The Old and the New

by Andrea Muse

In this inaugural installment of Briefly Noted, members of the *Tax Notes State* Advisory Council, formerly the *Tax Notes State* Advisory Board, share their state tax highlights of 2025.

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Highlights and Horizons

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As someone tasked with identifying "highlights of recent updates" in the triannual online revision of his treatise on state taxation,[1] I thought that responding to *Tax Notes State* Editor in Chief Andrea Muse's invitation to identify "the state tax highlights of 2025 . . . or on the horizon in 2026" would be a relatively easy assignment. In fact, however, I was overwhelmed by the number of topics addressed in my (and my fellow council members') contributions to *Tax Notes State* and other publications that would qualify as "highlights." Accordingly, with the caveat that the ensuing description of state tax highlights fails to mention most developments that would qualify as highlights (and that other council members will no doubt identify in their responses), I would identify the following highlights as noteworthy.

Taxation of Cryptoassets

If there are any topics that have pervaded the universe of state tax commentary during 2025, it is state taxation of cryptoassets. At the risk of breaking my arm patting myself on the back, support for this conclusion can be found in my (and my co-authors') efforts to address these issues,[2] as well as those of many other council members, and that support will likely continue in 2026.

Application of Sales Factor for Corporate Income Tax Purposes

One focus of interest that emerges from a review of state tax developments over the past year is the proper application of states' sales factors in their corporate income tax regimes. For example, California, a state whose economic significance needs no elaboration,[3] promulgated revised regulations addressing the sourcing of receipts from services and receipts from intangible property, effective January 1, 2026.[4] The long-awaited regulations attempt to modernize California's approach to sourcing services and

[1] *See* Jerome R. Hellerstein, Walter Hellerstein, and Andrew Appleby, *State Taxation*.

[2] *See* Walter Hellerstein and Appleby, "A State Tax Perspective on Proposed Federal Cryptoasset Guidance," *Tax Notes State*, Nov. 24, 2025, p. 539.

[3] As I regularly explain to foreign participants at international tax conferences where I am making a presentation on state tax issues as to why they should care about U.S. states, if California were a nation, it would be the fifth largest economy in the world, after the United States, China, Germany, and Japan.

[4] Cal. Code Regs. tit. 18, section 25136-2.

intangibles, including asset management services and professional services.[5] California's previous regulations required taxpayers to identify if their customer was an individual or a business, which proved difficult in practice. The revised regulations eliminate this distinction and instead now provide four sourcing presumptions applicable to all customers:

> The location of the receipt of the benefit of the service shall be presumed to be in this state to the extent the service predominantly relates to:
>
> a. Real property that is located in this state.
> b. Tangible personal property and the tangible personal property is located in this state when the service is received. If the tangible personal property is delivered directly or indirectly to the customer after the service is performed, the benefit of the service is received where the property is delivered, regardless of where the service is performed.
> c. Intangible property that is used in this state.
> d. Individuals who are physically present in this state at the time the service is delivered.[6]

Selected Highlights From Forthcoming Revision of the Treatise

I thought it might be appropriate to conclude with a selected list of highlights from the forthcoming revision of the treatise:

- First Amendment challenge to Maryland's digital advertising tax passthrough prohibition (the Fourth Circuit decision in *Chamber of Commerce of United States of America v. Lierman*[7]).
- State conformity issues related to the federal One Big Beautiful Bill Act (P.L. 119-21).
- Application of a look-through sourcing methodology in the context of pharmacy benefits management services (the Minnesota Supreme Court's decision in *Humana MarketPoint Inc. v. Commissioner of Revenue*[8]).
- Application of the "derived from its primary business activity" test to an energy company's gross receipts from commodities hedging transactions (the Oregon Tax Court's decision in *Chevron USA Inc. v. Department of Revenue*[9]).

[5] *Id.*; *see also* Kathleen K. Wright, "A Look at California's Market-Based Sourcing Regs on Services," *Tax Notes State*, Oct. 27, 2025, p. 215.

[6] Cal. Code Regs. tit. 18, section 25136-2(c)(1)(A). The regulations also provide a special look-through sourcing rule for "asset management services." Cal. Code Regs. tit. 18, section 25136-2(c)(2).

[7] *Chamber of Commerce of the United States of America v. Lierman*, 151 F.4th 530 (4th Cir. 2025).

[8] *Humana MarketPoint Inc. v. Commissioner of Revenue*, 25 N.W.3d 841 (Minn. 2025).

[9] *Chevron USA Inc. v. Department of Revenue*, TC5461 (Or. T.C. July 21, 2025).

To Conform, or Not to Conform? That Is the Question (for Most States in 2026)

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There is nothing like a massive federal income tax bill to make multistate tax professionals smile (that is, job security), and President Trump came through for them "big" time in 2025 by enacting the One Big Beautiful Bill Act on the Fourth of July. Many state legislators, however — not concerned with billable hours — will not be smiling at their additional workload caused by the OBBBA, which will carry through 2026 and likely beyond, depending on how their state tax laws interplay with the changes to the IRC. Regardless of whether their state's income tax laws conform to the code, legislators will be busier than ever, analyzing how the new federal changes to taxable income, deductions, and exemptions would — if not adopted or decoupled — affect their state's financial situations. Although for corporations, most states' starting points for determining state taxable income are tied directly to the code's definitions of taxable income (either before or after final deductions for net operating losses and special deductions (that is, either line 28 or line 30, respectively)), how those states conform to the federal definitions varies widely. Most states' versions of federal taxable income do not resemble each other and are nothing like the real thing.

Rolling Conformity States

Twenty-two states are rolling conformity states.[10] Rolling conformity states automatically adopt whatever provisions Congress and the president have enacted that affect their relevant federal taxable income starting point, effective upon enactment. Although automatic conformity is supposed to simplify matters, that applies only when the rolling conformity state can afford to accept the effects of the federal changes. When the dust settles, and the state budget directors inform their legislatures of the OBBBA's potential effects on their revenue, rolling conformity states' legislators must scramble to decide to either accept the changes or decouple from one or more of them. The scramble has begun. For example, Colorado's governor started the charge by calling a special session, which resulted in decoupling from certain OBBBA provisions, but accepting others (through inaction) on August 28, 2025. The governor has indicated that more cuts are coming in 2026.[11] In November Delaware decoupled from the OBBBA's research and development, qualified production equipment, and bonus depreciation provisions because the state's budget projections indicated that to leave them in place would cost about $355 million through 2027.[12] Other rolling conformity states will follow suit if their financial projections indicate that they just cannot afford some or all of the OBBBA's provisions.

Dated Conformity States

A roughly equal number of states have adopted the code only as of a certain date.[13] Those states will have a lot more time to consider how

[10] Alabama (corporate and financial institution tax), Alaska, Colorado, Connecticut (last day of every year), Delaware, the District of Columbia, Illinois, Iowa, Kansas, Louisiana, Maryland, Massachusetts, Missouri, Montana, Nebraska, New Jersey, New York, North Dakota, Oklahoma, Oregon, Rhode Island, and Utah have rolling conformity.

[11] Emily Hollingsworth, "Colorado Governor Extends Spending Cuts to Offset OBBBA Impact," *Tax Notes State*, Dec. 8, 2025, p. 736.

[12] Matthew Pertz, "Delaware Decouples From Several OBBBA Deductions," *Tax Notes State*, Dec. 1, 2025, p. 667.

[13] The states with dated conformity are: Arizona (Jan. 1, 2025); California (Jan. 1, 2015); Florida (Jan. 1, 2025); Georgia (Jan. 1, 2025); Hawaii (Dec. 24, 2024); Idaho (Jan. 1, 2025); Indiana (Jan. 1, 2023); Kentucky (Dec. 31, 2024); Maine (Dec. 31, 2024); Michigan (optional — Jan. 1, 2025, or year in effect); Minnesota (May 1, 2023); New Hampshire (Dec. 31, 2018); North Carolina (Jan. 1, 2023); South Carolina (Dec. 31, 2024); Texas (Jan. 1, 2007); Vermont (Dec. 31, 2024); Virginia (Jan. 1, 2023); and West Virginia (Dec. 31, 2024).

the OBBBA provisions will (or will not) affect their budgets, given that the new provisions will not affect them unless they specifically adopt them.

Remaining States

Yet the remaining few state legislatures couldn't care less.[14] These states have decided to enact a gross receipts tax instead of a state income tax, or they have declined to enact either. Those lucky legislators who do not have to worry about federal conformity can spend 2026 debating other pressing legislation that affects their states.

The Future for Multistate Tax Practitioners

Conformity continues to create legislative chaos, but it's great for business! What does all of this mean for multistate state and local tax professionals on both sides of the fence? Thank goodness for AI (ethically used and reviewed, of course) and modern tax return automation! The coming wave of states decoupling from or accepting OBBBA provisions is nothing new for veteran SALT practitioners. For many decades, they have been coping with hundreds of state deviations from federal taxable income that have occurred on a state-by-state basis each time Congress has passed new tax legislation. Coping with the next round of changes resulting from the advent of the OBBBA is just business as usual for us. After all, countless federal provisions have been enacted or tweaked over the years that have been targeted selectively by the various rolling and dated conformity states for either decoupling or acceptance on a state-by-state, provision-by-provision basis (depending on each state's ties to federal definitions and the provisions' then-current budgetary effects). It's a darned good thing that we SALT practitioners have advanced technology to cope with the chaos.

[14]The remaining states are: Alabama (individual income tax only), Arkansas, Michigan, Mississippi, Nevada, Ohio, Pennsylvania, South Dakota, Washington, and Wyoming.

OBBBA Is Not an Excuse for Adopting Bad State Tax Policies

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The Challenging State Budget Outlook for 2026 and Beyond

One of the key factors setting the agenda for state taxes in 2026 is the significant reduction in federal aid to states enacted in July as part of the One Big Beautiful Bill Act. As a partial offset to the large cuts in federal personal and corporate income taxes, the OBBBA decreased federal aid to states by about $1.1 trillion over a 10-year period. The largest reductions regard funding for Medicaid and the Supplemental Nutrition Assistance Program. Although the federal aid curtailment is heavily backloaded with most of the cuts taking effect in the second half of the 10-year period, many states are anxiously looking ahead and gauging the potential loss in state revenues.[15]

Because of these reductions, the volatility of state tax policy in 2026 is likely to measurably increase. Although the 2017 Tax Cuts and Jobs Act resulted in unexpected state tax windfalls,[16] the OBBBA is creating unanticipated state budget concerns. Amid the great uncertainty over the individual state impact and timing of reductions in federal aid it is reasonable for states to look ahead and plan for the combination of rainy day funds, budget cuts, and tax increases needed to balance future state budgets.

These developments, however, raise concerns that some states may use the state budget turmoil as an excuse to adopt tax increases on businesses that reflect unfair, unsound, or unconstitutional state tax policies. This is particularly true in conjunction with three controversial state tax policy proposals that have surfaced repeatedly in recent years: (1) the inclusion of a portion of foreign-source income in the corporate income tax base without foreign factor representation, (2) the expansion of the sales tax base to include not just business-to-consumer digital products but also business-to-business digital products, and (3) the enactment of gross receipts or sales taxes on digital advertising or data mining.

Taxation of Foreign-Source Income Without Foreign Factor Representation

There is a long history of a minority of states including a portion of foreign-source income in the corporate income tax base. This development began decades ago with the addition of a portion of foreign dividends to the corporate income tax base and continued with global intangible low-taxed income (renamed net controlled foreign corporation tested income in 2026) becoming the favored category for inclusion. In recent years, however, this trend has taken an ominous turn. For the first time ever, two states — Minnesota in 2023 and Illinois in 2025 — adopted statutes that include 50 percent of foreign-source income in the corporate income tax base without providing any foreign factor representation in the denominator of the state apportionment formula.[17] Never before has a state incorporated such a large portion of foreign-source income in the corporate income tax base without a commensurate inclusion of the foreign sales that contributed to the production of the income in the apportionment formula. The apprehension that more states will adopt this unfair and likely unconstitutional state tax apportionment methodology is warranted as California in 2021 and Massachusetts in late 2025 considered similar proposed legislation.[18]

[15] On the reductions in federal aid to states, see Congressional Budget Office, "Estimated Budgetary Effects of Public Law 119-21, to Provide for Reconciliation Pursuant to Title II of H. Con. Res. 14, Relative to CBO's January 2025 Baseline" (July 21, 2025).

[16] *See generally* Andrew Phillips and Steven Wlodychak, "The Impact of Federal Tax Reform on State Corporate Income Taxes," prepared for the State Tax Research Institute (STRI) by EY (Mar. 2018).

[17] Karl A. Frieden and Douglas L. Lindholm, "Revisiting the Debate Over State Taxation of Foreign-Source Income," *Tax Notes State*, June 23, 2025, p. 807, at 817-820.

[18] *Id.*

The addition of a significant amount of foreign-source income into the corporate income tax base without the inclusion of the apportionment factors that produced the income violates a fundamental principle of state taxation.[19] It also likely violates the commerce clause of the U.S. Constitution, which requires that foreign commerce is not discriminated against in favor of domestic commerce.[20]

We have explained elsewhere why states should not include any significant portion of foreign-source income in the corporate income tax base. To address the problem of low-taxed foreign-source income, the United States enacted a global minimum tax in the form of GILTI. At the international level, dozens of countries have followed suit, adopting some or all of the provisions of the OECD's pillar 2 global minimum tax.[21] Although the U.S. and OECD initiatives take slightly different approaches, they share the perspective that the problem of low-taxed foreign-source income should be addressed at the national, not the subnational level. The inclusion of foreign-source income in the national and subnational corporate income tax bases in the United States risks placing U.S. multinational entities at a competitive disadvantage compared with foreign MNEs.[22]

If states include foreign-source income in the corporate income tax base, however, they should follow the rules applied to domestic source income and include the sales that produced the income in the apportionment formula. To do otherwise, under the pretense of plugging an unexpected fiscal gap, is an unsound and constitutionally suspect state tax policy that creates a significant litigation risk and could require a state to refund all collected foreign-source income-related revenues.

Expanding the Sales Tax Base to Include B2C and B2B Digital Products

In recent years, a significant number of states have introduced legislation to expand their sales tax bases to include more digital products. The states' justifications are rooted in the continuing shift from a tangible goods-oriented economy to one more heavily weighted toward services and digital products. From the states' perspective, they risk an erosion of revenue base if they don't keep pace with the meteoric growth of the internet and e-commerce. A recent study by the Multistate Tax Commission highlights the dilemma, finding that one-third of the states include either a narrow range of digital products or none at all in the sales tax base, and another one-third include only a narrow- to middle-size range of digital products in the sales tax base.[23]

The determination to modernize the sales tax base to include more B2C digital products certainly comports with a well-designed, broad-based consumption tax. The problem is the proclivity of states to expand the sales tax base to include not just B2C but also B2B digital products. This tendency is rooted in the absence of a default method to avoid sales tax pyramiding and the temptation to raise more revenue by taxing supply chains more than once. A study conducted by COST in 2022 found that the sales taxation of B2B digital products is not just commonplace but is the overwhelming norm among states that tax digital products. The COST study researched six categories of software and digital products and found that more than 90 percent of the taxing states include B2C and B2B purchases in the sales tax base.[24]

[19] As stated in the treatise *State Taxation*, "the factors that are employed to apportion income among the states should reflect the factors that produce the income being apportioned. This virtually axiomatic proposition is also a principle of constitutional law." Hellerstein, Hellerstein, and Appleby, *State Taxation*, ch. 9C, para. 9.15(1).

[20] *See* Frieden and Joseph X. Donovan, "Where in the World Is Factor Representation for Foreign-Source Income?" *State Tax Notes*, Apr. 15, 2019, p. 199.

[21] Frieden and Lindholm, *supra* note 17; Frieden and Barbara M. Angus, "Convergence and Divergence of Global and U.S. Tax Policies," *Tax Notes State*, Aug. 30, 2021, p. 937; PwC's Pillar 2 Country Tracker (last visited Dec. 9, 2025).

[22] Frieden and Marilyn Wethekam, "The Impact of the OBBBA on State Taxation of Foreign-Source Income" in "Should States Fear the OBBBA?" *Tax Notes State*, Aug. 11, 2025, p. 379; Frieden and Lindholm, *supra* note 17. No other economically advanced nation includes foreign-source income in the corporate income tax base at the state level. *See* PwC, "Survey of Subnational Corporate Income Taxes in Major World Economies: Treatment of Foreign Source Income," prepared for STRI (Nov. 2019).

[23] MTC, "Digital Products Matrix updated 1-9-25," available at MTC, "Issues Related to Tax Imposition (Definitions)" (last visited Dec. 9, 2025).

[24] Frieden and Fredrick J. Nicely, "Digital-Business Input Exemptions: Lessons From Sales Tax History," *Tax Notes State*, Jan. 29, 2024, p. 355; Frieden, Nicely, and Priya D. Nair, "Down the Rabbit Hole: Sales Taxation of Digital Business Inputs," *Tax Notes State*, July 18, 2022, p. 265. The most recent states to address digital commerce — Maryland and Washington — have exacerbated the problem by adding primarily B2B purchases to their sales tax bases. This contradiction is not unique to digital products. State overreliance on sales tax revenue from B2B transactions is well documented, with business inputs making up on average 42 percent of the U.S. state and local sales tax base. Phillips and Muath Ibaid, "The Impact of Imposing Sales Taxes on Business Inputs," prepared for STRI and COST by EY (May 2019).

There is no disagreement among sales tax experts that a well-designed sales tax should exclude B2B transactions from the sales tax base to avoid sales tax pyramiding.[25] To its credit, as part of a multiyear digital products study project, the MTC seems ready to recommend an approach that encompasses a broad B2C digital products base inclusion combined with an equally broad B2B base exemption.[26]

In 2026 and beyond, as states face potentially large budget shortfalls, expanding the sales tax base to include more digital products is an increasingly attractive policy option. States have a challenge and an opportunity to limit digital sales tax base expansion to B2C transactions. The lessons are clear from recent sales tax history that the best opportunity to avoid digital sales tax pyramiding is to enact B2B exemptions at the same time B2C base expansion occurs.[27]

Taxes on Digital Advertising or Data Mining

A third disturbing tax trend that bears watching in 2026 is states' interest in imposing a gross receipts or sales tax on digital advertising or data mining. In 2025 about 15 states considered digital advertising or data mining legislative proposals. In the end, Washington became the second state, after Maryland, in enacting a tax on digital advertising, although Washington chose to do so within the traditional state sales tax as opposed to a separate gross receipts tax.[28]

No state has adopted a gross receipts or sales tax on nonmonetized data mining, but several states have considered it.[29] Most states are refraining from enacting new taxes on digital advertising or data mining as they await the outcome of litigation challenging the four-year-old Maryland digital advertising tax statute as violating the federal Internet Tax Freedom Act and the commerce clause.[30]

Despite all the hoopla over its novelty, a gross receipts or sales tax on digital advertising or data mining is really just another mechanism to impose a consumption tax on business inputs. These legislative proposals flip optimal sales tax policy on its head by solely adding B2B and not B2C transactions to the sales tax base.[31]

We have previously provided critiques on why gross receipts or sales taxes on digital advertising or data mining constitute bad state tax policy options.[32] These taxes are newfangled ways to perpetuate (and expand) sales tax pyramiding, turning single-stage retail sales taxes into something resembling multistage turnover taxes. Over the course of the 20th century, turnover taxes were rejected and replaced everywhere in the world because of the inefficiency and unfairness of taxing transactions more than once within the same supply chain.[33]

Conclusion

The movement of states to estimate the impact of future reductions in federal aid and explore possible budget and tax solutions is entirely appropriate. But those exercises should proceed with caution and not exacerbate state fiscal problems by adopting controversial state tax policies that engender widespread business opposition and create significant litigation risk threatening the adoption and sustenance of the revenue streams.

[25] Frieden and Nicely, *supra* note 24, at 361 n.33.

[26] MTC, "Proposed Model Definition of "Automated Digital Product," Regulations, and Related Exemption," available at MTC, "Issues Related to Tax Imposition (Definitions)," *supra* note 23.

[27] Frieden and Nicely, *supra* note 24, at 367-368.

[28] Richard D. Pomp, "Digital Ad Tax Isn't How Washington Should Modernize State Code," *Bloomberg Tax*, Nov. 6, 2025.

[29] On the challenges of imposing a gross receipts or sales tax on data collection, see Scott Palladino, "Not All Data Is Evil: An Evaluation of Data Tax Proposals," *Tax Notes State*, Apr. 21, 2025, p. 147.

[30] *See* Frieden and Lindholm, "A State DAT Relabeled a 'Digital Barter' Tax Is Still Bad Tax Policy," *Tax Notes State*, Aug. 5, 2024, p. 381; Frieden and Lindholm, "State Digital Services Taxes: A Bad Idea Under Any Theory," *Tax Notes State*, Apr. 10, 2023, p. 89.

[31] *See* Frieden and Lindholm, "A State DAT Relabeled a 'Digital Barter' Tax Is Still Bad Tax Policy," *supra note* 30; Frieden and Lindholm, "State Digital Services Taxes: A Bad Idea Under Any Theory," *supra* note 30.

[32] *See* Frieden and Lindholm, "A State DAT Relabeled a 'Digital Barter' Tax Is Still Bad Tax Policy," *supra note* 30; Frieden and Lindholm, "State Digital Services Taxes: A Bad Idea Under Any Theory," *supra* note 30.

[33] *See* Pomp, "Resisting the Siren Song of Gross Receipts Taxes: From the Middle Ages to Maryland's Tax on Digital Advertising," STRI (July 2022).

Penny Wise

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The lesson from 2025: Everything has a cost, even money.

One of the big state tax stories was the federal government's decision to stop issuing pennies — minting the last one on November 12, 2025. The National Conference of State Legislatures recently issued a white paper, "Elimination of the Penny: Cents-able Considerations," cataloging all the issues states must address, including clarification of sales and excise tax reporting requirements.[34] In short, it's more complicated than it looks.

So why ditch the penny? The cost to make each cent is now more than three times its value.[35] You don't need to be an economist to know that's a losing proposition. The cost of copper (still used in making pennies) has gone up, sure.[36] But it's not just that. (Nickels cost more than 13 cents to mint.[37]) The real problem is their value. Fifty years ago, the penny's purchasing power was six times what it is today.[38]

The penny issue is also an apt metaphor for two important aspects of our federal system. First, the federal government acts and the states must then react — a relationship that often shifts costs to the states. Second, unlike the federal government, the states can't print their own money but must, instead, balance their budgets. I expect these will be running themes for 2026 and beyond.

I say the federal government "prints" money. Of course, the chief way it does this is through the Federal Reserve's purchasing of securities. But just as important for the national economy may be that the federal government funds more of its functions today through debt. In 2025 the total national debt as a share of GDP was higher than at any time since World War II.[39] If nothing changes, the debt will be 156 percent of GDP by 2055.[40]

And what about federal budget deficits? According to the Congressional Budget Office, the budget deficit for fiscal 2025 was $1.8 trillion.[41] And yes — that's $1.8 trillion, with a "T." As a comparison, the National Association of State Budget Officers reports that in 2024, total state government expenditures, including federal funds and capital expenditures, were a little over $3 trillion.[42] Can you say, "unsustainable"?

For the states, all this just means waiting for the other shoe to drop. That shoe is the expected cut in federal funding for programs. States will either have to fund those programs themselves or face the inevitable consequences, including any political fallout. But that's not all. States with personal and corporate income taxes tied to the federal base will see their state revenues affected by recent federal changes as well as by substantial cuts in federal tax enforcement, which will increase the tax gap, affecting states directly and indirectly.[43] Add to this the risks of an economic downturn, and the outlook for 2026 is uncertain at best.

One last additional risk states face is the perennial push to get the federal government to limit state tax authority. In 2025 the U.S. Justice Department issued a request for comment on state policies with "out-of-state economic

[34] *See* NCSL, "Elimination of the Penny: Cents-able Considerations" (updated Nov. 21, 2025).

[35] *See* U.S. Mint, "Penny FAQs" (last updated Nov. 12, 2025).

[36] *See, e.g.*, Statista, "Average Prices for Copper Worldwide From 2014 to 2026" (last visited Dec. 17, 2025).

[37] *See* U.S. Mint, "2024 Annual Report," at 12 (2024).

[38] *See* Federal Reserve Bank of Minneapolis, "Inflation Calculator" (last visited Dec. 17, 2025).

[39] Committee for a Responsible Federal Budget, "Fix the National Debt" (last visited Dec. 17, 2025).

[40] *See* CBO, "The Long-Term Budget Outlook: 2025 to 2055" (Mar. 2025).

[41] *See* CBO, "Monthly Budget Review: Summary for Fiscal Year 2025" (Nov. 10, 2025).

[42] *See* National Association of State Budget Officers, "2024 State Expenditure Report, Fiscal Years 2022-2024," at 16 (2024).

[43] For a summary of the possible impacts, see the recent presentation by the Institute on Taxation and Economic Policy to the MTC Uniformity Committee. Carl Davis, "The Effects of IRS Enforcement on State Tax Revenues," ITEP (Nov. 18, 2025).

impacts."[44] In response, a few tax practitioners urged Congress to impose statutory limits on state taxes and grant federal courts the jurisdiction to hear disputes.[45]

So in summary, in 2026 state policymakers will have to deal with economic challenges coming down the pike and cuts to federal funding on which they have relied, all while facing the very same political pressures their federal counterparts face, along with potential pressures from those federal counterparts. And they'll do all of this while balancing their budgets. Just like they have for centuries.

Who knows? Maybe it will all work out. Still, it's probably wiser to prepare. And the best way for states to prepare is to work together. Here I put in a plug for the MTC, of course, and its programs to help states develop uniform tax policies, promote tax compliance, and enhance enforcement. But it's not just the MTC. The Federation of Tax Administrators helps states share information, manage common administrative issues, and develop workable tax systems, and the Streamlined Sales Tax Project continues to serve states (and taxpayers) by creating more uniform sales and use tax rules and identifying emerging issues. Other groups like the NCSL and the National Association of State Budget Officers are also good forums for states to work together.

If the lesson from 2025 is that everything has a cost, then the lesson from 2026 may be that states must pay those costs.

[44] *See* Justice Department release, "Justice Department and National Economic Council Partner to Identify State Laws With Out-of-State Economic Impacts" (Aug. 15, 2025).

[45] Paul Williams, "State Tax Rules Flagged to DOJ in Interstate Commerce Probe," *Law360 Tax Authority*, Nov. 7, 2025.

Does the 2025 *AMCA* Decision in New York Signal the Demise of P.L. 86-272?

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One of the flaws of P.L. 86-272 is that Congress has never formally addressed the treatment of the numerous technological changes to selling goods in the United States that have occurred since its enactment in 1959. Rather than merely using mail-order catalogs, landline marketing, and traveling sales representatives based out of traditional brick-and-mortar establishments, even the smallest companies are selling products nationally by using the internet, marketplace facilitators, and artificial intelligence. As a result, taxpayers selling nationally through websites are being challenged on their claims of P.L. 86-272 income tax immunity without congressional guidance.

On August 4, 2021, the Multistate Tax Commission (not Congress or Treasury) issued a "Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States Under Public Law 86-272,"[46] (another) nonbinding revised policy statement addressing the protection (or lack thereof) afforded by P.L. 86-272 to internet businesses.

Under the MTC statement, determining whether an internet seller is shielded from income taxation by P.L. 86-272 requires the same general analysis as persons selling goods by any other means. Thus, immunity applies to a person if their only business activity in that state is the mere solicitation of orders for sales of tangible personal property. The statement lists 11 examples of activities and notes whether those activities strip sellers of their P.L. 86-272 protection. These guidelines are so restrictive that any type of website activity by the seller, other than providing customer access, would destroy this immunity.[47]

Of course, MTC guidance means nothing unless it is adopted by a state. In response to the statement, states such as California,[48] New York,[49] New Jersey,[50] and most recently Massachusetts[51] have begun to issue their own guidance, incorporating either all or selected provisions of the MTC statement.

In April 2025 the American Catalog Mailers Association (ACMA) filed suit[52] in the New York Supreme Court against the New York State Department of Taxation and Finance, seeking a declaration that New York's adaptation of the statement was invalid because it conflicted with and was preempted by P.L. 86-272.[53] The ACMA argued that "the regulations impermissibly exclude its members from the protections of P.L. 86-272, even if the activities are engaged in outside of New York."[54] The court upheld New York's version of the statement, finding that the proposed regulation was valid and that P.L. 86-272 did not prohibit a state determination as to what activities exceed the solicitation of orders threshold. That said, the court also held that its decision could be applied only prospectively from the date the statement was issued (that is, as of

[46] MTC, "Statement of Information Concerning Practices of Multistate Tax Commission and Supporting States under P.L. 86-272" (rev. Aug. 4, 2021).

[47] For example, P.L. 86-272 protection is lost by placing cookies on computers unless their only activity is to gather customer information that is used only for the solicitation of orders for tangible personal property. Of course, immunity also is lost if a "business regularly provides post-sale assistance to in-state customers via either electronic chat or email that customers initiate by clicking on an icon on the business's website." *Id.* What's left?

[48] California FTB TAM No. 2022-01 (Feb. 14, 2022) (invalidated); FTB Publication 1050 (invalidated).

[49] N.Y. Comp. Codes R. & Regs. tit 20, section 1-2.10.

[50] New Jersey Division of Taxation, TB-108(R) (rev. Jan. 18, 2024).

[51] 830 Mass. Code Regs. section 63.39.1.

[52] *American Catalog Mailers Association v. Department of Taxation and Finance*, Index No. 903320-24 (N.Y. Sup. Ct. Albany County Apr. 28, 2025).

[53] As of May 2024, the American Catalog Mailers Association is now called the American Commerce Marketing Association. The association advocates for policy and legislation that benefits catalog, online, direct mail, and other remote marketers, as well as their suppliers.

[54] *ACMA*, Index No. 903320-24.

December 2023) and could not be applied retroactively to 2015.

On May 13, 2025, the ACMA filed its appeal to the New York Appellate Division, Third Department.[55] The ACMA is also informally challenging the new regulatory actions in Massachusetts and New Jersey, arguing that the regulations would eliminate P.L. 86-272 immunity for online retailers.[56] With nearly all retailers making sales via the internet, isn't it time for Congress to amend P.L. 86-272 to explicitly define what constitutes the "solicitation of orders"?[57] A proposed version of the One Big Beautiful Bill Act called for the expansion of protected solicitation to include "any business activity that facilitates the solicitation of orders even if that activity may also serve some independently valuable business function apart from solicitation."[58] Even though the measure was stricken from the OBBBA, taxpayers may have no choice but to appeal for congressional action if they think it is unlikely that the state legislatures and courts will provide relief.

New York's victory (assuming it stands) will encourage other states to expand their nexus laws to deny income tax immunity to out-of-state companies because of internet activities performed in state that exceed the statement's definition of activities that are beyond the mere solicitation of orders. The protection Congress afforded taxpayers by enacting P.L. 86-272 will become completely eviscerated if Congress does not take charge and restore immunity by defining its protection to include the way businesses operate today.

[55] There has been no further activity on the docket. The appellant has six months from that filing to perfect the appeal by preparing and filing the required documents to place the case on the court's calendar.

[56] Massachusetts and New Jersey have finalized new regulations that include examples of internet activities that are protected or unprotected under P.L. 86-272. *See* 830 CMR 63:39.1 (adopted Oct. 10, 2025) and N.J. Admin. Code section 18:7-1.9A (effective June 16, 2025).

[57] In H.R. 427, Congress was considering a proposal that would have amended P.L. 86-272 to explicitly define "solicitation of orders" to mean "any business activity that facilitates the solicitation of orders even if that activity may also serve some independently valuable business function apart from solicitation."

[58] H.R. Con. Res. 14, 119th Cong. (2025-2026).

Say It Ain't So: Do Taxpayers Always Lose in New York?

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In a decision out of New York's highest court in 2025, Judge Shirley Troutman began her dissenting opinion in a sales tax case by harkening back to an ominous proclamation by one of her fellow judges about five years ago: "The majority today declares a new rule: in New York, the taxpayer always loses."[59]

What set of circumstances could cause two New York judges to make such a declaration, and is this a trend that should worry practitioners in the new year?

Both opinions were issued in New York sales tax cases involving the scope and extent of the sales tax on information services. That tax is imposed on charges for the furnishing of information, including the service of "collecting, compiling or analyzing information of any kind or nature and furnishing reports thereof to other persons."[60] And the issue in both cases was the application of the statutory exclusion to this tax, which excluded the "furnishing of information which is personal or individual in nature and which is not or may not be substantially incorporated in reports furnished to other persons."[61]

In the 2019 *Wegmans* case, the New York Court of Appeals focused on the first clause of that exclusion, finding that the reports purchased by the taxpayer did not meet "personal or individual" exclusion because they included a compilation of publicly available data, that is, the prices of goods on supermarket shelves.[62] And in the more recent *Dynamic Logic* case from 2025, the court of appeals seemingly gutted the second part of the exclusion, holding that the inclusion of mere benchmark data in what otherwise were obviously personalized reports caused an advertising consulting service to fall within the scope of the tax. In the process, the majority in both cases created what appears to be a new statutory construction principle, which is that an *exclusion* from tax could be construed against the taxpayer. This is a departure from what the rule was up until recently, which was that only *exemptions* from tax could be construed against the taxpayer. And the results in both cases were disconcerting enough to lead well-respected judges on New York's highest court to make the pronouncement that, in sales tax cases, taxpayers always lose.

For what it's worth, sometimes I think they might have a point! Just this past fall, the New York Tax Appeals Tribunal held that charges for what otherwise would have been a nontaxable facilities management service were subject to sales tax because the customers were also given access to a software application that allowed the parties to communicate, send and receive invoices, and input and resolve service requests.[63] And to get there, the tribunal held that the "primary function" test — which has long been used by tax departments and courts in sales tax cases to determine the primary purpose or true object of a transaction — was inapplicable when part of what the customer received was tangible personal property. The authority for that conclusion, however, is highly questionable. But it's New York, right, where the taxpayer always loses?

Fortunately, though, that's not always true. As reported in a December 2025 installment[64] of Noonan's Notes, my *Tax Notes State* column, our firm was involved in a sales tax case in which not

[59] *Dynamic Logic Inc. v. Tax Appeals Tribunal*, 2025 NY Slip Op. 02262, at 6 (N.Y. Apr. 17, 2025) (Troutman, J., dissenting) (quoting *Wegmans Food Markets Inc. v. Tax Appeals Tribunal*, 131 N.E.3d 876, 882 (N.Y. 2019) (Stein, J., concurring)).

[60] N.Y. Tax Law section 1105(c)(1).

[61] *Id.*

[62] *Wegmans*, 131 N.E.3d at 880-881 (majority opinion).

[63] *Matter of FacilitySource LLC*, DTA Nos. 829500 and 829501 (N.Y. Tax App. Trib. Sept. 18, 2025).

[64] Timothy P. Noonan and Noah S. Chase, "New York Personal Income Tax Cases: A Year in Review," *Tax Notes State*, Dec. 22, 2025, p. 875.

only did the taxpayer succeed in invalidating an assessment, but was also able to recover attorney fees from the tax department on the basis that the position taken by the auditors was wrong and not even "substantially justified."[65] That kind of result is extremely rare, but sometimes good things happen to good people! And, maybe sometimes, taxpayers in New York can win.

Sure enough, in a December 2025 declaratory judgment action brought against the tax department directly in the New York Supreme Court, an Albany County judge held for the taxpayer, finding that the tax department was without legal authority to determine that services provided by the taxpayer on construction sites were subject to sales tax as "protective and detective services" under N.Y. Tax Law section 1105(c)(8).[66] What's especially unusual about this case isn't just that the taxpayer won, but also the procedural posture in which it was brought. In almost all New York sales tax cases, taxpayers are forced to go through the administrative appeals process to protest a tax assessment or the tax department's position on a particular issue. However, in this case the taxpayer used one of the important exceptions to this rule, which is that taxpayers are not required to exhaust their administrative remedies if their claim is that the tax asserted is "wholly inapplicable" to the taxpayer.[67] Making this argument allowed the taxpayer to achieve a speedier remedy through the New York courts, without resorting to its administrative remedies in the Division of Tax Appeals.

So despite the extremely valid concerns raised by judges on New York's highest court, taxpayers don't always lose in New York. But we New Yorkers must be persistent and realize that the only way a taxpayer always loses is if they don't try in the first place!

[65] *Matter of 74 Wythe Restaurant Co. LLC*, DTA Nos. 830441 and 850382 (N.Y. Div. Tax App. June 18, 2025).

[66] *Site Safety LLC v. N.Y. Department of Taxation and Finance*, No. 908673-23 (Sup. Ct. Albany County Dec. 2, 2025).

[67] *See, e.g., Site Safety LLC v. N.Y. State Department of Taxation and Finance*, 233 N.Y.S.3d 783, 787 (App. Div. 3d Dep't 2025) (collecting cases).

2025 Leaves Many Open Issues for California

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The year 2025 ended with significant unresolved litigation that could have far-reaching implications for California and state and local tax generally. I examine three important cases that have implications for 2026 and future years.

Case No. 1: *Florida v. California*

Florida has filed a complaint[68] directly with the U.S. Supreme Court (something that is allowed in certain circumstances that qualify as "original jurisdiction") challenging California's alternative apportionment provision.[69] Under this provision if a sale is substantial and arises from an occasional transaction, then those gross receipts are removed from the denominator of the sales factor. The business income from the sale stays in business income subject to apportionment, meaning that it will be apportioned to California using a higher overall apportionment percentage.

Florida's complaint challenges the California corporate special rule involving alternative apportionment.[70] Florida alleges that when the "large occasional sale occurs"[71] and these items are removed from the denominator of the sales factor, the California apportionment factor generally goes up, resulting in more income from the multistate business taxed by California. Florida also contends that the rule lacks a rational relationship to activity within California and violates the commerce, import-export, and due process clauses.

The case is significant in that it challenges the constitutional limits of the state income apportionment systems. If the U.S. Supreme Court decides to take this case, and if Florida wins, a lot of the flexibility states enjoy in structuring their own tax systems disappears.

The issues in the case deal with the fundamentals of state and local tax. Is the sales factor fair and consistent in its application? Is the sales factor achieving the objective of approximating where the taxpayer's market activity occurs? Historically, the thought process has been that the inclusion of distortive transactions that do not relate to market activity has the effect of blowing up the sales factor in ways that do not have anything to do with market demand.

If the justices decide to hear this case, then it would be easy to find that California's provision violates the internal and external consistency tests of the commerce clause.

California is certainly not alone in attempting to eliminate distortion from the sales factor. This issue does not just question California's apportionment methodology, but the apportionment process used by several states.

Case No. 2: *CalTax v. FTB and NTU v. FTB*

The purpose of these combined cases[72] is to challenge the validity and retroactive application of Cal. Rev. and Tax. Code section 25128.9, enacted in 2024.[73] Section 25128.9 was enacted in response to the decision in *Appeal of Microsoft Corp.*,[74] in which the California Office of Tax Appeals (OTA) held that Microsoft could include the full amount of certain foreign dividends (even the portion deducted from income under the water's-edge dividends received deduction)[75] in the sales factor.

In order to prevent other out-of-state multinationals from making the same argument

[68] Complaint, *Florida v. California*, No. 22O163 (U.S. Oct. 28, 2025).

[69] Cal. Code Regs. tit. 18, section 25137(c)(1)(A)(1).

[70] *Id.*

[71] *Id.*

[72] *California Taxpayers Association v. California Franchise Tax Board* and *National Taxpayers Union v. California Franchise Tax Board*, Case No. 24CV016118 (Cal. Super. Ct. Sacramento County Oct. 15, 2025).

[73] Stats. 2024 (Ch. 34, section 41 (S.B. 167) (effective June 27, 2024)).

[74] *Appeal of Microsoft Corp.*, No. 21037336 (Cal. OTA July 27, 2023).

[75] Cal. Rev. and Tax. Code section 24411.

(and receiving the same refund) the California Franchise Tax Board went to the Legislature and asked for a statutory amendment to make clear that its interpretation was a clarification of existing law and not a change in the law. The FTB had argued to the Legislature and again in the litigation that only receipts from activities producing apportionable income should be included in the sales factor. In a reply brief in the litigation, the FTB also said that the law has always excluded from the sales factor receipts related to income not included in the apportionable tax base.[76] Section 25128.9 applies to tax years beginning before, on, or after the effective date of the act adding this section. Therefore, the issue before the Sacramento County Superior Court was whether this is a valid clarification of existing law or an unconstitutional retroactive change.

The court granted summary judgment in favor of the FTB, holding that the taxpayer groups lacked standing to challenge section 25128.9 because they had not demonstrated that any of their members had exhausted administrative remedies or paid the disputed tax (and sued for a refund) as required by Article XIII, section 32, of the California Constitution. The court determined that the action was not "ripe" for adjudication because of the lack of an administrative record showing how section 25128.9 would affect a specific tax liability or collection action.[77] Although CalTax said it will not appeal, the National Taxpayer's Union has indicated it will.[78]

The decision is problematic because it reinforces the difficulty in challenging a state statute in California. It reinforces the "pay to play" rule, which means that in order to challenge a disputed tax, you must first pay the disputed tax and exhaust all administrative remedies (such as filing a refund claim and waiting for the refund claim to be denied). The result for these litigants is that they will have to show that at least one member of their organizations has paid the tax and exhausted administrative remedies and therefore is directly affected by the statute.

The above argument leads to the next issue, which is standing. A claim is not ripe until there is a specific tax liability in question. Because this case was dismissed on procedural grounds, it did not address the substantive arguments regarding section 25128.9 and its retroactive change in the law, due process issues, and whether the statute is unconstitutionally vague or inconsistent.

Case Number No. 3: *ACMA v. FTB*

This case involved the issuance of a technical advice memorandum[79] that provided guidance on various internet activities that went beyond the requirements of P.L. 86-272.

The American Catalog Mailers Association (ACMA, an organization representing remote sellers) filed suit[80] in a California Superior Court seeking a judgment against the FTB. The ACMA argued that the TAM was invalid because it contradicted P.L. 86-272 and the U.S. Constitution. In addition, the complaint alleged that the TAM was an underground regulation that had not been adopted in compliance with California's Administrative Procedure Act.

Ultimately the court granted the ACMA's motion for summary judgment on the California APA issue, holding that TAM 2022-01 and a related publication (Publication 1050) were "regulations" because they were generally applicable and interpreted the law for a class of taxpayers. The case brought to light the broad definition of a regulation,[81] which includes any rule of general application that implements, interprets, or makes specific the law enforced by an agency.

The FTB did not appeal and responded by removing all of the previously issued TAMs from its website. This result brings up questions regarding not only other guidance issued by the

[76] California FTB, Reply in further support of its motion for summary judgment or, in the alternative, summary adjudication on claims of California Taxpayers Association, *California Taxpayers Association v. California Franchise Tax Board* and *National Taxpayers Union v. California Franchise Tax Board*, Case No. 24CV016118 (Cal. Super. Ct. Sacramento County Sept. 19, 2025).

[77] *California Taxpayers Association v. California Franchise Tax Board* and *National Taxpayers Union v. California Franchise Tax Board*, Case No. 24CV016118.

[78] Paul Jones, CalTax Won't Appeal Ruling in California Apportionment Statute Suit," *Tax Notes State*, Dec. 15, 2025, p. 815.

[79] TAM 2022-01.

[80] *ACMA v. FTB*, Case No. CGC-22-601363 (Cal. Super. Ct. San Francisco County Dec. 13, 2023).

[81] Cal. Gov't Code section 11342.600.

FTB over the years, but also future guidance. Will this case now limit the guidance that the FTB issues on various issues? In addition, if the FTB determines that significantly more guidance must be issued under the regulation process, it will take a lot longer before guidance on any future issue becomes final (and able to be used by taxpayers).

Conclusion

The year 2025 left us with several significant unanswered questions that will roll into 2026. These issues deal primarily with apportionment and in large part address the fundamental question of what the sales factor is supposed to measure and how it should define a taxpayer's economic activity in the state. ■