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Massachusetts ATB Invalidates “Finnigan” Reallocation Rule as Applied to P.L. 86-272-Protected Combined Group Members

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On July 22, 2026, the Massachusetts Appellate Tax Board (“ATB” or “Board”) held that the “Finnigan” reallocation rule was unconstitutional as applied to PL 86-272 protected group members.

The case presented four core issues: (1) whether the Commissioner’s 2015 assessment was timely given the taxpayer’s 52-53-week fiscal year, (2) whether the “Combination Provision” regulation validly reclassified pure sales entities as § 38 manufacturers, (3) whether the “Reallocation Rule” (Finnigan adjustment) as applied to a P.L. 86-272-protected entity violated the Supremacy Clause, and (4) whether underpayment penalties under G.L. c. 62C, § 35A were properly assessed.

The taxpayer in the case was a combined group headed by the Manufacturing Member, a subsidiary of the Parent Company. The Manufacturing Member operated as a § 38 manufacturer producing value-added packaged meats at a plant in Massachusetts. Related entities included the Farmland Affiliate (a non-taxable fresh pork processor), Sales Affiliate A (which sold the Farmland Affiliate’s and other members’ products to unrelated third parties), and Sales Affiliate B (which sold the Manufacturing Member’s products).

The Board’s Holdings

Timeliness of the 2015 Assessment

The combined group used a 52-53-week fiscal year, meaning tax year “2015” ran from December 29, 2014 through January 3, 2016. However, the Commissioner’s notices, consent forms (Form A-37), and even the taxpayer’s own filings referenced calendar year dates (January 1, 2015–December 31, 2017). The taxpayer argued that the consent forms did not cover the full fiscal year 2015, rendering it untimely.

The Board rejected this argument, holding that the parties' mutual understanding of the tax periods at issue was dispositive. The Board credited testimony from the taxpayer's own State Tax Senior Director confirming the taxpayer was not misled. The Board distinguished Nissan Motor Corp. v. Commissioner of Revenue, 407 Mass. 153 (1990), noting no ambiguity existed where both parties clearly understood which periods were at issue. Thus, the 2015 assessment was deemed timely.

Combination Provision - § 38 Manufacturer Classification

Under G.L. c. 63, § 32B, each § 38 manufacturer member of a combined group uses single sales factor apportionment. The Commissioner's "Combination Provision" (830 CMR 63.32B.2(7)(g)2.a) provides that when a combined group member sells products manufactured by an affiliate to unrelated third parties, the activities of both the manufacturing and selling members are aggregated to determine whether the selling member qualifies as a § 38 manufacturer.

On audit, the Commissioner applied this regulation to reclassify Sales Affiliate A (2015, 2016) and Sales Affiliate B (2016, 2017) as § 38 manufacturers by aggregating their property, payroll, and receipts with those of their manufacturing affiliates.

The Board upheld the Combination Provision as within the Commissioner's express regulatory authority under G.L. c. 63, § 32B(f) to eliminate intercompany transactions and address associated apportionment factors and general authority under G.L. c. 62C, § 3. The Board distinguished Polaroid Corp. v. Commissioner of Revenue, 393 Mass. 490 (1984), which involved a regulation lacking express statutory authorization, and applied the deferential standard from Purity Supreme, Inc. v. Attorney General, 380 Mass. 762, 776 (1980).

Note: Effective January 1, 2025 all corporations use single sales factor apportionment regardless of manufacturer status. The Combination Provision issue is therefore of diminished prospective significance but remains relevant for open audit years predating the change.

Reallocation Rule / "Finnigan" Adjustment and P.L. 86-272

This issue produced the most significant and novel ruling in the case.

For 2017, Sales Affiliate A was a non-taxable member of the combined group because its sole Massachusetts activity was solicitation of orders protected under P.L. 86-272 (15 U.S.C. §§ 381–384). Under the Commissioner's Reallocation Rule (830 CMR 63.32B.2(7)(b)), when a combined group has non-taxable members with Massachusetts sales, the taxable members must include a pro-rata share of those non-taxable members' Massachusetts sales in their own sales-factor numerators—a mechanism often called a "Finnigan adjustment" or "throw-in" rule.

The taxpayer initially self-applied this rule on its 2017 Massachusetts combined return (reallocating approximately $85.7 million of Sales Affiliate A's Massachusetts receipts, representing roughly 47% of total Massachusetts sales, mostly to Sales Affiliate B). On appeal, however, the taxpayer challenged the rule, arguing it effectively taxed Sales Affiliate A's P.L. 86-272-protected income in violation of the Supremacy Clause.

The Board agreed with the taxpayer, holding that P.L. 86-272's protections cannot be circumvented through combined-reporting apportionment mechanics. The Board relied on *Frick v. Pennsylvania,* 268 U.S. 473, 494–95 (1925) (a state "cannot do indirectly what it is forbidden to do directly"), and drew support from the New Jersey Tax Court's decision in *Stanislaus Food Products Co. v. Director, Div. of Taxation.*

The Board rejected the Commissioner's reliance on *Arizona Dep't of Revenue v. Central Newspapers, Inc., 222 Ariz.* 626 (Ct. App. 2009), and *Matter of Disney Enterprises, Inc. v. Tax Appeals Tribunal of NY, 10 N.Y.3d 392* (2008), finding those cases unpersuasive. The Board concluded that P.L. 86-272's term "person" does not encompass an entire unitary group, and that federal preemption bars both direct taxation of a protected entity and indirect taxation of its protected income via reallocation to taxable affiliates.

As a result, the Board ordered an abatement of $239,719 for tax year 2017, which represented the difference in tax when Sales Affiliate A's Massachusetts receipts were removed from the combined return.

Underpayment Penalties

The Commissioner assessed 20% underpayment penalties for all three years. After the Board's rulings on the merits, the relevant underpayment percentages were 18.41% (2015, qualifying as a "substantial understatement") and 7.03% (2016, assessed on negligence/disregard grounds).

The taxpayer argued reasonable cause and substantial authority for its position that the Combination Provision was invalid. The Board disagreed, finding that the taxpayer knowingly took a position contrary to a duly promulgated regulation without attaching a disclosure statement to its returns. Under G.L. c. 62C, § 35A(d), a taxpayer may avoid penalties attributable to disregard of a regulation by adequately disclosing its contrary position. The Board cited Oracle USA, Inc. v. Commissioner of Revenue, 487 Mass. 518 (2021), and DOR's Technical Information Release 06-5 and Directive 12-7.

Penalties were sustained for 2015 and 2016. No penalty applied to 2017 because, following the Board's invalidation of the Reallocation Rule, there was no underpayment for that year.

Implications of the ATB's Decision

For Combined Groups with P.L. 86-272-Protected Members

- The Board's invalidation of the Finnigan/Reallocation Rule as applied to P.L. 86-272-protected members is the most significant aspect of this decision. Taxpayers currently subject to similar reallocation adjustments in Massachusetts should consider filing protective refund claims for open years.
- The Commissioner may appeal this decision to the Massachusetts Appeals Court. Taxpayers should monitor the case's procedural posture before taking aggressive positions solely in reliance on this ATB decision.
- Multistate taxpayers subject to Finnigan-style apportionment in other combined reporting jurisdictions should evaluate whether the ATB's reasoning could support challenges to similar mechanisms in those states.

For Taxpayers with Open Pre-2025 Audit Years

- The Board's approval of the Combination Provision means that DOR will likely continue to apply it aggressively for open years where separate manufacturing and sales entities exist within a combined group. Taxpayers with such structures for pre-2025 tax years should ensure they have assessed their exposure.
- Given the shift to mandatory single sales factor sourcing for all corporations effective January 1, 2025, this issue is winding down prospectively, but remains live for any year currently under audit or within the assessment statute.

Disclosure and Penalty Avoidance

- This case underscores the importance of disclosure when taking return positions contrary to a regulation. Under G.L. c. 62C, § 35A(d), attaching a disclosure statement to the return can prevent penalties even if the taxpayer's position is ultimately rejected. The Board's decision to uphold the penalties offers a reminder that taxpayers that disagree with a regulation must either: (a) follow it; (b) disclose their contrary position; or (c) risk penalties.