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7 Key Takeaways | State and Local Tax: Income Subject to Allocation

August 10, 2026

Kilpatrick's **Jordan Goodman** spoke at the IPT State Income Tax School held at Georgia Tech on July 28, 2026. In one of his three classes, he discussed the determination of whether income is subject to allocation or apportionment.

Key takeaways from Jordan's presentation include:

1. Historically, states have recognized two types of income: business and nonbusiness income. This distinction is important because it determines whether the income is spread among states or assigned to a single state.

2. The starting point is the Uniform Division of Income Tax Purposes Act ("UDITPA"), under which business income is defined as income arising from transactions and activity in the regular course of the taxpayer's trade or business, and also includes income from property when the acquisition, management, and disposition of that property are integral to regular business operations.

By contrast, nonbusiness income is essentially the residual category—everything that does not qualify as business income. The practical consequence is one of the most important takeaways: business income is apportioned, while nonbusiness income is allocated.

3. In some states, courts treat the definition as containing only a transactional test, meaning the question is whether the income arose from transactions in the regular course of the taxpayer's business. In other states, courts recognize both a transactional test and a functional test, and if either is satisfied, the income can be treated as business income.

4. Under the transactional test, the focus is on the frequency and regularity of the transaction, which asks whether the activity is part of the taxpayer's normal business operations rather than an isolated event.

Under the functional test, the focus shifts from the transaction itself to the relationship between the property and the taxpayer's business, meaning property-related income may still be business income even if the transaction is unusual or infrequent.

5. A key complication is when there is a complete liquidation or cessation-of-business. Here, states applying the functional test do not all agree on whether going out of business is a disposition that is an integral part of their regular trade or business.

6. Some states require the acquisition, management, and disposition of the property to be integral to the business, while others allow business-income treatment if acquisition, management, or disposition is integral.

That distinction matters a great deal in cases involving the sale of a business line or major asset, because taxpayers often argue those transactions are extraordinary and therefore should generate allocable nonbusiness income instead of apportioned business income.

7. It is important to note that many states and the Multistate Tax Commission no longer follow a perfectly uniform UDITPA model, and some have adopted non-uniform statutory definitions which expands the type of income that will be classified as business income subject to apportionment.

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