

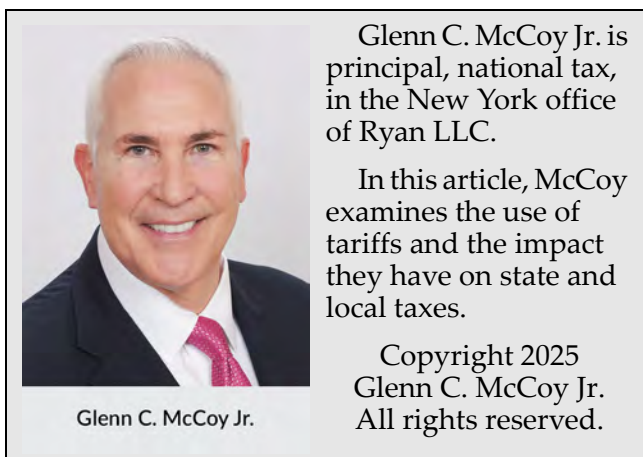
The State and Local Tax Effects of Tariffs

by Glenn C. McCoy Jr.

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The increased focus of the Trump administration's new or increased U.S. tariffs on foreign goods is realigning the way businesses operate by affecting costs and supply chains and shifting the competitive dynamics. Understanding tariffs and why they matter is essential for businesses that must navigate global policy shifts and withstand economic pressures. Unfortunately, tariffs are often misunderstood — and inaccurate assumptions about who pays them, how businesses are affected by them, or the length of their existence can lead to costly missteps.

Although it is unclear whether any of the proposed new or expanded U.S. (and potential foreign retaliatory) tariffs will be sustained long term, companies should still understand what tariffs are and how they affect their businesses. This article focuses on what tariffs are and how they affect a company's state and local tax liabilities.

What Is a Tariff?

A tariff is a tax or duty imposed by a receiving country on imports of goods brought into that country. The rate — expressed as a percentage of the value of the imported product — generally depends on the country of origin and product

being imported. Countries impose tariffs for various reasons, including, but not limited to, raising revenue, protecting domestic industries by offsetting the foreign country's real or perceived cost advantages, or favorably influencing trade with foreign nations. A tariff makes imported goods more expensive, which tends to discourage domestic businesses from purchasing imports if similar domestically produced goods are available.

Who Pays the Tariff and Who Benefits From It?

In the United States, the importer — the entity bringing the goods into the country — must pay the tariff directly to U.S. Customs and Border Protection, an agency of the Department of Homeland Security. The "importer of record" (importer) pays the tariff when the goods enter the United States. Thereafter, the importer typically passes this cost along to its customers in the supply chain, thus increasing their cost of the imported goods. For example, if a final product assembled in China to be sold in the United States contains component parts from several other countries, the entire value of that final product could be subject to U.S. tariffs at the rate that is imposed on Chinese goods.

The importer could be the buyer, the seller, or some third-party distributor. Businesses can expect to see tariff impacts through either tariffs paid directly to the U.S. government or surcharges paid to vendors (to reimburse them for tariffs). Determining exactly how much tax is due for these imported goods and who pays them requires a more detailed, fact-specific analysis.

Sales and Use Tax Implications

Accounting for tariffs can have significant impacts on a business's state sales and use tax (SUT) obligations. One of the most important issues is whether tariffs should be included or

excluded from the SUT base of the imported product. As noted above, the tariff is paid by the importer directly to U.S. Customs and Border Protection during the import clearance process. Although a tariff may seem similar to a sales tax (that is, it is imposed by the federal government as an excise tax on the actual value of purchased goods), a tariff is not imposed on a seller with the obligation to collect it from a purchaser — it is a federal excise tax imposed on the importer. Period. States define the terms “sales price” or “gross receipts” to include many charges that are “incidental to the sale,” and they generally, with some exceptions, tax the business inputs as part of the total sales price. With tariffs, however, the issue is whether the seller or the buyer is subject to the tariff. If the seller is the importer (that is, subject to the tariff), many states, like New York, have decided that the tariff is part of the product’s total cost and must be included as part of the SUT base, even if the tariff is a federal excise tax that is separately stated.¹

Several other states have issued similar guidance on the SUT implications of tariffs. Under the rationale of a ruling issued by California in 1987, the state’s sales tax is imposed on the sales price of property.² Under California law, sales price is defined as the total amount for which tangible personal property is sold or leased.³ Although most federal taxes are excluded from California’s definition of sales price,⁴ this federal exclusion does not apply to manufacturers or importers’ excise taxes that are passed on to the customer. Tariffs are considered an excise tax imposed on the importer and may not be excluded from the importer’s customer’s sales price.⁵ Accordingly, if the seller is the importer and passes the amount of the tariff on to their customer, the tariff becomes part of the SUT base and is taxed.⁶ In some instances, SUT on tariffs can reliably be avoided only if the

purchaser is the importer and is directly responsible for paying the tariffs.

More recently, in a general information letter issued by the Illinois Department of Revenue on April 7, 2025, the DOR took the same position as California, ruling that the identity of the person legally responsible for paying the tariff under federal law is the critical factor in determining whether SUT applies to the tariff.⁷ Federal import taxes are not deductible from gross receipts in computing the Illinois SUT liability. Therefore, if the seller is the importer and passes the amount of the tariff on to their customer, the amount of the tariff becomes part of the customer’s SUT base. Even if the tariff is stated separately on the customer’s invoice, it is still taxable.⁸

As of May 7, 2025, Washington state has taken a similar approach. Businesses may add surcharges to invoices to cover expenses such as tariffs. These surcharges are included in the selling price and are taxed, even if separately stated on an invoice.⁹ Surcharges are taxable under the same tax classification used to report the payment of the good or service purchased.

Sales tax issues may be further complicated if a purchaser buys imported items from a vendor but the sale occurs before the tariffs are applied. Changing tariff rates and tariff exclusions only serves to compound the confusion over the SUT treatment of tariffs. Purchase agreements should specify the party responsible for paying additional SUT in these situations.

Property Tax Implications

Property taxes can also be affected by tariffs. Although tariffs do not directly affect the assessed value of real property, they can affect the cost of building construction and renovation materials, which might increase the assessed value. The National Association of Home Builders estimates that 7 percent of all goods used in new residential construction originate

¹ TSB-M-83(11)S (June 15, 1983) and N.Y. Comp. Codes R. & Regs. tit. 20, section 526.5(b)(1)(i).

² Cal. Rev. & Tax. Code section 6201.

³ Cal. Rev. & Tax. Code section 6011(a).

⁴ Cal. Rev. & Tax. Code section 6011(c)(4).

⁵ See 18 Cal. Code Regs. 1620, Annotation 325.0232 (Apr. 8, 1987).

⁶ *Id.*

⁷ Illinois DOR, ST 25-0022-GIL (Apr. 7, 2025).

⁸ *Id.* (citing Ill. Adm. Code tit. 86, section 130.445).

⁹ See Washington DOR, “Surcharges Including Tariffs” (last accessed May 12, 2025).

from outside the United States.¹⁰ Imports for new construction were estimated at \$14 billion in 2024.¹¹ Much of this comes in the form of Canadian lumber.

While Canadian lumber is exempt from the new Trump tariffs, that could change later this year. On March 1 Trump ordered the secretary of commerce to initiate an investigation under section 232 of the Trade Expansion Act to determine the effects on the national security of imports of timber and lumber.¹² This report is due by late November, with additional tariffs called out as a potential response. The U.S. Commerce Department has already signaled that the existing 14.5 percent tariff on Canadian lumber could be increased to 34.5 percent later this year. Some builders estimate these recent actions could increase building costs by approximately \$10,900 per home.¹³

The tariff impact is even greater in states that tax personal property or business inventories. Tariffs are a cost of transporting property and are includable in the costs of inventories and assets.¹⁴ In states that use the cost method of valuing personal property for taxation, the amount of any tariffs could be included in the taxable measure.

Taxpayers must carefully account for the costs of property and inventories and separate the cost of tariffs when permitted. Valuation analyses focusing on fair market value rather than the cost of acquisition, including transportation and transaction costs, can also help reduce the burden of tariffs on property taxes. Also, to the extent tariffs result in higher costs and lower margins than historical levels, a case may exist for taxpayers to argue that their assets are negatively affected by economic obsolescence and would warrant depreciation beyond what is provided for in an assessor's

standard depreciation tables to arrive at an appropriate FMV.

Income Tax Implications

Businesses have options when choosing how to treat tariffs for tax and accounting purposes. For income tax purposes, tariffs are usually factored into the cost of acquiring property,¹⁵ but that is not the only option available to taxpayers.

IRC section 164 allows deductions for certain state, local, and foreign taxes. These include property taxes, income taxes, war profits taxes, excess profits taxes, and other taxes. IRC section 275 lists several federal taxes for which no deduction is allowed, including federal income taxes, federal war profits and excess profits taxes, estate and gift taxes, and others.

Certain federal taxes, such as import duties and tariffs, are not listed in either of these sections as being either deductible or nondeductible.

P.L. 88-272 (1964) removed former subsection (b) from IRC section 164, which denied a deduction for import duties. Import duties and tariffs are now addressed in Treas. reg. section 1.164-2(f), which indicates that although not deductible under section 164, those taxes may be deductible under section 162 as an ordinary and necessary expense paid or incurred during the tax year by a corporation or an individual in the conduct of any trade or business. Treas. reg. section 1.164-2(f) also indicates that those taxes may alternatively be considered as part of the cost of acquiring or producing property in a trade or business. The subsection does not mandate a specific approach. Businesses have the option of deducting import duties and tariffs under section 162 or treating the duties and tariffs as a part of the cost of acquiring or producing property in a trade or business.

For example, in *Summers v. Commissioner*, T.C. Memo. 1981-545, a taxpayer sought to deduct import duties on a motor vehicle under section 162. The Tax Court indicated that the

¹⁰National Association of Home Builders, "How Tariffs Impact the Home Building Industry" (last accessed May 22, 2025).

¹¹*Id.*

¹²The White House, "Addressing the Threat to National Security From Imports of Timber, Lumber" (Mar. 1, 2025).

¹³National Association of Home Builders, *supra* note 10.

¹⁴*See, e.g.*, PWC, "Accounting Implications of Tariffs," ASC 805-50-30-1, 805-50-30-2 (Mar. 13, 2025).

¹⁵For example, IRS Publication 551 (Dec. 2022) notes that federal excise taxes are typically included in the cost basis of property. See also Treas. reg. section 1.164-2(f), indicating that federal import or tariff duties may be considered as part of the cost of acquiring or producing property or deducted as section 162 expenses.

deduction would be allowed only if it were an ordinary and necessary business expense. In that case, the deduction was disallowed solely because the motor vehicle was used as a family car. A similar conclusion was reached in *Haman v. Commissioner*, T.C. Memo. 1972-118, and Rev. Rul. 73-91.

The correct choice for your business depends on specific activities of the business and transaction, the type of property purchased, and the amount of any tariffs paid. For example, it may be more prudent to include tariffs in the cost of goods sold for items that are resold or further manufactured after purchase. For items that are capitalized, businesses should collaborate closely with their accountants and tax consultants to decide between capitalizing tariffs or deducting them as ordinary and necessary business expenses.

Nexus Implications

Finally, tariffs can indirectly expand a company's income tax and SUT nexus by increasing inventory levels or sales volumes in certain states. For example, higher tariffs may prompt businesses to stockpile goods in warehouses in states where they did not previously have inventory, triggering physical nexus in those states and creating an income tax or sales tax filing obligation not previously required in the state.

The *Wayfair*¹⁶ decision created new economic nexus thresholds (for example, \$100,000 in annual sales) for sales tax collection purposes. Increased sales revenue in a state attributable to tariff-driven price hikes could trigger the threshold and create new sales tax collection obligations. Businesses must track nexus across jurisdictions and comply with varying SUT rules. This can be an overwhelming task for those with extensive import-export operations.

Conclusion

The Trump administration's continuing focus on the proposed expansion of tariffs has created the need for a deeper understanding of the SALT considerations of each state's laws. The nuances

of a state's specific statutes will create differences in the treatment of tariffs among states, requiring the need to clarify which party bears the economic burden of, and legal responsibility for, tariff-related costs. ■

¹⁶ *South Dakota v. Wayfair Inc.*, 585 U.S. 162 (2018).