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5 Key Takeaways | Sourcing and Apportionment Issues for Both Sales Taxes & Income Taxes

Kilpatrick partners **Jordan Goodman** and **David Hughes** recently presented "Sourcing and Apportionment Issues for Both Sales Taxes & Income Taxes" at the Council on State Taxation (COST) Southeast Regional State Tax Seminar. This annual event invites industry tax leaders to present and attend sessions covering important state tax updates and state tax issues nationally and in the Southeast.

Jordan and David's takeaways from their presentation include:

1. Income-tax apportionment and sales-tax sourcing serve distinct functions. Income-tax apportionment divides a multistate business's net income among states using factors such as property, payroll, and sales, while sales-tax sourcing assigns a particular transaction to one taxing jurisdiction. The differing objectives —fair division of the income tax base versus assigning tax on a sale or use—mean that similar transactions may be analyzed under materially different rules.

2. Services and bundled transactions require careful application of statutory "waterfall" rules. Under the SSUTA-style hierarchy used by Arkansas and many other states, sourcing generally moves from the seller's location where the purchaser receives the item or service, to the purchaser's receipt location and addresses on file, and ultimately to the ship-from or service-origin location if necessary. Determining the state in which a bundled sale is sourced can determine whether the transaction is taxable.

3. Fairness and constitutional constraints remain central safeguards against distorted state tax results. Complete Auto requires substantial nexus, fair apportionment, nondiscrimination, and a fair relationship to state-provided services, while internal and external consistency tests evaluate whether sourcing rules produce excessive or unrepresentative taxation. When the standard income-tax formula does not fairly represent in-state business activity, UDITPA § 18 and similar state provisions may permit alternative apportionment, although the party seeking it needs strong, fact-specific support for a reasonable alternative.

4. Destination sourcing is the prevailing framework for sales of tangible personal property, particularly after Wayfair. Most states source tangible-property sales to the delivery destination, although exceptions and hybrid rules remain, such as Ohio's origin-based option for qualifying intrastate transactions. Economic nexus following *South Dakota v. Wayfair* allows states to impose collection duties without physical presence, expanding compliance exposure for remote and online sellers.

5. Market-based sourcing has become the dominant income-tax approach for services and intangibles, but identifying where the customer receives the benefit is difficult. Arkansas adopted market-based sourcing for services and intangibles for tax years beginning on or after January 1, 2026, focusing on where services are delivered rather than where they originate. Digital products, SaaS, professional services, indirect customers, and multistate use present especially difficult benefit-location questions, as recent Washington, Minnesota, and Wisconsin cases illustrate.

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