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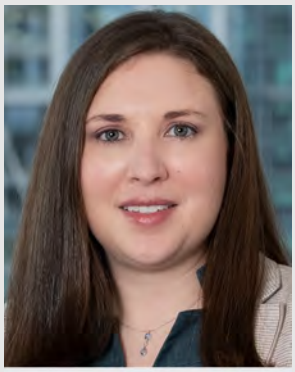

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In this installment of A Pinch of SALT, the authors examine this year's major state tax developments, including the expanding scope of state income taxation, new constitutional tests, and the broadening reach of digital goods taxation.

The state tax landscape continued to evolve in 2025: Economic conditions shifted, technology advanced, and not surprisingly, legal challenges ensued. Notable developments from 2025 include the expanding scope of state income taxation, new constitutional tests, and the broadening reach of digital goods taxation.

As the global and digital economy grows, traditional tax frameworks are under pressure. States are targeting digital goods and services more aggressively by introducing new legislation (or applying old statutes broadly) and drafting administrative guidance. Taxpayers are pushing back, challenging the reach and authority of state tax regimes. This article surveys the year's major litigation developments.

Income Apportionment and Sourcing Services

Determining a multistate taxpayer's income attributable to a state has dominated state tax litigation. This year saw a wave of cases addressing how receipts from services are sourced under market-based sourcing rules and how — if at all — states tax foreign income.

Look-Through Sourcing

For the past decade or more, states have embraced market-based sourcing rules to calculate the numerator of the apportionment sales factor. Most state statutes codifying market-based sourcing did not contemplate look-through apportionment — that is, deciding whether a sale is sourced to a customer or the customer's customer. Look-through apportionment seldom arose under the prior sales factor rule, which was calculated based on the taxpayer's income-producing activities, making customer location largely irrelevant. This "gap" in market-based sourcing rules is now bubbling up, and disputes are working their way through several states' court systems.

In *Humana*, the Minnesota Supreme Court reviewed whether the state's market-based sourcing statute, which did not address

look-through sourcing, nevertheless required it.[1] The taxpayer in *Humana* provided pharmacy benefit management services to a related-party insurance company, including contracting with pharmacies to provide prescription drugs to enrollees, administering prescription drug benefits, processing or paying pharmacy claims, and administering rebates on prescription drugs.[2] Minnesota determines the sales factor numerator applicable to service receipts based on where the service is received.[3]

The court determined that receipts from *some* of the services are received at the location of the ultimate beneficiaries — the plan members — not the taxpayer's direct customer (that is, the related-party insurance company).[4] But because of a stipulation entered into by the taxpayer and the state that proposed to source each of the taxpayer's services consistently, the court applied look-through apportionment to all of the taxpayer's pharmacy benefit management services.[5]

The term "received," as used in Minnesota's sourcing statute, was interpreted broadly. The court concluded that as it is used in Minnesota's sourcing statute, received "plainly means 'to come into possession of or get from some outside source,'" which does not require receipt by a direct customer.[6] In applying this interpretation, the court looked to see if the taxpayer interacted with the customer's customer.[7]

Given this case's unique facts, and the court's focus on the interaction of a taxpayer and its customer's customer, look-through apportionment may not be applicable to all sales of services — at least for Minnesota tax purposes. Rather, taxpayers should carefully consider the amount of engagement between a taxpayer and its ultimate market before concluding the location of receipt. Look-through apportionment has already produced divergent approaches in other states,[8] and we expect this to be an area of continuing controversy as states struggle with statutory gaps on this important question.

Treatment of Foreign Income

States also grappled with federal tax reform and applying apportionment rules to foreign income. In *Microsoft*, the Oregon Tax Court addressed the treatment of IRC section 965 repatriation amounts.[9] As it did for federal tax purposes, Microsoft included decades of foreign income in its Oregon tax return.[10] However, rather than subjecting this built-up repatriated income to a lower federal tax rate, Oregon applied an 80 percent dividends received deduction and taxed the remaining 20 percent of this repatriated income at its generally imposed tax rate.[11]

This dispute focused on the necessary sales-factor inclusion representing Microsoft's foreign activities that generated its foreign income.[12] The Oregon Department of Revenue sought to exclude all of Microsoft's foreign sales receipts (and associated activities) related to the foreign income.[13] Conversely, Microsoft sought to include the related foreign receipts (and activities) associated with the taxable foreign income.[14]

The court chose its own path and ruled that 20 percent of Microsoft's dividends (not sales receipts) must be included in its sales factor denominator.[15] Thus, the court granted a portion of Microsoft's refund claim.[16] The case is on appeal at the Oregon Supreme Court.

In contrast, the California Office of Tax Appeals (OTA) had ruled that Microsoft should include all of its foreign dividends in its sales

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

[2] *Id.* at 844-845.

[3] *Id.* at 850.

[4] *Id.* at 853.

[5] *Id.* at 857.

[6] *Id.* at 855.

[7] *Id.*

[8] *LendingTree LLC v. Department of Revenue*, 460 P.3d 640, 642 (Wash. Ct. App. 2020) (declining to source mortgage referral service to location of customer's customer).

[9] *Microsoft Corp. v. Department of Revenue*, No. TC 5413, at *28-37 (Or. Tax Ct. Apr. 29, 2025). The authors represent the taxpayer in this case.

[10] *Id.* at 688.

[11] *Id.* at 698.

[12] *Id.*

[13] *Id.* at 691.

[14] *Id.* at 690.

[15] *Id.* at 697.

[16] *Id.* at 698.

factor.[17] California allows for a 75 percent dividends received deduction. The Franchise Tax Board determined that the 25 percent dividends included in Microsoft's taxable income should also be included in the company's sales factor.[18] The OTA rejected the FTB's "matching principle" argument that the apportionment factor inclusion must match — and be limited to — the amount included in taxable income.[19]

Because the OTA cannot appeal it further, the *Microsoft* ruling is final. However, the State Legislature approved S.B. 167, which prevents the application of this decision both prospectively and retroactively.[20] The bill excludes from California's apportionment formula any receipts from transactions or activities that generate income not included in net income for tax purposes.[21] This exclusion applies to deductions, exemptions, eliminations, or nonrecognition.[22]

These divergent outcomes highlight the difficulty in apportioning foreign income. It is not a new challenge, but it arises more frequently because of federal tax changes. Increasing litigation is a near certainty.

A different state tax difficulty arises in the context of combined reporting. Illinois and several other states require related domestic companies to be included in a combined return.[23] Foreign companies (that is, those incorporated outside the United States) are excluded from this water's-edge combined return.[24] However, several states provide an exception for 80/20 companies: If 80 percent or more of a domestic company's property and payroll factors are outside the United States, then the company is treated as if it is foreign and is therefore excluded from the water's-edge report.[25] A business excluded from a water's-edge combined report may be beneficial (if the company is profitable) or detrimental (if the company is in a loss).

In *PepsiCo*, the Illinois Court of Appeals examined the status of whether intercompany employment arrangements allowed the company to achieve 80/20 status under Illinois law.[26] PepsiCo excluded this 80/20 company because it owned disregarded entities that had a foreign workforce.[27] Because the 80/20 company was profitable, excluding it from PepsiCo's report reduced PepsiCo's taxable income.[28] However, the court determined that the 80/20 company's personnel were employed by other PepsiCo domestic affiliates, and it therefore disallowed 80/20 treatment.[29]

Several states provide similar 80/20 treatment, and we expect continued scrutiny, including suggestions to repeal this treatment. Characterizing an entity as foreign or domestic based solely on place of incorporation elevates form over substance, whereas evaluating the substance of a corporation based on its apportionment factors makes sense.

Limitations on State and Local Taxation

States and localities have broad authority to impose taxes, but that power is not unlimited. State and federal law — constitutional and statutory — protect taxpayers from arbitrary or unfair taxation. These limitations arise under doctrines such as state uniformity clauses, the dormant commerce clause, the First Amendment, and due process principles.

[17] *Appeal of Microsoft Corp.*, OTA Case No. 21037336 (California OTA, July 27, 2023); *In re Appeal of Microsoft Corp.*, OTA Case No. 21037336 (California OTA, Feb. 14, 2024) (denying the Franchise Tax Board's petition for rehearing and affirming its opinion in *Appeal of Microsoft Corp.*).

[18] *Appeal of Microsoft Corp.* at 17-18.

[19] *Id.* at 14.

[20] Cal. S.B. 167, ch. 34, 2023-2024 Sess. (Cal. 2024); Cal. Rev. & Tax. Code section 25128.9.

[21] Cal. S.B. 167, ch. 34, section 41.

[22] *Id.*

[23] *See, e.g.*, 35 Ill. Comp. Stat. 5/502(a) (2024).

[24] *Id.*

[25] *See, e.g.*, 35 Ill. Comp. Stat. 5/304(e).

[26] *PepsiCo Inc. v. Department of Revenue*, 2025 IL App (1st) 230913, *appeal denied*, No. 131799 (Ill. Sept. 24, 2025).

[27] *PepsiCo Inc.*, 263 N.E.3d at 133-135.

[28] *Id.* at 126-127.

[29] *Id.* at 132, 134.

State Uniformity Clause

In *Delta*, the Oregon Supreme Court considered a challenge to Oregon's property tax system.[30] Central assessment only applies to a limited set of industries.[31] Oregon's central assessment method includes both tangible and intangible property; other businesses are taxed only on tangible property.[32] Delta was subject to Oregon central assessment and therefore had to include its valuable intangibles in its property tax base.[33] Because of the arbitrariness of requiring only select industries to include IP in the tax base, Delta argued — and the Oregon Tax Court held — that the differential treatment violated the state constitution's uniformity protections and the U.S. Constitution's equal protection clause.[34] However, the state supreme court reversed, holding that the tax system was rationally related to state goals, including administrative efficiency.[35] The taxpayer is seeking review at the U.S. Supreme Court.

In another case involving a claim of differential treatment between taxpayers, the Pennsylvania Supreme Court ruled in *NHL Players Association* that a strict uniformity standard applied under the state constitution.[36] Athletes were subject to Pittsburgh's 3 percent tax on nonresident income at city stadiums — known as the jock tax.[37] Residents, however, paid only a 1 percent tax.[38] The court struck down the jock tax as violating the state constitution's uniformity clause, finding no legitimate justification for the heavier burden on nonresidents.[39] The *NHL* and *Delta* cases reflect competing views on the degree of protection available under state law uniformity protections — with Oregon opting for very little protection and Pennsylvania providing more robust guardrails.

Dormant Commerce Clause

The dormant commerce clause remained the most litigated constitutional limitation on state taxation in 2025. A good example of an imposition that threatens to discriminate against interstate commerce — as forbidden under the dormant commerce clause — is *American Trucking*.[40]

In that case, the First Circuit considered whether Rhode Island's differential toll structure for commercial vehicles violated the dormant commerce clause.[41] The system included an exemption for single-unit trucks and capped the number and amount of tolls paid on the travel of any particular truck.[42] The taxpayer claimed that exempting single-unit trucks — which are smaller than other trucks subject to the toll structure — discriminated against interstate commerce because those smaller trucks are typically owned by in-state trucking companies.[43]

The court upheld the small truck exemption, finding it nondiscriminatory because larger tractor trailers caused greater road damage.[44] However, the court struck down the toll caps, which favored in-state trucking companies that were more likely to benefit from the cap without a corresponding relationship to road use.[45] Unfortunately for all involved, the court remedied this discrimination by doing away with the cap for all taxpayers (that is, it cured the discrimination by leveling up the toll so that no one received the benefit of the cap).[46] Commerce clause discrimination cases can result in winning the battle (the tax was partially unconstitutional),

[30] *Delta Air Lines Inc. v. Department of Revenue*, 573 P.3d 856 (2025).
[31] *Id.* at 861.
[32] *Id.*
[33] *Id.*
[34] *Id.* at 865.
[35] *Id.* at 876, 878.
[36] *National Hockey League Players Association v. City of Pittsburgh*, 343 A.3d 1165 (Pa. 2025).
[37] *Id.* at 1168, n.11.
[38] *Id.* at 1168.
[39] *Id.* at 1174.
[40] *American Trucking Association Inc. v. Rhode Island Turnpike*, 123 F.4th 27 (1st Cir. 2024).
[41] *Id.* at 37.
[42] *Id.* at 33.
[43] *Id.* at 37.
[44] *Id.* at 37-40.
[45] *Id.* at 50-51.
[46] *Id.* at 53.

but losing the war (the remedy to cure the discrimination was to invalidate a benefit for all).

First Amendment

The Fourth Circuit addressed the sticky issue of when a tax provision violates the First Amendment in *Chamber of Commerce*.[47] The case examined Maryland's digital advertising gross receipts tax that, in part, prohibits companies from passing through the tax via a separate charge on a customer invoice.[48]

The court held that the passthrough ban regulated protected, content-based speech.[49] The court also found that the passthrough prohibition was not justified because it did not advance a substantial governmental interest.[50]

Other states impose passthrough prohibitions, and those bans — like Maryland's — are not only bad tax policy but may violate the First Amendment.

Procedural Due Process

Taxpayers and revenue agencies frequently communicate via calls, emails, and formal documents. When can an informal communication satisfy a procedural requirement? The Nevada Supreme Court addressed this issue in the context of a procedural due process challenge.[51] Procedural due process requires that a government action must be fair when it seeks to deprive a person of life, liberty, or property (for example, tax revenue).

A Nevada statute required a taxpayer to enter into a written agreement with the Department of Taxation before seeking judicial review of a challenged tax.[52] The department sought to dismiss the taxpayer's challenge because it determined that email correspondence between the taxpayer and the agency did not constitute an agreement.[53] The court held that the email correspondence met the statute's requirements, emphasizing that taxpayers should be able to rely on agency advice.[54] The department's attempt to ignore the email violated basic notions of justice and fair play.[55]

Similarly, the Maryland Appellate Court rejected the Maryland comptroller's attempt to deny a refund claim because the statute of limitations expired.[56] The taxpayer was assessed tax and later filed a refund claim.[57] The comptroller contended that the four-year statute of limitations had expired at the time the refund claim was filed.[58] The comptroller had agreed to extensions of the limitations period but sought to invalidate those extensions.[59] The court held that the four-year statute of limitations did not apply when a taxpayer is assessed tax; rather, a separate limitations provision applied.[60] As a result, the court did not address whether the comptroller could ignore its waivers of the limitations period. Taxpayers are warned to be on alert for "now you see it, now you don't" waivers by the comptroller.

P.L. 86-272 — Narrowing Protections

States are adopting stricter interpretations of P.L. 86-272, a federal law that prohibits the imposition of a net income tax on an out-of-state seller of tangible personal property that limits its in-state activity to soliciting orders.[61] Litigation and proposed federal legislation seek to clarify the scope of this long-standing federal law.

In Wisconsin, a travel agency claimed protection under P.L. 86-272 even though it

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

[48] *Id.* at 541.

[49] *Id.* at 541-543.

[50] *Id.* at 541-542.

[51] *Hohl Motorsports Inc. v. Department of Revenue*, 563 P.3d 306 (Nev. 2025).

[52] *Id.* at 306.

[53] *Id.*

[54] *Id.*

[55] *Id.*

[56] *In re Comptroller of Maryland*, 328 A.3d 811 (Md. Ct. Spec. App. 2024), *cert. granted sub nom. Comptroller of Maryland v. Potomac Edison Co.*, 334 A.3d 827 (Md. 2025). Oral arguments were heard on October 1, 2025. The Supreme Court of Maryland has yet to publish a decision.

[57] *In re Comptroller of Maryland*, 328 A.3d 811 (Md. Ct. Spec. App. 2024).

[58] *Id.* at 817-818.

[59] *Id.* at 820.

[60] *Id.* at 822.

[61] P.L. 86-272, 73 Stat. 555 (1959) (codified as amended at 15 U.S.C. sections 381-384).

licensed software as a service (SaaS).[62] In *ASAP Cruises*, the taxpayer urged the court to consider its SaaS offering as tangible personal property or to expand P.L. 86-272 to apply to service providers. The court rejected both positions, finding the SaaS arrangement was for services, not goods, and was therefore not within the scope of P.L. 86-272.[63] The definition of tangible personal property may have been apparent when P.L. 86-272 was enacted in 1959, but it is not so easily determined today.

Rather than a specific application of P.L. 86-272 to a taxpayer's facts, a New York case challenged a general interpretation of the federal law. In *American Catalog Mailers*, the court upheld the state's adoption of an interpretation of P.L. 86-272 promoted by the Multistate Tax Commission.[64] The MTC, an organization comprising state members, offers interpretations of tax statutes. As part of its work, the MTC promulgated a proposed interpretation of P.L. 86-272 that concluded that the placement of specific cookies on in-state devices exceeded P.L. 86-272.[65] This interpretation undoubtedly reflects a narrow reading of P.L. 86-272 and has attracted a lot of commentary. A trade association's challenge to New York's adoption of this interpretation was partially successful: The court upheld the validity of the regulation but ruled that the state could not retroactively apply it.[66]

Several states have adopted some or all of the MTC's P.L. 86-272 interpretation, and further litigation is coming. Conflicting state court decisions could lead to review by the U.S. Supreme Court.

Digital Goods and Services Taxation

The types and structures of digital goods transactions lead to state tax uncertainty. Many state laws were adopted decades ago and have not been updated to reflect evolving digital offerings. Two notable decisions illustrate the difficulties that courts face in applying the old regimes to new models.

The Colorado Court of Appeals considered whether streaming services are tangible personal property subject to sales tax in *Netflix*.[67] Colorado imposes its sales tax on tangible personal property. The taxpayer and the DOR disagreed as to whether the taxpayer's well-known streaming video service constituted a taxable sale of tangible property or an excluded sale of a service.[68] The court held that streaming subscriptions are taxable because tangible personal property includes items perceptible by any sense, including sight and sound.[69] In reaching its decision, the court looked to a 1935 dictionary definition of tangible property — reflecting the definition in use at the time the tax was enacted.[70] Netflix petitioned the Colorado Supreme Court for review.

This case exemplifies the use of dictionaries to give meaning to statutory terms, and the desire of a court to reach a result that avoids, in its view, a loophole.

Remote Work

The COVID-19 pandemic tested state tax sourcing rules as remote work became widespread. In 2025 courts reviewed several fact patterns that reflect how remote work affects state taxation.

The New York Tax Tribunal reaffirmed the convenience of the employer rule, which generally sources wages to New York unless an out-of-state work location is mandated by employer necessity. In *Matter of Zelinsky*, a New York law school professor argued that pandemic-related campus closures required him to work from his Connecticut home.[71] Brushing aside his inability to work in New York, the tribunal held that work by the professor could be performed

[62] *ASAP Cruises Inc. v. Wisconsin DOR*, No. 2023AP1251 (Wis. Ct. App. June 3, 2025).

[63] *Id.* at 5.

[64] *American Catalog Mailers Association v. Department of Taxation*, 2025 N.Y. Misc. LEXIS 3642 (Apr. 25, 2025).

[65] *Id.* at 10.

[66] *Id.* at 13.

[67] *Netflix Inc. v. Colorado Department of Revenue*, 575 P.3d 465 (2025).

[68] *Id.* at 466.

[69] *Id.* at 471.

[70] *Id.* at 470-471.

[71] *In re Zelinsky*, DTA Nos. 830517 and 830681 (N.Y. Tax App. Trib. May 9, 2025).

anywhere and that it was his choice to not work from New York.[72] This head-scratching decision is hard to square with the purpose of New York's convenience of the employer rule, which is intended to treat an employee as working in New York if the employee chooses to work elsewhere for convenience. The case is on appeal.

Earlier this year, the U.S. Supreme Court denied certiorari in *Zilka*.[73] The Pennsylvania Supreme Court considered whether a Philadelphia resident working in Delaware was entitled to a credit against her local Philadelphia wage tax for her Delaware state income taxes.[74] The court ruled against the taxpayer, holding that state taxes and local taxes are separate levies, analyzed separately, and need not be aggregated for dormant commerce clause analysis.[75]

Together, *Zelinsky* and *Zilka* illustrate growing friction between residence-based and source-based taxation as remote work blurs boundaries. As employers adopt permanent remote policies and employees relocate, clearer frameworks are needed to address multijurisdictional tax obligations.

That wraps up our take on the most interesting state tax cases of 2025. And we recognize that there were a number of other meaningful contenders. There will be no letup in 2026, as we expect appellate decisions in some of the cases discussed here, as well as decisions in other important pending cases. ■

[72] *Id.* at 26.

[73] *Zilka v. City of Philadelphia, Tax Review Board, cert. denied,* No. 23-914 (U.S. Jan. 31, 2025).

[74] *Zilka,* 304 A.3d 1153, 1156 (Pa. 2023).

[75] *Id.* at 1172.