

Trends in State Income Taxation of Multistate Businesses

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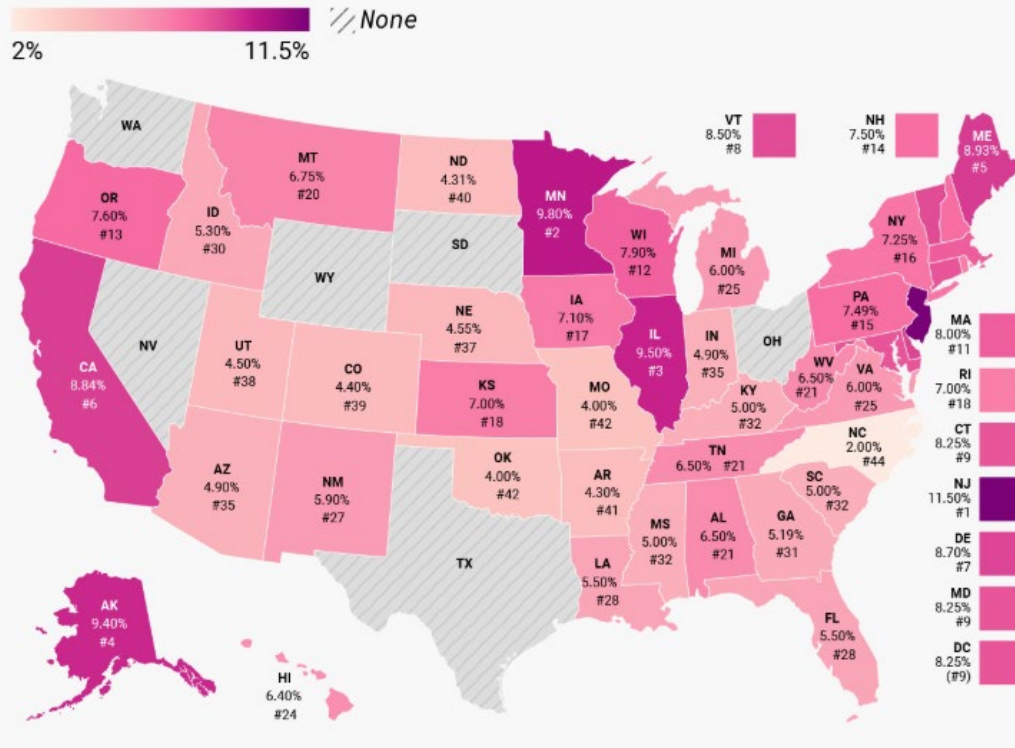
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State Income Tax for Multistate Businesses

- Introduction
- Constitutional Limitations on State Taxation
- Public Law 86-272
- Apportionment
- Throw-out / Throwback Rules
- Practical Considerations

Corporate Net Income Tax

Top Marginal Corporate Income Tax Rates as of January 1, 2026



- 44 states levy a corporate income tax
- A handful of states impose a gross receipts tax instead of (NV, OH, TX, WA) or in addition to (DE, OR, TE) net income tax

Source: Tax Foundation

Constitutional Limitations



- Commerce Clause: “Congress shall have the power... to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.” Art. I, § 8, Cl. 3
 - *Dormant Commerce Clause*: Judicial doctrine that the Constitution prohibits states from enacting regulations that unduly restrict interstate commerce, even where Congress has not legislated in the area.
 - *Affirmative Commerce Clause*: Where Congress *has* legislated in an area, federal law preempts conflicting state law

Constitutional Limitations

- *Northwestern States Portland Cement Company v. State of Minnesota*, 79 S. Ct. 357 (1959).
 - Commerce Clause does not prohibit a state from imposing a nondiscriminatory, fairly-apportioned net income tax on an out-of-state corporation engaged in interstate commerce within the taxing state
 - Prior to this decision, businesses engaged in purely interstate commerce had been understood to be exempt from state taxation

Constitutional Limitations

- *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977)
 - A state tax is permissible under the dormant commerce clause if the tax:
 1. Applies to activity with a substantial nexus with the state
 2. Is fairly apportioned
 3. Does not discriminate against interstate commerce
 4. Is fairly related to the services provide by the state

Federal Limitations: P.L. 86-272

- Enacted by Congress in 1959 in response to the *Northwestern States* decision.
- “No State ... shall have power to impose ..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 ... are ...the solicitation of orders ... for sales of tangible personal property ... sent outside the State for approval ... and ... filled by shipment or delivery from a point outside the State...”

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States Push Back on P.L. 86-272

- Multistate Tax Commission: Created to oppose greater affirmative regulation of state taxation, anticipated in the wake of the *Northwestern States Decision*
- MTC “Statement of Information Concerning Practices of Multistate Tax Commission and Signatory States Under Public Law 86-272”
 - Originally adopted in 1986, revised in 1993, 1994, 2001 and 2021
 - Initially focused on definition of “solicitation” as used in P.L. 86-272
 - 2021 amendments address “activities conducted via the internet”

States Push Back on P.L. 86-272

- 2022: California publishes TAM 2022-01 and revises Publication FTB-1050. Both publications adopt the MTC's view of internet activities and sought to apply them retroactively.
 - “As a general rule, when a business interacts with a customer via the business's website or app, the business engages in a business activity within the customer's state.”
- 2023: California State Court declared regulation void as an “underground regulation”

States Push Back on P.L. 86-272

- 2023: New York adopts formal regulations regarding the application of PL 86-272, asserting a right to impose income tax on out-of-state companies based on activities conducted “via the internet.” Asserts the right to enforce retroactively to 2015.
- 2025: New York Court holds that regulation cannot be enforced retroactively. Appeal pending regarding core question of whether the regulation itself is preempted by P.L. 86-272

States Push Back on P.L. 86-272

- 2025: New Jersey adopts formal regulations adopting the MTC position on PL 86-272. Definition of “doing business” is expanded to include “internet activities,” such as:
 - Providing post-sales assistance through an electronic chat, email, or application that the taxpayer’s customers access, including “chat rooms for troubleshooting problems.”
 - Regulation challenged in court, pending decision

States Push Back on P.L. 86-272

- P.L. 86-272's protections continue to be challenged by states, including Massachusetts, Wisconsin and others.
- Congress has not amended or repealed P.L. 86-272 since 1959.
 - Version of OBBBA passed by House of Representatives included a provision that would have expanded the federal law's protections
 - Stripped from reconciliation version of the bill (and not included in enacted law) under Senate's "Byrd Rule"

Multistate Taxation: Apportionment

- If a business engaged in interstate commerce is subject to multiple states' net income tax, it must apportion its income among the states.
 - Traditional approach (UDITPA): three factor apportionment (sales/receipts, payroll, property)
 - Trend: single factor apportionment (sales/receipts)

Throwback / Throw-out Rules

- Receipts factor is a fraction, the numerator of which is total receipts in the taxing state, measured on a destination basis, and the denominator is the total receipts of the taxpayer everywhere
 - Throwback rule: If a taxpayer is not “taxable” in a particular destination state (e.g., because it does not have nexus in the state or is protected by P.L. 86-272), receipts are “thrown back” to the state from which the goods were shipped, increasing the numerator of the sales factor in that state.
 - Throw-out rule: Receipts from states where a taxpayer is not taxable are removed from the denominator of the sales factor

Inconsistent State Apportionment formulas

- Different states utilize different apportionment formulas (e.g. 3-factor vs. single-factor) and have inconsistently adopted throw-out and throwback rules.
- States may disagree about whether a business is taxable in another state, for purposes of applying a state's throw-out or throwback rule.
- This is of particular concern at a time when states are challenging the traditional understanding of P.L 86-272
 - Danger of double-taxation.
 - Long timelines for audits and assessments may limit ability to seek refund of taxes paid to one state, if another state assesses tax on the same income

Practical Considerations

- Nexus:
 - Sales to a state in excess of state's economic nexus threshold?
 - Property, payroll, or activity by agents or independent contractors in a state?
- P.L. 86-272:
 - Is activity within a state limited to protected “solicitation?”
 - Has a state adopted regulations regarding “internet activities?”
- Apportionment:
 - Is the business entitled/required to apportion its income among several states?
 - How do the apportionment rules and throw-out/throwback rules of those states interact?

Thank you.

