



TAXPAYERS'
FEDERATION
— OF ILLINOIS —

Income Tax Apportionment & Nexus Update

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Agenda

- Illinois Senate Bill 3019
- Nexus Updates
- Apportionment Updates
- General Income Tax Updates



Illinois Senate Bill 3019

Illinois Senate Bill 3019

- Illinois Senate Bill 3019 was signed into law on June 16, 2026 and included several updates related to income tax filings for tax years ending on or after December 31, 2026.
- Apportionment for Unitary Groups
 - Illinois has updated their guidance to calculate unitary group sales apportionment using the Finnigan methodology. Prior to SB 3019, the state allowed taxpayers to calculate sales apportionment using Joyce methodology



Illinois Senate Bill 3019 (cont'd)

- Under previous Illinois guidance, the state allowed a 100% Dividends Received Deduction for GILTI under IRC 951A. SB 3019 updates this guidance to allow only a 50% DRD deduction.
 - Under current guidance, no apportionment relief is provided
- SB 3019 provides that gains and losses from sales or exchanges of an S corporation or from an interest in a partnership, other than an investment partnership, are allocated to Illinois based on the average of the PTE's Illinois apportionment factor in the year of the sale and the two tax years immediately preceding the year of the sale or exchange.



Illinois Senate Bill 3019 (cont'd)

- Illinois requires an addition of certain interest and intangible expenses paid or accrued to a related foreign party with 80% or more of its total business activity outside of the US during the tax year. However, several exceptions apply to the addback requirement. SB 3019 eliminated two of the exceptions.
 - Subject to tax exception: The bill repeals the exception for interest paid or accrued to a related party to the extent that the party receiving the interest income was subject to a net income tax in a foreign country or another state jurisdiction.
 - Not for purpose of tax avoidance exception: The bill repeals the exception for interest paid or accrued to a related party to the extent the interest expense is paid in connection with an arm's length agreement and is not for the purposes of Illinois corporate income tax avoidance.



Illinois Senate Bill 3019 (cont'd)

- NOL Limitation – SB 3019 extends and modifies the limitation of NOL deductions for C corporations. The changes are as follows:
 - Ending on or after 12/31/2026 - \$500,000
 - Ending on or after 12/31/2027 – Greater of \$500,000 or 15% of net income
 - Ending on or after 12/31/2028 – Greater of \$500,000 or 30% of net income
 - Ending on or after 12/31/2029 – Greater of \$500,000 or 50% of net income
 - Ending on or after 12/31/2030 – Greater of \$500,000 or 65% of net income
 - Ending on or after 12/31/2031 – Greater of \$500,000 or 80% of net income
- Allowable NOL carryover period is extended by one year for each year the limitation applies
- Does not impact the treatment of NOL deductions for S corporations or partnerships



Illinois Senate Bill 3019 (cont'd)

- SB 3019 amends the PTET calculation for taxable years ending on or after December 31, 2026
- Partnerships may elect between two alternative calculation methods on an annual basis
 - Full distributive share: The PTET base includes residents' full distributive share of income and nonresidents' Illinois apportioned or allocated income
 - Illinois-sourced income: The PTET base includes Illinois apportioned or allocated income for both resident and nonresident owners
- Further analysis should be completed to determine if full distributive share method is beneficial for resident partners
 - Depending on the ownership composition and apportionment profiles of the partnership, it may not be more beneficial for Illinois resident partners to elect full distributive share method.



Illinois Senate Bill 3019 (cont'd)

- Illinois has decoupled from the federal exclusions for gain from the sale of Qualified Small Business Stock (QSBS) under §1202
- Effective for tax years ending on or after 12/31/2026
- Taxpayers must add back to their Illinois base any gain excluded under IRC §1202



Illinois Senate Bill 3019 (cont'd)

- Considerations surrounding estimated taxes and penalty notices
 - 2025 changes were implemented after Q2 estimates were due
 - Many of the changes may result in higher tax due for 2025 than anticipated under prior guidance used for Q1 and Q2 estimates
 - Taxpayers will likely receive underpayment of estimated tax notices assessing penalty and interest when IL DOR system defaults to assume equal 25% installments due based on 2025 final liability
 - Safe Harbor Method
 - Annualized-Income Installment Method
 - Proactively address with clients so they do not dismiss notices when received
 - IL will take from any overpayment credit and not send an additional bill



Nexus Updates

Nexus: California

Matter of MGG Enterprice Inc., OTA No. 240917424 (March 2,2026)

- California assessed \$800 minimum franchise tax on MGG Enterprise, Inc. (a Nevada corporation), based on the FTB's determination that MGG was "doing business" in California.
- The corporation had a single employee who resided in California and was paid approximately \$12,000 in wages.
- MGG contended it did not meet the bright-line nexus thresholds, but the OTA held that paying wages to even one California employee constituted a profit-motivated transaction sufficient to establish "doing business."



Nexus: Maine

***State Tax Assessor v. Fifth Generation, Inc.*, 2026 ME 30 (Me. April 2, 2026)**

- Fifth Generation, Inc. (Tito's Vodka) is a Texas-based S corporation that sold spirits into Maine.
 - Maine's three-tier alcohol system required Fifth Generation to store products in a state-approved bailment warehouse, retaining title until removal for sale.
 - Fifth Generation had no real property or payroll in Maine, but its broker accessed Maine warehouses and sales occurred through the State bureau. Fifth Generation did not file pass-through withholding returns.
- Issue: Whether Fifth Generation had nexus in Maine and was required to withhold pass-through entity tax, or whether it was exempt under P.L. 86-272.
- Holding: Fifth Generation has nexus with Maine.
 - Retention of title to inventory stored in Maine created in-state ownership of personal property.
 - Sales occurred from Maine, not solely via interstate solicitation.
 - P.L. 86-272 does not protect activities beyond solicitation, including inventory ownership and in-state sales logistics.
 - Maine's alcohol regulatory scheme served legitimate state interests and did not violate the Commerce Clause.



PL 86-272: New York

American Catalog Mailers Assoc. v. Dep't of Taxation and Finance, N.Y. App. Div. (3d Dep't), No. CV-25-0865, May 7, 2026

- American Catalog Mailers Association challenged NY's regulation, arguing that NY was improperly narrowing PL 86-272 protection by treating certain internet activities as taxable business activity
- The court upheld the regulation, finding it is not facially preempted because it applies to internet activities conducted in NY
- Key point: Digital activities may exceed PL 86-272 protection when they go beyond solicitation, activities entirely ancillary to solicitation, or de minimis activities
- Takeaway: Out-of-state sellers should evaluate website functionality, including post-sale support and data-gathering cookies, when assessing NY income tax filing exposure.
- The court did not decide how the regulation applies to any specific taxpayer's facts.
- Appealed to New York Court of Appeals in July 2026 – decision pending



Combination: New York

Matter of Charter Communications, Inc. v. N.Y.S. Tax Appeals Trib., No. CV-24-0971 (N.Y. App. Div. Dec. 24, 2025)

- Charter filed combined franchise tax returns and claimed a reduced tax rate as a qualified emerging technology company (“QETC”), but certain members of the combined group were not located in New York during the relevant tax years.
- Issue: Whether every member of a combined tax group must independently qualify as a QETC for the entire group to receive a reduced franchise tax rate.
- Holding: Each member of the combined group must independently satisfy the QETC definition — including the requirement of being “located in New York” — for the group to receive the reduced rate.
 - The Court also rejected Charter's alternative argument to “decombine” the group and apply different rates to different members, finding it would distort the group’s economic activity.
 - Charter’s dormant Commerce Clause challenge rejected, no constitutional violation because out-of-state companies can still benefit if they demonstrate a real property connection to New York.



Apportionment Updates

Microsoft Corp. v. Minnesota Commissioner of Revenue (Pending)

- Microsoft is asking MN Tax Court to refund approx. \$32.5M of MN Income Tax for FYE 06/30/2024
 - Microsoft argues that MN's current apportionment method unfairly overstates the amount of its income attributable to MN because MN taxes a portion of GILTI but does not include the foreign sales that generate the GILTI income in the apportionment formula
 - Because most of Microsoft's sales and operations occur outside of MN and outside of the US, Microsoft argues that the state's formula exaggerates the share of income taxable by MN
 - Microsoft requested permission to use an alternative apportionment method that would include foreign subsidiary sales in the denominator of the sales factor
 - MN Tax Court denied the request arguing that:
 - The Legislature intentionally classified GILTI as dividend income
 - MN already provide relief through the 50% dividends received deduction
 - Foreign subsidiaries are not members of the MN combined group, so their sales should not be included
 - Microsoft failed to prove that the statutory formula is unfair or that its proposed worldwide method is the correct alternative
 - Outcome could influence how MN and potentially other states address:
 - GILTI factor representation
 - Alternative apportionment requests
 - Foreign divided taxation
 - Foreign commerce clause challenges
 - Worldwide vs Waters-Edge reporting concepts



Microsoft v. Oregon DOR

- Microsoft reported a one-time IRC § 965 inclusion arising from the accumulated earnings of its controlled foreign corporations
- Oregon allowed an 80% dividends-received deduction but excluded the remaining taxable portion from Microsoft's sales-factor denominator
- Microsoft argued that the taxable 20% should be represented in the denominator because the income arose from its unitary business activities
- The Oregon Tax Court agreed that the taxable portion must be reincluded in the denominator under Oregon's factor-representation principles
- The court rejected Microsoft's broader requests for 100% factor representation or separate accounting



General Income Tax Updates

Colorado – Corporate Tax Reform

- HB 26-1289 was signed into law by Governor Polis making combined reporting the state's default filing methodology effective January 1, 2027
- A combined group may instead make a water's-edge election, which is binding for 10 years
- Repeals the 80/20 exclusion rule, which excluded corporations with more than 80% of their property and payroll located outside the U.S. from the unitary combined state return
- Eliminates deductions for amounts included under IRC §§ 951(a) and 951(A)(a) and other intercompany items



Colorado – MTC Adoption on Combined Reporting

- In 2024, Colorado adopted the Multistate Tax Commission's ("MTC") model combined reporting statute, effective beginning January 1, 2026
- The legislation eliminates Colorado's prior "three-of-six" unity test that limited which affiliated corporations were included in a combined report
- Under the MTC's model, corporations are included in the combined group based on whether they are engaged in a unitary business
- The MTC defines "unitary business" as follows:
 - A single economic enterprise that is made up either of separate parts of a single business entity or of a commonly controlled group of entities. These parts are interdependent, integrated, and interrelated to provide synergy, mutual benefit, a sharing of value, and a significant flow of value



Various Tax Updates

- California: SB 122 extends the temporary \$5M cap on credit utilization for an additional 3 years, through TY 2029. Taxpayers may continue to elect a refundable credit up to 20% of the credit that would have been available but for the limitation. Beginning in TY 2030, CA establishes a permanent limitation allowing business tax credits up to \$5M per company or 70% of tax liability.
- Connecticut: Tax years beginning on or after January 1, 2026
 - Decouples from Sec 168(n)
 - Conforms to Sec 174A (decoupled for 2025)
- Hawaii: State will conform to OBBBA for Sec 163(j) for tax years beginning after December 31, 2025
- Iowa: Guidance was amended to clarify that the state will allow a NCTI subtraction under DRD rules for tax years beginning on or after January 1, 2026
 - Previously the statute specifically referenced GILTI (and not NCTI) under IRC Section 951A
 - Senate File 2492 removes the specific reference to GILTI and allows a subtraction for all income under IRC Section 951A
- Maine: Phased in conformity for domestic R&E expenditures beginning in 2026 with full conformity achieved in 2030
 - 100% for 2025
 - 70% for 2026
 - 50% for 2027
 - 30% for 2028
 - 10% for 2029



Various Tax Updates

- Massachusetts: HB 5470 delayed conformity to several OBBBA provisions
 - State decouples for Sec 168(n), Sec 163(j) and Sec 179(b) for 2025 & 2026 but will then conform in tax year 2027.
 - State decouples for Sec 174A for 2025 but will then conform beginning with tax years on or after January 1, 2026
- New Jersey: Established a temporary NOL limitation of \$1M New Jersey source income for tax years ending on or after July 31, 2026 and before July 31, 2030.
 - Any portion of the NOL deduction affected by limitation may be carried forward and utilized for six additional tax years after it otherwise would have expired
 - Tax years ending after July 31, 2026 but before July 31, 2032, taxpayers may claim NOL deductions previously limited by the temporary cap, up to 75% of allocated net income.
- Rhode Island: HB 7127A decouples Rhode Island from several provisions of OBBBA
 - Section 174A – tax years beginning on or after January 1, 2026 requires modification for domestic R&E expenditures
 - Section 163(j) – tax years beginning on or after January 1, 2027 requires taxpayer to calculate interest expense limitation using tax EBIT instead of tax EBITDA
 - Rhode Island previously paused automatic conformity to OBBBA for 2025 tax year so for Sec 163(j) this means the state will decouple in 2025, conform in 2026, and decouple again for 2027 and beyond

