

## Federal law may protect remote sellers from state net income taxes



David M. Kall | Friday, July 12, 2019

Behind the landmark U.S. Supreme Court case *South Dakota v. Wayfair* that now allows states to levy sales and use taxes on remote sellers with “economic nexus” lurks a similar, yet distinct, issue with respect to state corporate net income taxes. Sales taxes are levied on transactions, in contrast to corporate net income taxes that are imposed for the privilege of doing business in a particular state. The difference may seem inconsequential at first blush, but different factors matter when analyzing whether a business triggers nexus for state income tax purposes as opposed to sales and use tax purposes.

### **Public Law 86-272**

Known today as Public Law 86-272, Congress enacted the Interstate Income Act in 1959 in response to two U.S. Supreme Court cases allowing states to impose net income taxes on businesses with limited in-state activity.<sup>1</sup> P.L. 86-272, in relevant part, provides the following:

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

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(1).

In short, P.L. 86-272 prohibits states from levying net income taxes on businesses with in-state activities limited to soliciting orders for tangible personal property and fulfilling those orders by shipment or delivery from a point outside the state. By enacting this statute, Congress implicitly weighed-in on the boundary line as to where a corporate net income tax is constitutional and where it may not be.

### **Issues Persist**

Fast forward 70 years and there is far different business landscape and legal environment for business than there was in 1959. The *South Dakota v. Wayfair* case in 2018 now allows states to levy sales and use taxes on remote sellers regardless of whether they have an in-state physical presence. So long as remote sellers have a threshold number of in-state transactions or amount of revenue generated from in-state consumers, they could trigger use tax collection duties.

P.L. 86-272, however, may provide similarly situated remote sellers with defenses against state net income taxes. On June 28, 2019, the New Jersey Tax Court upheld the ongoing validity of P.L. 86-272 in striking down an assessment that the State of New Jersey levied specifically on companies protected from the New Jersey Corporation Business Tax (i.e. a net income tax) due to P.L. 86-272. In *Stanislaus Food Products Company v. Director*, the New Jersey Tax Court held that the assessment at issue was “an end-run around P.L. 86-272.” While the *Stanislaus* case does not address the intersection of sales and net income tax nexus, it goes to show that P.L. 86-272 can provide businesses with protection from aggressive state income taxation.

### Know Your Rights

The *Stanislaus* case demonstrates that state taxing authorities including the New Jersey Department of Revenue can take aggressive positions when levying taxes, particularly with the wind at their backs following the 2018 *Wayfair* decision. Businesses that may be subject to sales and use tax obligations under economic nexus standards following pre-or-post-*Wayfair* state tax legislation should nonetheless consider their rights and protections from net income taxes under P.L. 86-272.

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<sup>1</sup> See, *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959); *Brown-Forman Distillers Corp. v. Collector of Revenue*, 234 La. 651, appeal dismissed, 359 U.S. 28 (1959).



**David M. Kall**

Team member bio