

5 Key Takeaways | Federal Preemption in State Tax: Where the Lines Are Drawn

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Kilpatrick's [David Hughes](#) recently joined a panel of fellow thought leaders to discuss “Federal Preemption in State Tax: Where the Lines Are Drawn” at the [COST Spring Meeting and Audit Sessions](#).

Federal law often sets boundaries on state taxing authority, but these boundaries are not always clear. This panel explored the doctrine of federal preemption and its critical role in shaping state tax policy and enforcement. They also discussed how federal statutes, regulations, and constitutional principles can override state tax laws, and what that means for businesses operating across jurisdictions.

David's key takeaways from the session include:

1. **Constitutional Foundations of Federal Preemption.** The boundaries between federal and state taxing authority are rooted in the Supremacy Clause, which establish that federal law can override state tax laws, particularly when state taxes impede or conflict with federal objectives or protected activities.
2. **Evolution and Scope of Public Law 86-272.** P.L. 86-272 was enacted to protect interstate sellers of tangible personal property from state income taxes when their in-state activities are limited to solicitation. However, states and the Multistate Tax Commission have sought to narrow its protections, especially for digital and internet-based activities, prompting ongoing litigation over the statute's interpretation and retroactive application.
3. **Internet Tax Freedom Act (ITFA).** ITFA preempts state and local governments from taxing internet access and imposing discriminatory taxes on electronic commerce. Courts have interpreted ITFA broadly, often striking down state taxes that treat digital transactions or services less favorably than their analog counterparts, but debates continue over what constitutes “similar” property or services.
4. **State Tax Innovation and Federal Challenges.** States have introduced new taxes—such as digital advertising and social media taxes—that target modern business models, often leading to federal preemption challenges. Recent cases show courts scrutinizing whether these taxes conflict with federal statutes like ITFA and whether retroactive or expansive state regulations violate constitutional protection.
5. **The Anti-Commandeering Principle and State Compliance.** Federal preemption statutes like ITFA and P.L. 86-272 prohibit states from imposing certain taxes but do not require states to enact or enforce new laws, distinguishing them from unconstitutional “commandeering” of state governments. Nonetheless,

some states have argued that federal limitations on state taxing powers may run afoul of the anti-commandeering doctrine, an issue that remains contested.

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