clause authority. Thus, whether *Wayfair* relaxed the constitutional nexus standards should not be relevant to whether the Draft Regulations are consistent with the Congressional intent.[17]

The Draft Regulations appear to adopt a somewhat bifurcated approach to the concept of "business activities" within New York State. On the one hand, consistent with the MTC's Statement, the Draft Regulations do not appear to change the historic interpretation of P.L 86-272 with respect to the non-physical business activities conducted in 1959, principally mail and telephonic communication, which are not treated as in-state "business activities" that could nullify P.L. 86-272 protections. On the other hand, a different standard applies to at least certain, newer, Internet-based forms of communication. Calling a person in another state on the telephone for a purpose unrelated to solicitation of orders will not void the protections of P.L. 86-272, but engaging in a website chat with that person for the same purpose — perhaps even using the same smartphone — apparently will. It is unclear why one form of activity is permitted and the other is not. Leaving aside the presence of items such as "cookies" (discussed below), it is not clear what the conceptual difference is between the two activities, if any.[18]

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[16] *Direct Marketing Ass'n. v. Brohl,* 575 U.S. 1, 16 (2015) (concurring opinion).

[17] We note that if Congress desires to scale back the P.L. 86-272 protections from tax in light of *Wayfair*, it could certainly do so. Having one clear federal rule applicable to all states would be more desirable than a patchwork of different state interpretations and court decisions involving the scope of P.L. 86-272 protections from tax.

[18] For example, a hearing-impaired person may use text telephone technology ("TTY") during a phone call to convert voice to text. In other words, the phone call may become an exchange of written messages delivered

What is clear is that as businesses migrate increasingly to newer and more efficient forms of communication, the Draft Regulations would erode the protections of P.L. 86-272, potentially to the vanishing point. Whether that is an a legally justifiable result in light of the statutory language and Congressional intention is discussed below.

a. Federal Preemption Principles

Under the Supremacy Clause of the United States Constitution,[19] a valid exercise of Congressional authority such as the regulation of interstate commerce under P.L. 86-272 preempts any conflicting state law. This federal preemption applies whether the conflict with federal law results from state legislative, judicial or administrative action, such as by regulation.[20] Preemption can apply where the state action is expressly prohibited by federal law or is in direct conflict with federal law. An example of the former is the federal Internet Tax Freedom Act,[21] which expressly limits state taxation of Internet access and discriminatory taxes on electronic commerce. The Supreme Court has held that traditional state powers are not preempted unless there is a "clear and manifest" Congressional intent to do so.[22]

When a federal statute unambiguously limits states from imposing a particular kind of tax affecting interstate commerce, it is not necessary to look beyond the plain language of the federal statute in determining whether state taxation is pre-empted. *Aloha Airlines, Inc. v. Dir. of Tax'n of Hawaii*, 407 U.S. 7 (1983) (upholding the clear Congressional prohibition of the imposition of state gross receipts taxes on airlines). P.L. 86-272 does expressly prohibit the imposition of state income taxation under the conditions set forth in the federal law – an express preemption statute – and it can be argued that by substantially removing those protections, the Draft Regulations violate the Supremacy Clause and should be preempted. For similar reasons, it can also be argued that they are in direct conflict with P.L. 86-272 and preempted for that reason.

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electronically. This and similar technologies would seem to blur the line between a call (protected activity) and a chat (unprotected activity) even further.

[19] U.S. Const. art. VI., § 2.

[20] Cornell Law School, Legal Information Institute, available at Preemption | Wex | US Law | LII / Legal Information Institute (cornell.edu) (searched on Nov. 8, 2022).

[21] Pub. L. No. 105-277, tit. XI, §§ 1100 *et seq*, 112 Stat. 2681 (1998). This Report does not discuss whether the Draft Regulations are preempted by the Internet Tax Freedom Act. *But see Hamer Article*, p. 1222.

[22] *See, e.g., Department of Revenue of Or. v. ACF Indus.*, 510 U.S. 332 (1994); *Rice v. Santa Fe Elevator Corp*., 331 U.S. 218 (1947); *Heublein* at 275 (1972). In a more recent decision involving an "express" preemption provision, the Supreme Court stated that because the federal law contained an express preemption clause, it "do[es] not invoke any presumption against preemption but instead focus[es] on the plain wording of the [statutory] clause, which necessarily contains the best evidence of Congress' pre-emptive intent." *Puerto Rico v. Franklin Cal. Tax-Free Trust*, 136 S. Ct. 1938, 1946 (2016) (involving an interpretation of a federal Bankruptcy Code preemption provision) (internal quotation marks omitted).

Nothing in P.L. 86-272 prohibits states from interpreting it by regulation. Indeed, since Congress did not provide any mechanism for the law to be interpreted, it has been left to the states to do so, by regulation or otherwise. As a result, the states, not the federal government, have been interpreting various aspects of P.L. 86-272 virtually since its inception. Congress has preempted state regulation in certain areas. In some cases, such as medical devices, Congress preempted all state regulation. In others, such as labels on prescription drugs, Congress allowed federal regulatory agencies to set national minimum standards, but did not preempt state regulations imposing more stringent standards than those imposed by federal regulators. Clearly, no such limitations are contained in P.L. 86-272, and we proceed to consider whether the Draft Regulations are a proper interpretation of that law.

b. Statutory Language of P.L. 86-272

We begin by first considering whether the interpretation of P.L. 86-272 in the Draft Regulations is consistent with the language of P.L 86-272. The operative statutory language precludes the imposition of state net income taxes in the following case:

> if the only business activities within such State by or on behalf of such person . . . [are] the solicitation of orders . . . for sales of tangible personal property, which . . . are sent outside the State for approval or rejection, and, if approved, are filled by shipment or delivery from a point outside the State.

The threshold question is whether the wording of the federal law — specifically the words "the only business activities within such State by or on behalf of such person" — include activities where the taxpayer in question, and persons acting on its behalf, are physically located outside of the State in question but those persons communicate with in-state persons from outside the State. Examples of such communications would include interstate mail and telephonic communications when the statute was passed in 1959, and today would also include email, website "chats" and other electronic forms of interstate communication largely conducted over the Internet. The statutory language does not explicitly refer to physical presence, and it is therefore arguably unclear and potentially susceptible of more than one interpretation.

One interpretation is that the language should be deemed to include such "remote" activities physically conducted from outside the state, even when the seller has no physical presence or property within the state other than that related to solicitation activities. In the broadest formulation of this interpretation, the existence of any non-solicitation interstate mail or telephonic communication would void the protection of P.L. 86-272 as an "in state" business activity. Obviously, the drafters were aware in 1959 that such interstate communication occurred regularly, and it seems evident that they did not thereby intend to limit the protections of the statute only to businesses that did not engage in any forms of interstate communication other than related to the solicitation of orders. Implicit evidence of this intention is seen in the failure (or perhaps more accurately, the unwillingness) since 1959 of any state taxing authority to advance this

interpretation, and the fact that the principal means of interstate non-physical communication existing in 1959 — mail and telephone — were not addressed by either the Statement or by the Draft Regulations. However, it is possible that one might conclude that while forms of interstate communication existing in 1959 do not fall within the penumbra of an in-state business activity, newer forms of communication may. These arguments are discussed below.

The other interpretation, focusing on the fact that the statutory language is very location-driven (solicitation activities "within such State"; orders "sent outside the State" for approval; fulfillment of orders "from a point outside the State"), treats all activity as occurring where the person undertaking such activity is physically located. Thus, a solicitation by a person physically located in state is an in-state business activity, sending an order to a person physically located out of state for approval satisfies the sending requirement, and fulfillment from a stock of goods physically located outside the state satisfies the delivery requirement. Using this approach, there are few if any interpretative questions about the scope of the statute other than the scope of the term "solicitation" and whether or to what extent *de minimis* non-solicitation activities are permitted.[23]

Having said this, it certainly would have been clearer had the federal law referred to "business activities *physically conducted* within such State."[24] While Congress may have assumed that the words "physically conducted" would have been superfluous, the statute as written is arguably ambiguous.

c. Congressional Intent of P.L. 86-272

Given this arguable ambiguity, it is necessary to apply principles of statutory construction. These principles take into account extrinsic considerations, the most important of which is legislative intent. Ascertaining Congressional intent may be more difficult where, as here, the activity being evaluated — activities conducted via the Internet — did not exist at the time the law was enacted. Notwithstanding these challenges, the Executive Committee believes that there are several factors which are relevant to the interpretation of P.L. 86-272. These factors, it is argued by a substantial majority of members of the Executive Committee, support a conclusion that Congress did not intend to preclude P.L. 86-272 protection for non-solicitation activities that were physically conducted outside the taxing state.

First, P.L. 86-272 was a direct Congressional response to the *Northwestern States* decision, which involved whether Minnesota could tax a corporation having an in-state physical presence through the presence of sales representatives operating out of leased office space. The Supreme

[23] *See Wrigley* at 231-32.

[24] For that matter, P.L. 86-272 would also have been clearer had it referred to "business activities within such State *regardless of whether physically conducted in the State*" (emphasis added).

Court has acknowledged that the uncertainty in the business community over the decision in *Northwestern States*, along with the Court's decision to let stand two other state appellate court decisions upholding the taxation of corporations with in-state salesmen, "were the driving force behind the enactment of [P.L. 86-272]."[25] There is no meaningful dispute that Congress was addressing situations involving the state taxation of businesses having an in-state physical presence.[26]

Second, the general view among the states when P.L. 86-272 was enacted in 1959 was that in-state physical presence was a requirement for nexus to tax. Since the purpose for P.L. 86-272 was to shield from tax businesses that actually had nexus with the taxing state, by considering "business activities within such State," Congress should be assumed to have been aware that the phrase pertained to activities physically conducted in the taxing state — that is, nexus-creating activities as those activities were understood in 1959. There was no need at that time for Congress to have been concerned with activities that were physically conducted outside the taxing state, since by definition such activities were assumed not to create nexus. Put another way, it would have been peculiar for Congress to have gone out of its way to protect a class of physical in-state activities if that protection would have been mooted by other ordinary course of activities physically conducted out-of-state. For example, telephone and mail communications were in existence in 1959. It may reasonably be concluded that although in 1959 Congress did not deliberate on the effect of communications that would not be developed until decades later, the absence of any reference in P.L. 86-272 to business activities such as telephone and mail communications strongly suggests that Congress was only concerned with activities physically conducted in the taxing state. P.L. 86-272 would have been a nullity or near nullity had telephone and mail communications with customers been considered an in-state "business activity" that could defeat P.L 86-272 protections, since such forms of non-solicitation interstate communication regularly occurred in 1959 and in prior years.[27] Hence, it must be assumed that Congress would

[25] *Wrigley* at p. 222. *See also, Senate Finance Committee Report*, "State Taxation of Income from Interstate Commerce," No. 658, p. 2–3 (Aug. 31, 1959) (citing to *Northwestern States* as creating the need for the legislation that resulted in the enactment of P.L. 86-272).

[26] In the Minority Views section of the *Senate Finance Committee Report*, which views were in opposition to the enactment of P.L. 86-272 unless further study was undertaken, Senators Gore and McCarthy observed that *Northwestern States* involved "definite, physical activities carried on in the taxing State[]," and commented that the Court "has not said that the State can levy a tax on or measured by net income for casual business, mail order business, radio broadcasting crossing state lines, or other types of business about which so many have expressed apprehension." *Senate Finance Committee Report*, p. 11.

[27] Responding to the argument that by treating online "chat" more harshly than providing customer service by telephone the MTC Statement violates the anti-discrimination prohibition of the Internet Tax Freedom Act ("ITFA"), Mr. Hamer takes the position that whether customer service provided by telephone is a protected activity "is an open question," and that any discriminatory treatment would not violate the ITFA because it would be the result of P.L. 86-272, not state law. *Hamer Article* at 1222.

not have enacted a law that it knew provided no protections for the vast majority of businesses in 1959.[28]

Perhaps another way of stating this principle is that statutes should be interpreted in a manner which is consistent with the contemporaneous understanding of the terms and concepts used in the statute, rather than in a manner that would render those terms and concepts a nullity. A somewhat similar issue arose in *Wisconsin Central Ltd. v. United States*, 138 S. Ct. 2067 (2018), which was issued on the same day as *Wayfair* and which dealt with the question of whether employee stock options constituted "monetary remuneration" under the Railroad Retirement Act of 1937. In that case the Supreme Court articulated the first prong of this principle as follows: "As usual, our job is to interpret the statute's words consistent with their ordinary meaning at the time Congress enacted the statute." *Wisconsin Central Ltd.* at 2070.[29] In a similar vein, the Supreme Court, in interpreting whether prohibited sex discrimination under the Civil Rights Act of 1964, included discrimination based on sexual orientation, also looked to ordinary meaning at the time of enactment, noting: "If judges could add to, remodel, update, or detract from other statutory terms inspired only by extraterritorial sources and our own imaginations, we would risk amending statutes outside the legislative process reserved for the people's representatives." *Bostock v. Clayton Cty*., 140 S. Ct. 1731, 1738 (2020).[30]

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[28] In *Wrigley*, the Supreme Court, using similar reasoning, rejected the State of Wisconsin's position that the words "solicitation of orders" be given a narrow interpretation, saying:

> [L]imiting "solicitation of orders" to actual requests for purchases would reduce Section 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.)

Similarly, interpreting "business activities within such State" to include letters mailed or telephone calls placed to a customer in that state from outside the state would not only have eroded the protections of P.L. 86-272 to the vanishing point, it would have done so in a very aleatory manner where the existence and volume of non-solicitation letters mailed and long distance phone calls placed to various states would need to be tallied and tracked each year in order to establish the presence or absence of nexus. The fact that such undertakings were never suggested much less implemented give implicit support to the view that at the time of the implementation of P.L. 86-272 the very concept of business activities in a particular state did not include activities actually carried out physically in another state.

[29] In his article, Mr. Hamer viewed the analogy to *Wisconsin Central* as "flawed," stating that Justice Gorsuch's reasoning was consistent with the view that even though the internet did not exist in 1959, this did not preclude interpreting the term "business activities within the State" as including interactions with customers over the internet. *Hamer Article* at 1221. But the point is whether the Court's reasoning precluded treating an interstate telephone call as a business activity of the seller in the state where the seller was not located, and if it did, what implication that reasoning had for the same or similar types of internet activity.

[30] In that sense, the majority agrees with the minority view, expressed below, that "attempting to divine Congressional intent for an entirely new means of conducting business is misplaced." Under the rule of statutory construction laid out in *Wisconsin Central* and *Bostock*, words are to be given their generally understood meaning at the time of enactment. At that time, the generally understood meaning of "business activities within" a state required physical presence in that state and therefore the statute should be construed accordingly. There is no need to "divine" Congressional intent since that intent was manifest. Indeed, the opposite is true. To prove that physical presence was not required there must be a statutory basis to depart from the then generally accepted understanding of the words used in the statute and no such basis exists.

While a minority of the Executive Committee argue that Congress was not addressing physical presence, merely the specific activities in issue in *Northwestern States*, the majority believe that if physical presence is not relevant to the definition of a business activity then it is hard to explain why non-solicitation interstate telephonic and mail communications are not themselves fatal, which would have thereby rendered P.L. 86-272 a nullity or near nullity since inception. In other words, either placing a phone call to another state is a business activity in that other state or it is not. If it is a business activity, then even if that activity alone could not create nexus, then P.L. 86-272 was always a nullity (or nearly so) because the class of protected activities (salesmen physically present in the state) already conferred nexus under the *Northwestern States* decision. In this regard, it should be noted that such a narrow interpretative approach was rejected by the Supreme Court in the *Wrigley* decision regarding the scope to be given to the term "solicitation", and the Statement (and the Draft Regulations) effectively "grandfather" these forms of non-physical business activities.[31]

Adherents of the physical presence approach reject the dismissal of Congressional intent as essentially making policy judgments better left to Congress which they would argue has already spoken in this matter, albeit not entirely clearly. Advocates of the Statement might reply that even if this is ordinarily the case, given Congress' inability or unwillingness to authorize or implement uniform federal guidance on this question over the course of many decades that states should have latitude to fill that vacuum by interpreting the language as they see fit, even if such an interpretation is either inconsistent with the original Congressional intent or renders the statute a nullity or near nullity. The majority of the Executive Committee is of the view, however, that under principles of statutory construction, Congressional intent not only cannot be disregarded, but represents the most critical extrinsic consideration for interpreting an arguably ambiguous statute like P.L. 86-272.

An alternative argument is that there was Congressional intent to protect non-physical communication activities in existence when P.L. 86-272 was enacted, but not such activities which came into existence later. The problem with this sort of historical approach is that there is no way to know where to draw the line. Cell phones were not invented in 1959 either, but presumably an interstate telephone call placed via a cell phone from out of state would be as protected as a call placed from a land line.[32] If that is the case, then the question arises as to where and why to draw these lines. The contrary view is that Congress should be presumed to have been aware of the general notion of technological progress. Therefore, there is no need to engage in a speculation about which specific forms of possible future technological innovation Congress had foreseen.

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[31] Indeed, in *Wrigley*, the Supreme Court concluded that an overly narrow interpretation of the term "solicitation" "would reduce § 381(a)(1) to a nullity" and "would cause § 381 to leave virtually unchanged the law that existed before its enactment [in 1959]." *Wrigley* at 226. As a result, the Court held that the term necessarily included activities that were "entirely ancillary" to solicitation.

[32] Besides having to decide whether land line phones are more deserving of P.L. 86-272 protection than cell phones, a similar analysis would have to be undertaken for other technologies such as texting and TTY mode.

d. Placement of "Cookies" on Customer Computers

We next considered whether the presence of Internet "cookies" is relevant for P.L. 86-272 purposes. Cookies are text data files stored on the computers and physical communications devices of customers that visit a vendor's web site.[33] The Draft Regulations treat the placement of a corporation's "cookies" on a New York State customer's computers or other electronic devices — typically resulting from the customer accessing the corporation's web site — as an in-state business activity of the corporation. They distinguish between cookies used for remembering items in a customer's online "shopping cart" (a protected activity considered ancillary to solicitation) and cookies used by the business to gather customer information for use in production and product development (an activity presumably not considered sufficiently directly related to solicitation) that will subject the corporation to tax.

We question whether Internet cookies can be viewed as an independent in-state business activity. To our knowledge, the only state that has formally taken the position that cookies confer nexus is Massachusetts, which in 2017 adopted a sales tax regulation providing that a corporation's use of Internet cookies downloaded onto in-state customer computers "constitute the requisite in-state physical presence" to subject the corporation to a sales tax collection obligation, notwithstanding the court's decision in *Quill*.[34] The legality of that regulation was challenged, and in *U.S. Auto Parts Network, Inc.*, the Massachusetts Appellate Tax Board held that placement of Internet cookies by an online retailer of auto parts on the computers of its Massachusetts customers was not evidence of the seller's in-state physical presence and could not be a basis for a finding of nexus for sales tax collection purposes.

Interestingly, the Appellate Tax Board's conclusion was premised on the reasoning of *Wayfair*. The Board noted that Wayfair also used cookies, apps and other forms of electronic in-state "presence" but declined to rule that these were sufficient to create in-state nexus under *Quill*, at least as the Board interpreted that decision. In other words, had the Supreme Court in *Wayfair* concluded that cookies created physical presence, there would have been no need for the Court to expand the then prevailing notions of nexus to include non-physical activities since Wayfair would clearly have had cookies — and therefore nexus — in all 50 states. The Board accordingly concluded that the Court's decision in *Wayfair* was inconsistent with a finding that placement of cookies or apps on a vendee's electronic equipment, standing alone, is sufficient to create nexus

[33] *See, e.g., U.S. Auto Parts Network, Inc. v. Comm'r*, Docket No. C339523 (Mass. App. Tax Board, Dec. 7, 2021), available at https://www.mass.gov/doc/us-auto-parts-network-inc-v-commissioner-of-revenue-december-7-2021/download.

[34] 830 Code Mass. Regs. 64H.1.7.

at least if physical presence is required for nexus. The case is currently on appeal to the Massachusetts Supreme Judicial Court.[35]

A fundamental predicate to the question of whether cookies confer nexus is whether cookies ought to be considered physical objects which are the property of the vendor. If cookies are physical objects which remain the vendor's property, then we might analogize a vendor's placement of cookies to a vendor lending its customers phones or other devices that they could use to order goods, both of which could constitute physical presence. If cookies are not physical objects and/or do not remain the vendor's property, however, then communication with in-state customers through the placement of cookies can be considered a modern-day equivalent to communications with customers by telephone in 1959, albeit one providing for more extensive customer interactions. To date, we are aware of no instance of New York State (or any state) having taken the position that telephone communications with a corporation's in-state customers (toll-free or otherwise) constituted an in-state business activity. As noted above, had the states treated telephone communications as non-qualifying in-state activities when Congress enacted P.L. 86-272 in 1959, it would have meant that Congress enacted a virtually meaningless law that offered no protection from tax for the vast majority of interstate businesses. As a matter of statutory construction, the courts may not impute to the legislature the act of enacting a statue which is ineffective or otherwise meaningless.[36]

The absence of judicial or quasi-judicial authority for treating Internet cookies placed on customer computers as an in-state business activity, the fact that cookies can be reasonably analogized to the role played by telephones before the Internet, and the negative inference from *Wayfair* drawn by the Massachusetts Appellate Tax Board in the *U.S. Auto Parts* decision all point to the conclusion that the placement and use of cookies should not be considered relevant for nexus and P.L. 86-272 purposes.[37]

Some Executive Committee members disagree, and consider the presence of cookies to be the differentiating factor which if deemed to be physical property of the vendor should be treated as being physically present in the computer or similar device of the vendee. As noted above, we

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[35] On November 4, 2022, oral argument in *U.S. Auto Parts* was heard by the Massachusetts Supreme Judicial Court. "Wayfair Retroactivity, Cookies Confound Massachusetts Justices," BLOOMBERG TAX, Daily Tax Report (Nov. 4, 2022), available at https://news.bloombergtax.com/daily-tax-report-state/wayfair-retroactivity-cookies-confound-massachusetts-justices. In reference to Internet cookies constituting a basis for nexus, one justice reportedly asked Massachusetts counsel, "So you're saying electrons satisfy a substantial nexus to Massachusetts?"

[36] McKinney's Ann. Consol. Laws of New York, Statutes, § 144. *See also, Wrigley* at 226.

[37] Even if "cookies" are within the penumbra of physical presence, that presence may be so evanescent as to be disregarded under the Supreme Court's "de minimis activities" analysis. *See Wrigley* at 230 ("[T]he venerable maxim *de minimis non curat* ("the law cares not for trifles") is part of the established background of legal principles against which all [legislative] enactments are adopted and which all enactment (absent contrary indication) are deemed to accept."). Also, unless it can be shown that the cookies remain the property of the vendor, and not of the customer on whose computer they are placed, it would arguably seem irrelevant to this discussion even if they are regarded as a physical object.

are aware of only one state, Massachusetts, that has formally taken the position that cookies stored on the computers of customers constituted a form of in-state physical presence and that is litigating the issue (in *U.S. Auto Parts*).

e. Minority View of Executive Committee

A minority of Executive Committee members raised several points in support of the Draft Regulations.

1. Congress intended only a narrow protection from tax. Some members take the approach that Congress intended to provide only very narrow protection for in-state solicitation activities that were in issue in *Northwestern States*. So, the intent of Congress had nothing to do with physical presence but was instead focused on other issues, which is the reason the physical presence issue had seldom if ever been raised in P.L. 86-272 litigation, even as recently as the *Wrigley* decision in 1992. Therefore, in the absence of a "clear and manifest" Congressional intent to preclude state taxation of businesses engaged in interstate Internet non-solicitation communications with customers, the Department should not be preempted from doing so.

2. Protection limited to forms of communications in existence in 1959. Even if it is determined that at least the use of these forms of communication in existence circa 1959 were not intended to impinge on the protections of P.L. 86-272, then the question arises as to whether later technological developments were also similarly protected. Certain members took the approach that the implied Congressional intent to protect non-physical in-state business activities is deserving of deference, but only for the types of activities in existence in 1959, which did not include, for example, the Internet. This is consistent with the approach taken by the Statement and the Draft Regulations. Under this application of the rules of statutory interpretation, P.L. 86-272 would not have been a nullity when enacted because telephone and mail communications were not considered in-state business activities at that time.

3. Congressional Intent is Not Relevant in Light of Technological Changes. Some members are of the opinion that even if Congressional intent in 1959 was to exclude from the ambit of the term "business activities within such State" the activities of persons not physically located within such state, that intent is no longer dispositive or even relevant in light of subsequent technological changes. Rather, the question should be what the right answer should be. In this view, while perhaps not perfect (e.g., due to the "grandfathering" of telephone and mail communication), the Statement (and accordingly the Draft Regulations) come closer to the "right" answer than the physical presence approach discussed above, and accordingly should be considered a valid interpretation of P.L. 86-272. For example, the presence of cookies facilitates customer communications beyond earlier forms of customer communications, and also if deemed to be physical property of the vendor should be treated as being physically present in the computer or similar device of the vendee.

Put differently, the minority believes that transacting business through the Internet is fundamentally different than conducting business over the telephone or through the mails. The Internet simply offers businesses a way of delivering products (often inextricably linked with the delivery of services) that is far more extensive than the types of "remote" activities that were in existence in 1959. Accordingly, it is not necessarily appropriate to base the analysis on analogizing Internet activity to activity conducted by means of the mail or telephone. For example, if a company selling prescription drugs over the Internet also provides an online examination with a physician, is the company merely soliciting sales or really delivering a combination of product and an unprotected service? In the minority's view, attempting to divine Congressional intent for an entirely new means of conducting business is misplaced. The analysis should be focused on the nature of the physical and Internet-based activity occurring in the state and whether such activity is actually limited to soliciting sales of tangible property. Since the draft regulations are focused in this manner, the minority believes that such regulations are consistent with applicable law.

f. Comments on Examples in Draft Regulation

This section assumes that what is described above as the "physical presence" test is correct and that cookies do not constitute physical presence. It analyses the examples in the Draft regulations from that perspective, it being understood that adherents of the contrary view would support the result reached by the Draft Regulations in each of the examples discussed.

The Tax Section agrees with conclusions in the three examples of protected Internet activities — *i.e.*, static FAQs placed on a seller's website (Example 6), the placement of cookies on customer computers to track purchases (Example 11), and the use of the seller's website to allow customers to search for and purchase items (Example 16) — all of which involve clear instances of either solicitation or activities ancillary to solicitation, whether or not considered an in-state business activity, or in the case of static FAQs in Example 6, do not rise to the level of an "activity" in the first place.

We note that Example 14 treats the in-state maintenance by a marketplace facilitator (such as Amazon or eBay) of a marketplace provider's inventory, such as at the facilitator's fulfillment center in the State, as an unprotected in-state activity. We do not disagree that the storage of a provider's goods in the State may not be a protected activity under P.L 86-272, both because the maintenance of a stock of goods in the State is arguably not ancillary to solicitation and because it

presents the possibility that the goods would not be shipped or delivered to customers "from a point outside the State."[38]

With regard to Example 6, the Department should elaborate on its stated rationale (that it is a "de minimis" activity) to make clear that both static and dynamic FAQs are always protected activities, regardless of the volume of FAQs and their source (for instance, it should not matter that an FAQ resulted from an interaction with a customer). In Example 11, while cookies used to track customer purchases are unquestionably ancillary to solicitation, at a minimum it should be clarified that the condition that the cookies "perform no other function" means they are not actually used for other functions, not that they are incapable of being used for some other purpose.

The remaining eight examples depict various activities that the Department considers unprotected. It is assumed that none of the activities in the examples is physically performed by the seller in New York State. For the reasons set forth above, a majority of the Tax Section believes that such out-of-state activities, even if not solicitation or ancillary to solicitation, should have no bearing on the seller's protections under P.L. 86-272 so long as the seller's actual in-state activities do not exceed solicitation or activities ancillary to solicitation.[39]

Several of the examples are particularly problematic as they seek to convert a business' ordinary and prudent customer support activities that are performed outside the State into in-state activities that remove P.L. 86-272 protection. The use of e-mail or electronic "chat" functions to furnish customer support as a basis to remove P.L. 86-272 protections (Example 7), seems especially overbroad. Businesses large and small have historically provided customer support telephone numbers to product owners, often toll-free, to answer customer questions. We have found no instances where the Department took the position that the use of such customer support numbers by customers in New York State removed P.L. 86-272 protection. In recent years, the Internet has provided an accessible, and presumably less costly, means of providing the same type of customer support. It is difficult to see the basis for treating online customer support as defeating P.L. 86-272 protections, while coming to the contrary conclusion for telephonic customer support.

Along the same lines, repair or upgrading of products sold by the seller by transmitting code or other electronic instructions through the Internet (Example 12) seems substantially similar to the furnishing of product repair instructions provided by telephone or by mailing the instructions

[38] We note that a Pennsylvania court recently held that the storage of a nonresident seller's merchandise at an in-state warehouse of a marketplace facilitator (Amazon) was not shown to constitute sufficient in-State nexus of the seller for sales tax collection and personal income tax purposes, where the seller had no control over the merchandise once it was sent to the facilitator. *Online Merchants Guild v. Hassell*, Commonwealth Court of Pennsylvania, No. 179 M.D. 2021, Sept. 9, 2022.

[39] While we question whether the examples in the Draft Regulations of non-solicitation activities conducted through the Internet represent "business activities within [New York] State," we agree that the described activities are not necessarily "solicitation" or "entirely ancillary" to solicitation.

to the customer. We have found no instances of the Department treating the latter as removing P.L. 86-272 protections, and we see no reasonable basis for the former activities to do so.

Other examples of unprotected activities via the Internet present other concerns. The seller's use of its website to invite viewers to fill out and submit electronic applications for non-sales employment through the website (Example 9) is certainly not solicitation or ancillary to solicitation. However, it is also not an activity that is conducted in New York State merely because it is solicited through a corporation's website. The recruiting of employees by advertising in trade publications or by the use of recruiting firms has not previously been the basis for removing P.L. 86-272 protections in the State. Such potential employees are not necessarily customers. It should have no bearing on a corporation's P.L. 86-272 protections.

The fact that the cookies may be used to gather customer search information to, among other things, help the seller identify new items to offer for sale (Example 10) — which is arguably neither solicitation nor ancillary to solicitation — does not evidence that the seller is engaging in unprotected activities in New York State, just as receiving information from one of the seller's brick and mortar retailers about its customer requests for a new or different product would not have constituted engaging in unprotected activities prior to the advent of the Internet.

g. Prospective-Only Application

Finally, if the Draft Regulations are promulgated in substantially their current form, they should be given a prospective-only effective date. That would be necessary as a matter of due process and fundamental fairness since it would constitute a significant change in the Department's long-standing interpretation that could not reasonably have been anticipated by the public.

The Appellate Division decision in *Hilton Hotel Corp. v. Comm'r of Finance*, 219 A.D. 2d 470 (2nd Dep't 1995) is instructive. At issue was a New York City utility tax assessment against the Waldorf-Astoria Hotel on the hotel's long-distance telephone call surcharges, which for nearly 50 years the City of New York had interpreted as not being taxable. The Department of Finance changed its interpretation and assessed the tax retroactively. On appeal, the Appellate Division held that it was arbitrary and capricious to retroactively apply the new policy. The court applied the three-part test for determining the non-retroactivity of a judicial decision enunciated by the Supreme Court in *Chevon Oil Co. v. Huson*, 404 U.S. 97 (1971). It found that for nearly 50 years the hotel industry had relied on government opinion letters not imposing the tax, and that there was no showing either that retroactive application would further the new rule or that prospective application would undermine its effect. The court held that the tax assessment should be cancelled.

If adopted, the Draft Regulations present at least as compelling a case for prospective-only application as in *Hilton Hotel*. They would represent a new principle of law contrary to the

longstanding policy of the Department. Retroactive application would not further the new interpretation nor would prospective-only application harm it. There would also be substantial inequities resulting from retroactive application by exposing businesses to unanticipated Article 9-A liabilities. It would also be more consistent with *Wayfair* inasmuch as the South Dakota statute upheld as constitutional by the Court by its terms was only to have prospective application if the Court overturned *Quill*, which it did. The Tax Section urges that the Draft Regulations be made to apply prospectively only.

D. Conclusion

It seems likely that if promulgated in its present form, the Draft Regulations will significantly diminish the longstanding protections afforded by P.L. 86-272, which for more than 60 years have been interpreted by the Department, and by the vast majority of states, as based on a corporation's physical in-state activities.[40] In applying rules of statutory construction, we believe there is sufficient evidence of Congressional intent that P.L. 86-272 only considers "business activities" that in 1959 resulted in taxable nexus — that is, activities physically conducted in the taxing state. To conclude that Congress did not intend to protect interstate communications as they existed in 1959 would, to quote the Supreme Court in *Wrigley*, "reduce [P.L. 86-272] to a nullity" and "would cause [86-272] to leave virtually unchanged the law that existed before its enactment," a result that we find unsupportable under principles of statutory interpretation. The *Wayfair* decision should not be a basis for undoing that Congressional intent, which only Congress, having exercised its Commerce Clause authority, should undertake.

[40] In its most recently released draft regulations regarding P.L. 86-272 prior to the current draft, released in April 2021, the Department continued to base exemption under P.L. 86-272 on whether "the activities of the corporation in New York" exceeded solicitation. *See*, *e.g.*, Article 9-A Business Corporation Franchise Tax Draft Regulations, Section 1 § 1-2.4(a)(9)(i), (iv) and (vi) (N.Y.S. Department of Taxation & Finance, April 2021).