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Massachusetts ATB rules that P.L. 86-272 insulates protected income from combined group apportionment inclusion

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In brief

What happened?

The Massachusetts Appellate Tax Board (ATB) agreed with the taxpayer that a unitary combined group member that is protected by P.L. 86-272 may not have its sales included in the apportionment calculation for taxable group members. Rejecting precedent from other states, the ATB concluded that by including the protected group member's sales in the apportionment factor, "Massachusetts has done indirectly what it cannot do directly."

In addition, the ATB upheld the Massachusetts rule that considers the joint activities of a corporation engaged in manufacturing activities and a related combined group member selling the property so manufactured for the purpose of determining the appropriate method of apportioning income to be used by the combined group member selling the manufactured goods.

[*Smithfield Packaged Meats Corp. v. Commissioner of Revenue*, Mass. Appellate Tax Bd., Docket No. C344811, 7/22/2026]

Why is it relevant?

While P.L. 86-272 restricts states from imposing income-based taxes on out-of-state businesses that limit their in-state activity to solicitation of sales of tangible personal property, many combined reporting states (such as Massachusetts) employ the "Finnigan" rule to include destination receipts in the numerator of the combined group's sales factor (or the sales factor of taxable members of the combined group) notwithstanding a group member's P.L. 86-272 protection. This decision provides a potential refund opportunity for combined groups with members protected by P.L. 86-272 that make sales into Massachusetts.

Actions to consider

Taxpayers that filed a Massachusetts combined report that includes members protected by P.L. 86-272 whose Massachusetts destined sales were assigned to the taxable members of the combined group under an application of the Finnigan rule may consider filing amended returns to claim refunds.

Note that amended returns must be filed within three years of the date that the original return was filed and include a statement explaining the reason why the return has been amended. If the Massachusetts Department of Revenue appeals the *Smithfield Packaged Meats* decision, it is unclear how the Department will treat the amended returns pending the appeal.

In detail

Background

For each of the tax years at issue (2015-2017), Smithfield Foods Inc. was the parent company of a combined group filing its Massachusetts combined report under the principal reporting corporation, John Morrell and Co. (later known as Smithfield Packaged Meats Corp.). The parties agreed that Morrell was a "§ 38 manufacturer" required to apportion income using a single sales factor.

For the 2015 tax year, the combined group included Smithfield Farmland Sales Corp., later known as Smithfield Fresh Meats Sales Corp., which was a subsidiary of Smithfield Farmland Corp. (also an affiliate of Morrell). Fresh Meats Sales sold products produced by affiliated members of the combined group, and Farmland sold its pork cuts to Fresh Meats Sales. For the 2016 tax year, the combined group included one other taxable member – Smithfield Packaged Meats Sales Corp., a subsidiary of Morrell – which similarly sold products produced by affiliated members of the combined group.

For the 2017 tax year, Fresh Meats Sales ceased to be a taxable member of the combined group due to the application of P.L. 86-272 because (1) it had no employees permanently based in, and no real or personal property located in, Massachusetts; and (2) its employees were engaged exclusively in the solicitation of orders for pork products, which were accepted or rejected at locations outside of the Commonwealth and, if approved, were filled by shipments or delivery from points outside of Massachusetts.

Audit adjustments

On audit, the Commissioner applied the "Combination Provision" (830 CMR 63.32B.2(7)(g)2.a), which provides that if a combined group member making a sale to a purchaser that is not a member of the group has previously acquired the sold property from another combined group member, the activities of both the member producing the property and the member making the sale to the nonmember must be considered jointly for purposes of determining the appropriate apportionment formula of the member making the sale. As a result, the Commissioner reclassified Fresh Meats Sales as a § 38 manufacturer for 2015 and 2016 and reclassified Packaged Meats Sales as a § 38 manufacturer for 2016 and 2017.

Under the Finnigan rule (830 CMR 63.32B.2(7)(b)), Massachusetts may assign sales to Massachusetts (the state of destination) for apportionment purposes where at least one member of a unitary group is taxable in Massachusetts, but where the actual seller is not. Although the appellant applied the Finnigan rule in its original 2017 combined return, on audit the appellant argued that the Finnigan adjustment – which included Fresh Meat Sales' Massachusetts-destination sales in the combined group numerator – resulted in distorted apportionment for the 2017 tax year and improperly frustrated the objectives of P.L. 86- 272 in violation of the Supremacy Clause of the US Constitution.

ATB appeal

On appeal to the ATB, the appellant disputed the validity of the Combination Provision to all the tax years at issue, in addition to the application of the Finnigan rule for the 2017 tax year.

The ATB found that (1) for the 2015 tax year, Fresh Meats Sales was properly classified as a § 38 manufacturer; (2) for the 2016 tax year, Packaged Meats Sales and Fresh Meats Sales were properly classified as § 38 manufacturers; and (3) for the 2017 tax year, Packaged Meats Sales was properly classified as a § 38 manufacturer. The ATB found that "it is not unreasonable to ascribe to the purchasing entity the apportionment attributes of the manufacturer for purposes of determining the purchasing entity's share of the unitary group's combined income for a year in which the purchasing entity sells to unrelated parties the manufactured products it bought from the manufacturer, treating the receipts from those sales as sales attributable to manufacturing activities as they would have been had the manufacturer made the sales directly to unrelated parties."

However, the ATB found that the Finnigan adjustment applied to the 2017 tax year "had the effect of taxing in Massachusetts income fully reflective of the Massachusetts sales of Fresh Meats Sales by including in the numerator of the sales apportionment fractions used by taxable members of the Combined Group, the Massachusetts sales of a nontaxable member of the group whose income was protected from taxation by P.L. 86-272."

The ATB found that P.L. 86-272 "does not simply limit a state's ability to tax an out-of-state entity by asserting taxing jurisdiction directly over that entity. The income earned by a P.L. 86-272 protected entity is tax exempt, without qualification." The ATB noted that in enacting P.L. 86-272, Congress rejected an earlier version of the legislation that focused on the taxation of a person rather than on the taxation of income.

The ATB reviewed other state court rulings on the application of the Finnigan rule to unitary groups, noting that the New York Court of Appeals in *Matter of Disney Enterprises* concluded that "apportionment did not amount to tax." However, the ATB noted a concurrence in *Matter of Disney Enterprises* that found to include a company's receipts in the numerator of the apportionment formula "would be to increase the tax in proportion to those receipts – and thus in substance to tax the income associated with those receipts."

The ATB concluded: "In the instant case, the combined group taxable income reported on the appellant's combined return for the tax year 2017 included that of the P.L. 86-272 protected entity and, through an apportionment formula whose numerator included the Massachusetts sales receipts of Fresh Meats

Sales, more income was taxable in Massachusetts than would have been the case had those sales been omitted from the numerator of each taxable member's sales apportionment fraction."

"In effect, both subsume the activities of a P.L. 86-272 protected entity within the activities of a combined or consolidated reporting group as a whole – placing combined and consolidated reporting, and concepts of apportionment, ahead of the constitutional principles embedded in the Supremacy Clause of the U.S. Constitution."

Let's talk

To discuss the potential application of this decision to your business, please contact:

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