

State and Local Taxes

State and local tax (SALT) issues consistently rank among the top concerns of tax and finance professionals. BDO's 2025 Tax Strategist Survey found that the most prevalent issues in audits and disputes were SALT-related (52%). It's no surprise why. State laws evolve rapidly and vary widely by entity, income, or industry.

This year will only bring more complexity. The OBBBA made significant changes to federal tax law that will have many implications for state tax planning based on conformity decisions. Fortunately, there are plenty of planning strategies, including nexus evaluations and apportionment reviews, to manage state tax issues.

State Conformity Planning Considerations

State considerations will be important for companies implementing the OBBBA changes. The dizzying variety in state conformity regimes can present planning challenges.

States are split roughly 50-50 between conforming to the U.S. Internal Revenue Code on a rolling basis versus a fixed-date basis. Complicating the picture, states in both categories often choose not to conform to specific provisions for policy or revenue reasons.

States with rolling conformity will generally incorporate OBBBA changes by default unless they specifically opt to decouple from particular provisions. States with fixed-date conformity will have to proactively update their conformity dates or rules to implement any OBBBA changes. Fixed-date states are even more likely to make state-specific deviations as part of the process.

Many of the most important provisions in the OBBBA offer multiple implementation options, and the state treatment will be a major factor in planning decisions. Companies should fully assess the state implications of various federal planning strategies. Key considerations for major provisions include:

- **Section 174 expensing:** The restoration of expensing of domestic research costs will potentially harmonize the federal and state treatment for the handful of states that have already decoupled from the pre-OBBBA rules requiring five-year capitalization. States that follow the capitalization rules might need to consider whether to revert to expensing and whether to incorporate the federal transition rules for accelerating unused deductions. Companies should pay particular attention to how quickly states with fixed conformity dates react because the provision is generally effective for tax years beginning after 2024.
- **Section 163(j):** Many states will be tempted to decouple from the OBBBA provision restoring the more favorable calculation of the limit on the interest deduction under Section 163(j), which could be costly. Because the rules are generally effective for tax years beginning after 2024, fixed-date conformity states will face an early deadline for action.
- **Bonus depreciation:** Many states already decouple from bonus depreciation for revenue reasons and will be unaffected by the restoration of the 100% rate. All states will have to decide whether to conform to the new expensing provision for building

property used in some production activities. Current conformity statutes for bonus depreciation likely will not cover the new provision because it was created under new Section 168(n) and not incorporated as part of the existing bonus depreciation rules under Section 168(k).

- **Base erosion and anti-abuse tax:** The BEAT rate will increase from 10% to 10.5%, but taxpayers retain planning options such as interest capitalization and the election to waive deductions under Reg. §1.59A-3(c)(6). Companies should consider the state income tax implications of those choices.
- **Section 250 deduction:** For states that allow the deduction under Section 250 for foreign-derived intangible income (now foreign-derived deduction-eligible income or FDDEI) and global intangible low-taxed income (now net controlled foreign corporation (CFC) tested income or NCTI), the amounts will likely need to be recomputed. When there are differences in profile between a company's federal consolidated group and state filing (for example, a combined group with different members for state purposes or a state that requires separate filing), companies should remember that the NCTI inclusion must be recomputed.
- **Charitable contributions:** The new 1% floor for corporate charitable deductions is likely to create significant differences in state and federal charitable carryforwards.

Turning State Tax Complexities into a Plan for Success

SALT laws evolve rapidly and are becoming increasingly convoluted. However, what makes state tax so challenging isn't just the complexity – it's also the inconsistency. Rules vary not just across states but also within the same state based on the type of entity, income, or industry. Navigating the fragmented state tax landscape requires proactive strategies and trusted guidance to manage compliance, reduce tax liabilities, and mitigate risks. That's why companies of all sizes should consider a range of planning strategies.

A holistic review of state tax issues can unlock tax savings opportunities by helping companies identify nexus and filing obligations, uncover potential past exposures, and leverage voluntary disclosure programs to limit penalties and interest. Companies should also analyze apportionment methods and filing practices in order to correctly perform tax calculations, and to potentially reveal missed deductions, credits, or alternative methods that can reduce state tax liabilities.

It's critical to have robust internal and external resources in the tax function to strategically plan for changes. Quality professional guidance supports business restructurings, expansions, and mergers and acquisitions by improving state tax outcomes and preventing future risks related to combined reporting and intercompany transactions.

Companies should also make sure they have an effective audit defense. This includes preparing documentation, engaging with tax authorities, and leveraging deep knowledge of state statutes and processes to resolve audits efficiently and avoid prolonged disputes and unfavorable outcomes.

Planning Considerations

State taxation cannot be treated as an afterthought because it can affect where a company operates or how it is structured. Without an informed approach, companies risk missing state tax savings, facing unexpected state tax liabilities, and losing control over a growing portion of their tax profiles. Ensuring the tax function has adequate internal and external support can turn those risks into advantages by offering not just compliance but also strategy and foresight.

Harnessing the Power of State Apportionment Rules

Apportioning income across the states where a public company does business is a highly complicated area of SALT, especially given that states continue to change their apportionment rules and guidance. It takes a deep tax bench to keep up with the ever-evolving SALT landscape. Understanding apportionment, particularly sales factor sourcing, can help businesses identify tax liabilities and savings opportunities across different states.

While states have shifted from three-factor to single-sales factor formulas, using market-based sourcing for services and intangibles, their methodologies vary. That results in diverse interpretations of where sales are sourced, such as in the context of services which may focus on the location where the service is delivered, where the customer is located, or where the benefit of the service is received. Further, states apply different sourcing rules depending on service type and industry, or how the intangible was used, with cascading rules that require moving through multiple sourcing methods if the location cannot be determined, sometimes requiring reasonable approximations. And despite some state guidance, ambiguities remain, leading to multiple reasonable interpretations of sourcing methods, especially when applying reasonable approximation methods.

Many states also allow requests for alternative apportionment methods if standard methods do not fairly represent activities conducted in the state, but approval depends on following specific procedures and maintaining proper documentation.

Planning Considerations

It is important to examine each company's facts. The nature of a public company's revenue streams and business activities influences which sourcing rules apply, with distinctions such as in-person versus electronic services affecting sourcing outcomes. Detailed apportionment studies help uncover tax exposures and savings by analyzing company facts against varied state rules, preventing overreporting or underreporting across states.

Addressing SALT Exposure Using Effective Transfer Pricing Strategies

State transfer pricing is an often overlooked but critical element of tax planning. While companies frequently focus on federal and international transfer pricing issues, the state implications can be equally material. Ignoring state transfer pricing considerations can expose

companies to substantial state tax risk, unexpected state tax liabilities, and missed opportunities for state tax savings.

Every transfer pricing arrangement that affects related-party transactions has potential state tax consequences, whether in cross-border contexts or purely domestic settings. States apply their own rules, often diverging significantly from federal standards, creating substantial complexity. If state impacts are not analyzed, companies can face duplicative adjustments, double taxation, or disallowed deductions.

Integrating state transfer pricing into overall tax planning delivers two key advantages: It reduces exposure to audit challenges and penalties, and it can unlock meaningful tax savings by aligning intercompany pricing with state-specific requirements. Companies that proactively incorporate state rules into their transfer pricing policies strengthen compliance, lower risk, and improve after-tax results.

Given the differences in state rules — from separate reporting jurisdictions to combined reporting states with unique adjustment powers — thoughtful planning and detailed documentation are essential. By embedding state transfer pricing analyses into benchmarking, implementation, and continual monitoring, taxpayers can better navigate the evolving SALT landscape while safeguarding enterprise value.