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The Constitution's Dormant Commerce Clause Limits The Power of States to Tax Their Residents — *Comptroller of the Treasury Of Maryland v. Brian Wynne et ux.*

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On May 18, 2015, the Supreme Court in a surprisingly close 5-4 decision found that Maryland's failure to grant a credit against its county income tax for out-of-state income taxes paid by Maryland residents violates the Constitution's Commerce Clause. In *Comptroller of the Treasury of Maryland v. Brian Wynne et ux.*[1] the Court held that the failure to grant the credit incentivized taxpayers to conduct intrastate rather than interstate business in violation of the judicially created ''dormant'' or ''negative'' Commerce Clause. The majority and dissenting opinions illustrate the enormous differences among the Justices regarding their views of the power of states to tax their residents.

An ideologically diverse majority of Justices Breyer, Sotomayer, Kennedy, Roberts and Alito (who authored the opinion) looked to well-established judicial precedent interpreting the Commerce Clause to apply to actions of states as well as the federal government. The principal dissent by Justice Ginsburg (joined by Justices Kagan and Scalia) argued that the Commerce Clause should not interfere with policy decisions by states to tax their residents who consume state services. Finally, in separate dissents, Justices Scalia and Thomas condemn the Court's interpretation of the Commerce Clause arguing that the Constitution does not prohibit states from discriminating against interstate commerce. These widely differing views over a relatively technical issue regarding the authority of states to tax their residents illustrate a more fundamental division among the Justices regarding the Constitution and the power of government which will undoubtedly appear in future decisions.

MARYLAND STATUTE

Like many states, Maryland taxes the worldwide income of its residents, with the tax consisting of a state income tax set by the legislature[2] and a county tax that applies only to residents of each county at a rate set by the county within a range (capped at 3.2%) established by the state.[3] The county tax is considered to be a state tax in that it is collected by the state and distributed to the county where the individual resides.[4]

Nonresidents of Maryland are subject to the state income tax on all income earned in Maryland and a special nonresident tax, in lieu of the county tax, is levied on Maryland source income at a rate equal to the lowest county tax rate, currently 1.25%.[5]

To the extent its residents are taxable on their income earned outside the state, Maryland allows a credit for income taxes paid to other states measured by the lesser of the amount of tax paid to the other state or an amount equal to the Maryland state tax on the out-of-state income.[6] In the case where an S corporation pays tax to another state on behalf of a Mary-

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[1] 575 U.S. __, 135 S. Ct. 1787 (2015) (hereinafter *Wynne*).

[2] Md. Code Ann. Tax-Gen §10-105.

[3] *Id.* §10-103, §10-106.

[4] *Frey v. Comptroller of Treasury*, 422 Md. 111, 125, 141–142; 29 A.3d 475, 483, 492 (2011). In fact, for constitutional purposes, there is no distinction between state and local taxes. *See* Hellerstein, *et al.*, *State Taxation*, 3d ed., ¶19.02[9].

[5] *Id.* §10-106.1.

[6] *Id.* §10-703.

land shareholder, the credit allowed to the shareholder may not exceed his or her pro rata share of that tax.[7]

But Maryland did not allow a similar credit for out-of-state taxes against its county income tax.[8] As a result, a Maryland resident who paid out-of-state income taxes in excess of the Maryland state income tax on the out-of-state income could not apply the excess to offset the county income tax. For example, if a Maryland resident's state income tax rate is 5% and his county's income tax rate is 2% and he earns all of his income in another state with a rate of 6%, he owes no state tax but still owes the 2% county income tax. In short, income a Maryland resident earns outside the state was potentially taxed twice.

FACTS OF WYNNE

Brian and Karen Wynne, residents of Howard County, Maryland in 2006, owned stock in Maxim Healthcare Services, Inc., an S corporation filing income tax returns in 39 states. In 2006, the Wynnes earned over $2.6 million in taxable income, much of it from their 2.4% interest in Maxim, paying approximately $208,000 of Maryland and Howard County income tax. Because of Maxim's business in other states, the Wynnes claimed a credit of $84,550 for income taxes paid by Maxim on their behalf to other states attributable to their distributive share of Maxim income reported on their Maryland return.

The Wynnes did not file personal income tax returns in the other states, but rather Maxim filed ''composite'' returns on behalf of all its shareholders reporting the tax paid attributable to the Wynnes on their Form K-1. To relieve owners of partnerships and S corporations of the burden of filing nonresident returns in states where the pass-through entity does business most states permit the entity to file a return on behalf of the nonresident owners who have no other income in that state. Generally, however, when a nonresident owner consents to be included in the composite return, the individual is taxed at the state's highest marginal rate.

The Wynnes credited these taxes against their Maryland tax, including the county tax. Citing Maryland's statute that a resident may claim a credit only against the *state* income tax, the Comptroller of the Treasury disallowed the credit against the Howard County tax resulting in an adjustment of approximately $25,000.

LOWER COURTS' OPINIONS

The Wynnes appealed the Comptroller's decision to the Maryland Tax Court where they argued, for the first time, that the limitation of the credit to the state tax for taxes paid to other states discriminated against interstate commerce in violation of the Commerce Clause. The Tax Court summarily held in favor of the Comptroller, but upon appeal, the Circuit Court for Howard County and ultimately Maryland's highest court, the Court of Appeals,[9] held that denying the credit or not allocating the Wynnes' income among the states where it was earned was unconstitutional. In finding for the taxpayers, the Court of Appeals pointed out that while the Tax Court is an administrative agency of the state, its decisions should generally be afforded deference; but in this case, because the issue was on a question of constitutional law, courts could overrule the agency's determination.[10]

In its decision, with two dissents, affirming the Howard County Circuit Court, the Court of Appeals evaluated the validity of Maryland's statute under the Commerce Clause using the seminal four-part test of *Complete Auto Transit, Inc. v. Brady*,[11] which requires a tax arising from activity (1) have substantial nexus with the taxing state; (2) be fairly apportioned; (3) not discriminate against interstate commerce; and (4) be fairly related to service provided by the taxing state. The Court of Appeals held that the failure to grant a credit for the out-of-state taxes against the county tax violated both the fair apportionment and nondiscrimination requirements of *Complete Auto*.[12]

Specifically, the Court of Appeals found that the Maryland statute was not fairly apportioned, i.e., ''internally consistent,'' because if all other states adopted Maryland's rule, interstate commerce would be taxed at a higher rate than intrastate commerce.[13] Lacking internal consistency the court held that the tax discriminated against interstate commerce because it denied residents a credit on income taxes paid to other

[7] *Id.* §10-703(c)(2). Maryland adopts the rules of the Internal Revenue Code for the treatment of S corporations so that income, deductions credits, etc. of the corporation pass through to its shareholders. *See* I.R.C. §1366.

[8] *Id.* §10–703(a). In *Stern v. Comptroller of the Treasury*, 316 A.2d 240 (1974), the Court of Appeals had held that a credit was required against the county tax under Maryland law, but the state legislature promptly responded by amending the statute to make clear no credit could be claimed against the county tax. The Court of Appeals then, without reference to the Commerce Clause, upheld the right of the legislature to change the statute to deny the credit for out-of-state taxes against the county tax. *Maryland State Comptroller of the Treasury v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006).

[9] *Maryland State Comptroller of Treasury v. Wynne*, 431 Md. 147, 64 A.3d 453 (Md. 2013).

[10] 431 Md. Ct. 160-161, 64 A.3d at 460–461.

[11] 430 U.S. 274, 97 S. Ct. 1076 (1977).

[12] For a discussion of the lower court opinions discussing *Complete Auto* and the dormant Commerce Clause, see Williamson and Hobbs, *Does the Constitution's Dormant Commerce Clause Limit a State's Power to Tax Its Resident? Maryland v. Wynne*, 56 Tax Mgmt. Memo. 3 (Jan. 12, 2015), and Fader, *May States Double Tax Their Residents' Income?* 68 Tax Law. 367 (2015).

[13] Although not an issue in this case, the fair apportionment requirement of *Complete Auto* also requires ''external consistency,'' i.e., the tax must actually reflect a reasonable sense of the appropriate proportions to the business transacted in a state relative to other states. *Container Corp. of Am. v. Franchise Tax Bd.*, 463 U.S. 159, 169–170 (1983). External consistency examines whether ''the economic justification for the state's claim upon the value taxed to discover whether a state's tax reaches beyond that portion of value that is fairly attributable to activity within the taxing state.'' *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). *See generally* Hellerstein, *et al.*, State Taxation, 3d ed. ¶4.16[2].

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states resulting in an overall tax on income earned in interstate commerce at a higher effective rate than income earned intrastate.[14]

Upon petition of Maryland's Comptroller of the Treasury appealing the decision of the Court of Appeals, the Supreme Court granted certiorari to consider the following question: "Does the United States Constitution prohibit a state from taxing all the income of its residents — wherever earned — by mandating a credit for taxes paid on income earned in other states?"[15] While the Court held the answer to this specific question was "no," the majority opinion nevertheless concluded that the Commerce Clause does, in fact, prohibit a state's tax regime from discriminating against interstate commerce.

DORMANT COMMERCE CLAUSE

Justice Alito began his majority opinion pointing out that the Commerce Clause grants Congress power to "regulate Commerce. . . among the several states."[16] Its words alone only authorize Congress to regulate interstate commerce. But quoting from *Hughes v. Oklahoma*[17] the Court said the Commerce Clause:

> [r]eflected a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.[18]

With this intent in mind, for many years the Supreme Court has expanded the meaning of the Commerce Clause to include a prohibition upon the states from interfering with interstate commerce regardless of any congressional action. Quoting from *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[19] the Court found that although the Commerce Clause reads only as a positive grant of power to Congress, the Supreme Court has:

> . . .consistently held this language to contain a further negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to legislate on the subject.[20]

While the Court acknowledged that this interpretation of the Commerce Clause to apply to the actions of states is not free of criticism,[21] it found the interpretation had "deep roots" dating from the 19th century to permit the judiciary to oversee state action that might interfere with interstate commerce.[22]

In the majority's view, absent a dormant Commerce Clause, states would be able to discriminate against or place burdens upon interstate commerce that Congress itself could not, a result the Framers of the Constitution specifically wanted to avoid.[23] In short, the dormant Commerce Clause precludes states from discriminating between transactions on the basis of some interstate element[24] so that a state may not tax a transaction more heavily when it crosses state lines than when it occurs entirely within the state.[25]

Consequently, looking at the long line of cases acknowledging the existence of a dormant Commerce

[14] The Court of Appeals subsequently issued a brief clarification that Maryland could avoid discrimination against interstate commerce not only by granting a credit against the county tax but also by providing for some method of apportionment of income between Maryland and other states. *See* 431 Md. at 189, 64 A.3d at 478 (2013).

[15] 572 U.S. __, 134 S. Ct. 2660 (2014). In support of Maryland's petition the Solicitor General submitted an amicus brief arguing that the Court of Appeals ruled incorrectly and that the Due Process Clause authorized states to tax residents on all their income. *See Brief for the United States as Amicus Curiae*, *Md. State Comptroller of the Treasury v. Wynne*.

[16] U.S. CONST. Art. I, §8, cl. 3.

[17] 441 U.S. 322 (1979).

[18] *Id.* at 325–326.

[19] 514 U.S. 175 (1995).

[20] *Id.* at 179.

[21] *See, e.g., Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 609–620 (1997) (Thomas, J. dissenting), and *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 259–265 (1987) (Scalia, J. concurring in part and dissenting in part).

[22] *Wynne* at 1794, citing *Case of the State Freight Tax*, 15 Wall. 232 (1873); *Cooley v. Board of Wardens of Port of Philadelphia ex rel. Soc. for Relief of Distressed Pilots*, 12 How. 299 (1852); *Gibbons v. Ogden*, 9 Wheat. 1 (1824).

[23] See *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), where the Court stated the dormant Commerce Clause "effectuates the Framers' purpose to' preven[t] a State from retreating into economic isolation or jeopardizing the welfare of the Nation as a whole, as it would do if it were free to place burdens on the flow of commerce across its borders that commerce wholly within those borders would not bear.' " *Id.* at 330–331, quoting *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 180 (1995).

[24] *Boston Stock Exchange v. State Tax Commissioner*, 429 U.S. 318 (1977). In holding a transfer tax on security transactions that taxed out-of-state sales more heavily than intrastate sales violated the dormant Commerce Clause the Court stated:

> ". . .[W]e also reject the [government's] argument that the tax should be sustained because it is imposed on a local event at the end of interstate commerce. While it is true that, absent an undue burden on interstate commerce, the Commerce Clause does not prohibit the State from taxing the transfer of property within the State, the tax may not discriminate between transactions on the basis of some interstate elements. " *Id.* at 332 n. 12.

[25] See *Armco Inc. v. Hardesty*, 467 U.S. 638 (1954), where the Court stated:

> "It long has been established that the Commerce Clause of its own force protects free trade among the States. . . . That is, a State may not tax a transaction or incident more heavily when it crosses state lines than

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Clause, the Court held that these precedents "all but dictate the result reached by Maryland's highest court" in finding Maryland's tax scheme unconstitutional.[26] Specifically, the Court relied upon three cases where the potential of double taxation of income earned outside the state of residency discriminated in favor of intrastate over interstate economic activity in violation of the Commerce Clause.

In *J.D. Adams Mfg. Co. v. Storen*,[27] Indiana taxed the worldwide income of every Indiana resident, including the out-of-state sales of the petitioner, an Indiana corporation. Ruling the tax regime violated the dormant Commerce Clause, the Court found that the "vice of the statute" was that it taxed without apportionment receipts derived from activities in interstate commerce thereby subjecting interstate commerce to a risk of double taxation to which intrastate commerce is not exposed.[28]

Similarly, in *Gavin, White & Prince, Inc. v. Henneford*,[29] the state of Washington taxed all the income of persons doing business in the state, including the income earned by a Washington corporation in shipping products to other states. Again, the Supreme Court found the risk of multiple taxation on such interstate commerce to which local commerce was not subject violated the Commerce Clause.

Finally, in *Central Greyhound Lines, Inc. v. Mealey*[30] New York taxed a corporation's gross receipts derived from services provided in neighboring states. Noting that these other states might tax this portion of the company's income, the Court held the tax violated the dormant Commerce Clause because it imposed a discriminatory burden on interstate commerce.

The Court rejected arguments that attempted to distinguish these cases because, unlike *Wynne*, they involved taxes on gross receipts of a corporation rather than the net income of an individual. The Court, however, saw these decisions turning on the threat of multiple taxation regardless of the tax base or whether the taxpayer was a corporation or individual. Thus, the Court found any attempt to distinguish a tax on gross receipts from a tax on the net income to be "arid," looking instead to the economic impact of the tax rather than the derivation of the base upon which it is assessed.[31]

The Court also dismissed the view that the dormant Commerce Clause should treat individuals such as the Wynnes differently from corporations. While acknowledging that states provide their residents with many services not extended to corporations, corporations still benefit from state and local services; and, while individuals, unlike corporations, can vote against legislators who enact laws, the constitutionality of a law is independent from whether the tax was approved by resident voters.[32] Furthermore, as a practical matter, the notion that individuals such as the Wynnes who are subject to possible double taxation have a remedy in the voting booth is "fanciful" given that a distinct minority of Maryland's residents earn income out of the state.[33] Thus, *dicta* in *Goldberg v. Sweet*[34] that the Commerce Clause should not protect state residents from their own state taxes is incorrect. The Commerce Clause looks to the effect of a statute, not the motives of the voters or legislators for enacting a law that has a discriminatory result.[35]

While states possess under the Due Process Clause of the Fourteenth Amendment[36] the jurisdictional power to tax their residents on their worldwide income,[37] the dormant Commerce Clause requires that such authority be tempered to avoid double taxation that discriminates against interstate commerce.[38] "Legion" are the cases that have applied the dormant Commerce Clause to strike down taxes that a state had the jurisdictional power to enact. The Court concluded that to discard this well-reasoned interpretation of the Commerce Clause would constitute an unnecessary and unreasonable "sea change" in the law solely to satisfy Maryland's short-term fiscal needs.[39]

INTERNAL CONSISTENCY

Finding that Maryland's statute implicates the dormant Commerce Clause, the Court then turned its attention to the "internal consistency" test many courts have used to determine if a state tax discriminates against interstate commerce. This test looks to whether identical application of the tax in question by every state would place interstate commerce at a disadvantage compared to intrastate commerce.[40] In

when it occurs entirely within the State." *Id.* at 642 (citations omitted).

[26] *Wynne* at 1794.

[27] 304 U.S. 307 (1938).

[28] *Id.* at 309–311.

[29] 305 U.S. 434 (1939).

[30] 334 U.S. 653 (1948).

[31] *Wynne* at 1796.

[32] *Id.* at 1797.

[33] *Id.* at 1798.

[34] 488 U.S. 252 (1989), where the Court stated "It is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Id.* at 266.

[35] *Wynne* at 1799.

[36] The Due Process Clause of the Fourteenth Amendment provides that no state may "deprive any person of life, liberty or property without due process of law." U.S. CONST. amend. XIV, §1. There is also a Due Process Clause in the Fifth Amendment that limits the powers of the federal government. U.S. CONST. amend. V.

[37] See *Oklahoma Tax Commission v. Chickasaw Nation*, 515 U.S. 450 (1995), where the Court stated: ". . .[A] jurisdiction, such as Oklahoma, may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Id.* at 462–463.

[38] See *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), where the Court stated: ". . .[While] a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." *Id.* at 305.

[39] *Wynne* at 1799.

[40] The Supreme Court first described the internal consistency to restrain state taxing power in *Container Corp. of America v. Fran-*

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Oklahoma Tax Commission v. Jefferson Lines, Inc.,[41] the Court described the test as follows:

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the economic reality reflected by the tax, but simply looks to the structure of the tax to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with intrastate commerce. A failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction, since allowing such a tax in one state would place interstate commerce at the mercy of those remaining states that might impose an identical tax.[42]

Noting the use of this test in at least seven other Supreme Court cases over the last three decades,[43] the Court found the virtue of the test to be that it allows the judiciary to distinguish tax schemes that, in fact, discriminate against interstate commerce from tax policies that are not discriminatory but may nevertheless result in double taxation simply due to the different incentives offered by separate tax regimes.[44] To illustrate a nondiscriminatory tax scheme that might result in double taxation, the Court cited *Moorman Manufacturing Co. v. Bair*[45] where Iowa's single-factor sales formula for imposing its income tax did not violate the Commerce Clause despite the operation of most states' three factor formula of property, payroll and sales. The Court stated:

> The only conceivable constitutional basis for invalidating the Iowa statute would be that the Commerce Clause prohibits any overlap in the computation of taxable income by the States. If the Constitution were read to mandate such precision in interstate taxation, the consequences would extend far beyond this particular case. For some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income. Accepting appellant's view of the Constitution, therefore, would require extensive judicial law-making. Its logic is not limited to prohibition on the use of a single-factor apportionment formula. The asserted constitutional flaw in that formula is that it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation. But a host of other division of income problems create precisely the same risk and would similarly rise to constitutional proportions.[46]

Applying the internal consistency test to Maryland's statute, the Court used the following example to demonstrate the disadvantage Maryland's tax regime imposes on interstate commerce.

> *Example:* Every state in the Union has a tax similar to Maryland's county and nonresident taxes where residents pay a 1.25% tax on both income earned in and without Maryland and nonresidents pay a 1.25% tax on income earned in the state. April and Bob are residents of State A but April earns all her income in State A whereas Bob earns all his income in State B. Without a credit for State B's tax against State A's tax, Bob pays double the tax whereas April pays tax only once to State A.

In short, the internal consistency test demonstrates that Maryland's tax scheme is inherently discriminatory, operating as a sort of tariff which is the paradigmatic example of a law discriminating against interstate commerce.[47]

REJECTION OF A RULE OF PRIORITY

Finally, the Court made clear that its analysis does not require a state basing its tax on residence to recede its jurisdictional power to a state basing its tax on source.[48] While Maryland could meet the internal consistency test by offering a credit for taxes paid to

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chise Tax Board, 463 U.S. 159 (1983). *See* Hellerstein, *et al.*, *State Taxation*, 3d ed. ¶4.16 [1].

[41] 514 U.S. 175 (1995).

[42] *Id.* at 185.

[43] *American Trucking Assns., Inc. v. Michigan Pub. Serv. Commission*, 549 U.S. 429 (2005); *Oklahoma Tax Commission v. Jefferson Lines Inc.*, 514 U.S. 175 (1995); *Goldberg v. Sweet*, 488 U.S. 252 (1989); *American Trucking Assns., Inc. v. Scheiner*, 483 U.S. 266 (1987); *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232 (1987); *Armeo Inc. v. Hardesty*, 467 U.S. 638 (1984); and *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

[44] See generally Mason, *Made in America for European Tax: The Internal Consistency Test*, 49 Boston College L. Rev. 1277 (2008), suggesting the European Court of Justice adopt the Supreme Court's internal consistency test to determine if overlapping tax jurisdictions by member states is discriminatory.

[45] 437 U.S. 267 (1978).

[46] *Id.* at 278.

[47] *Wynne* at 1804, citing *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 193 (1977).

[48] See Hellerstein, *Deciphering the Supreme Court's Opinion in Wynne*, 123 J. Tax 4 (July 2015), arguing that to avoid double taxation a state taxing on the basis of residency should yield tax-

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other states, the Court emphasized that Maryland could comply with the dormant Commerce Clause in other ways.[49] Thus, Maryland could render its scheme internally consistent (despite continuing to deny residents like the Wynnes a credit for out-of-state taxes) by repealing the county tax on nonresidents' Maryland source income. Maryland also could meet the internal consistency test by repealing its tax on nonresidents for their Maryland source income and taxing the worldwide income of its residents with no credit for the payment of out-of-state taxes.

PRINCIPAL DISSENT

Justice Ginsburg, joined by Justices Scalia and Kagan, would have found the dormant Commerce Clause inapplicable to Maryland's tax scheme and upheld the state's right to tax the worldwide income of its residents. In the dissent's view, nothing in the Constitution or the Court's prior decisions dictated that the state of an individual's domicile recede its taxing power to another state where an individual earns income. While states often offer their residents credits for income taxes paid to other states, that is a matter of policy not mandated by the dormant Commerce Clause.[50]

The dissent found that because a state provides more services to its residents than those who live elsewhere the state may demand more of them, regardless of the residents' obligations to other states. In addition, residents of a state, unlike nonresidents, possess political power to change a tax regime which they believe unfair. While the political process may not guard against facially discriminatory taxes calling for the dormant Commerce Clause to invalidate, for example, a state taxing residents at a higher rate for out-of-state activities than for in-state activities, the dissent found that Maryland's tax policies should generally be left to the voters of Maryland.

The dissent believed the power of a state to tax the worldwide income of its residents should not be diminished because another state chooses to tax nonresidents who earn income within its borders. A taxpayer living in one state and working in another receives protection and benefits from both and should be called upon to share the costs of government in both, albeit exposing the taxpayer to potential double taxation. In short, Maryland's decision to tax its residents at the risk of their being double taxed is a policy decision that should be left to Maryland and Congress, not the Court.[51]

The dissent cited *Shaffer v. Carter*[52] and *West Publishing Co. v. McColgan*[53] for instances where the Court did not invoke the dormant Commerce Clause to disallow state taxes on a resident's worldwide income where a credit for taxes paid to other states was not provided. However, as noted by the majority, the tax in *Shaffer* was not an income tax and the issue of double taxation never arose; and *West Publishing* was a summary decision of limited precedential value because the Court only affirmed the lower court's judgment, not its reasoning or rationale.[54]

In addition to questioning the majority's reliance on *J.D. Adams*, *Gwin, White & Prince*, and *Central Greyhound Lines* which dealt with taxes on gross receipts of corporations, not the net income of individuals, the dissent also challenged the majority's adherence to the internal consistency test for determining the application of the dormant Commerce Clause. Specifically, the majority and dissent disagreed over whether the Court in *American Trucking Assns, Inc. v. Michigan Pub. Serv. Commission*,[55] which permitted a flat $100 fee on trucks making point-to-point deliveries in Michigan, was precedent that a tax need not be internally consistent to satisfy the dormant Commerce Clause. The dissent saw no reason to distinguish a flat toll charge which may be internally inconsistent from a residence based income tax that must be internally consistent.[56]

Justice Alito responded that *American Trucking* did not hold the tax in question was internally inconsistent, but only what the petitioner argued in the case.[57] But, regardless of whether the specific charge in *American Trucking* was internally consistent, the ma-

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ing rights to states taxing the same income based on source.

[49] *Wynne* at 1805.

[50] *Id.* at 1813.

[51] *Id.* at 1815–1816

[52] 252 U.S. 37, 51 (1920). In asserting the dormant Commerce Clause did not prevent Oklahoma from seizing a nonresident's property in the state for the nonresident's failure to pay Oklahoma income tax, the Court stated:

> "Income taxes are a recognized method of distributing the burdens of government, favored because requiring contributions from those who realize current pecuniary benefits under the protection of the government, and because the tax may be readily proportioned to their ability to pay." *Id.* at 51.

[53] 328 U.S. 823 (1946). The Court summarily affirmed the holding of the California Supreme Court that California may tax the worldwide income of a domiciliary regardless of another state taxing the person's income earned within its borders. *See* 27 Cal.2d 705, 166 P.2d 861 (1946).

[54] *Id.* at 1800–1801.

[55] 545 U.S. 429 (2005).

[56] At least one commentator concluded from *American Trucking* that internal consistency was irrelevant for taxes on "local" business. *See* W. Hellerstein, *Is 'Internal Consistency' Dead? Reflections on an Evolving Commerce Clause Restraint on State Taxation*, 61 Tax L. Rev. 1 (2007); Hellerstein, *et al.*, *State Taxation*, 3d ed. ¶4.16 [1] [a] [v].

[57] In dueling footnotes Justices Alito and Ginsburg debate whether *American Trucking* rejects the internal consistency test. Thus, Justice Alito states *American Trucking* depended on an empirical showing that petitioners failed to make, namely, that the challenged tax imposed a heavier burden on interstate truckers in general than it did on intrastate truckers. *Wynne*, n. 7. Justice Ginsburg responded that *American Trucking* made no reference to empirical data to a test based on the hypothetical effect it would have if law in all 50 states so that the internal consistency test was effectively excused in the case. *Wynne*, n. 6 (Ginsburg, J. dissenting).

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jority's wholehearted adoption of the internal consistency test in *Wynne* makes clear that the doctrine will be the standard for judging whether future state and local taxes discriminate against interstate commerce.

Finally, the dissent pointed out that the double taxation which the internal consistency test is intended to prevent would be satisfied if Maryland repealed its tax on nonresidents earning income in Maryland, a result that would still subject the Wynnes to double tax.[58]

> *Example:* State A taxes its residents on their worldwide income but does not tax nonresidents on their State A income. State B taxes its residents only on their State B income but still taxes nonresidents on their State B income. While both state's tax schemes are internally consistent, the tax burden on April and Bob in the prior example remain unchanged. April, a resident of State A, would pay a 1.25% tax only once to State A. Bob would still pay a 1.25% tax to State A where he resides and a 1.25% tax where he earns the income.

The example above illustrates that the internal consistency test can be met not by lowering Bob's taxes or raising April's taxes, but by eliminating the taxes imposed on some third taxpayer (say, Cathy).[59] This approach, argues the dissent, hardly cures the discrimination intended by the internal consistency test.

In sum, the dissent acknowledged the dormant Commerce Clause to be part of the Constitution, but believed its application in this case was incorrect. Finding the majority's reliance on *J.D. Adam*, *Gwin White & Prince*, and *Central Greyhound Lines* incorrect and citing *Shaffer*, *West Publishing*, and *American Trucking* to find Maryland tax scheme not in violation of the dormant Commerce Clause, the dissent ultimately concludes the issue to be one of policy best left to the state legislatures and Congress, not the judiciary.

SCALIA DISSENT

While joining the principal dissent to demonstrate the incompatibility of the majority opinion with prior dormant Commerce Clause cases, Justice Scalia (joined in part by Justice Thomas) filed a separate dissent to declare the dormant Commerce Clause to be nothing more than a ''judicial fraud'' invented by courts to set aside state laws that they believe impose too great a burden on interstate commerce.[60] The fundamental problem with the dormant Commerce Clause, in Justice Scalia's opinion, is that the Commerce Clause ''says nothing about prohibiting state laws that burden commerce.''[61]

Acknowledging the doctrine has been part of the Court's interpretation of the Commerce Clause for over 100 years, Justice Scalia declared that age alone is not an excuse for ''brazen invention.''[62] In Justice Scalia's view only the Import/Export Clause[63] and the Duty of Tonnage Clause[64] impose direct limitations on the ability of the states to impose taxes under the Constitution. The Commerce Clause only empowers Congress to prohibit taxes that may burden interstate commerce and does not authorize the judiciary to set aside state taxes that it deems too burdensome.

The consequence of such judge made law is a ''bestiary'' of ad hoc tests and exceptions, such as the internal consistency rule, which bear no resemblance to anything in the Constitution's text, structure or other legal traditions.[65] Because no principle anchors the doctrine, Justice Scalia finds it to be unstable and incompatible with the role of the judiciary, compelling the Court to balance the needs of commerce against the needs of state governments, a task the Constitution assigns to the legislature, not judges.[66]

In Justice Scalia's view, rather than this ''ad hocery,'' Congress could prescribe uniform national rules to address the problem of multiple taxation. The Court's creation of an internal consistency test to avoid double taxation in a hypothetical world where all states adopt the same internally consistent tax, does not reflect the real world where different states adopt different internally consistent taxes. Thus, if Maryland imposes its income tax on people who live in Maryland regardless of where they work (one internally consistent scheme), while Virginia imposes its income tax on people who work in Virginia regardless of where they live (another internally consistent scheme) Marylanders who work in Virginia remain subject to double taxation.

Nevertheless, after condemning the ''Synthetic Commerce Clause'' to be incompatible with the role of the judiciary, Justice Scalia concludes he will adhere to it under the doctrine of *stare decisis* but only when a state tax discriminates on its face against interstate commerce or cannot be distinguished from a tax which the Court has already held unconstitutional. In this case Maryland's law is not facially discrimina-

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[58] *Wynne* at 1822.

[59] *Id.* at 1823.

[60] *Id.* at 1807. The majority points out that this ''fraudulent'' doctrine has been applied in dozens of the Court's opinions, joined by dozens of Justices. *Id.* at 1806.

[61] *Id.* at 1808.

[62] *Id.*

[63] ''No State shall, without the consent of Congress, lay any imposts or duties on imports or exports. . .'' U.S. CONST. Art. I §10 cls. 2.

[64] ''No State shall, without the consent of Congress, lay any duty of tonnage, keep troops or ships of war in time of peace. . .'' US CONST. Art. I §10 cls. 3. The Tonnage Clause recognizes that if states were free to tax the privilege of access to their harbors the prohibition in Article I, §10, clause 2 against duties on imports and exports could be nullified by taxing the vessels transporting the merchandise. *See Polar Tankers, Inc. v. City of Valdez, Alaska*, 557 U.S. 1 (2009).

[65] *Wynne* at 1809.

[66] *Id.* at 1810.

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tory and reflects a decision made by the state legislature not to grant a credit against its tax; a policy decision, in Justice Scalia's view, the Constitution does not prohibit.[67]

THOMAS DISSENT

Finally, Justice Thomas did not join the principal dissent, rather writing his own opinion (joined in part by Justice Scalia) to declare the dormant Commerce Clause to have no basis in the Constitution and calling for complete reversal of the doctrine. Looking to the Framers' intent, Justice Thomas found no indication that they believed the Commerce Clause should in any way restrict the ability of states to tax their residents. Responding to Justice Alito pointing out that the Framers were unaware that some day it would be commonplace for a taxpayer to live in one state and work in another,[68] Justice Thomas points out that in deference to duly enacted laws of a state, particularly those concerning the pradigmatically sovereign activity of taxation, the burden of proof should fall on those who would use the Constitution to overturn them.[69]

MARYLAND'S REACTION TO DECISION

With its statute ruled unconstitutional, Maryland must now refund an estimated $201.6 million of tax, including $25,000 to the Wynnes, as well as interest on those refunds dating back as far as the 2006 tax year.[70] In addition, the ruling will reduce future local county tax revenue by approximately $43 million annually, $24.2 million from Montgomery County alone.[71]

Anticipating the Court's decision, Maryland's General Assembly in April passed the Budget Reconciliation and Financing Act of 2015[72] directing the Attorney General to inform the Comptroller of Maryland whether *Wynne* invalidates the practice of not allowing residents a credit against the county tax for out-of-state income taxes. Accordingly, upon release of *Wynne* on May 18, the Attorney General on May 29, wrote the Comptroller that the decision, in fact, mandates refunds.[73] The Attorney General's letter added that the Supreme Court did not prescribe what action the state must take in response to its decision, but noted the Court did state Maryland ''could cure the problem with its current system by granting a credit for taxes paid to other states.''[74] Therefore, upon the issuance of the Attorney General's letter, the Act automatically amended Maryland's law to provide for the credit;[75] and the Comptroller was instructed to draw amounts for the payment of refunds and interest from existing reserves, with subsequent recoupment of these amounts from the counties.[76]

With respect to the interest paid on such refunds, the General Assembly previously acted in 2014 to reduce the standard 13% interest rate on refunds, instructing the Comptroller to set the annual interest rate for *Wynne*-related income tax refunds at a percentage (rounded to the nearest whole number) equal to the ''average prime rate of interest quoted by commercial banks to large businesses during fiscal year 2015, based on a determination by the Board of Governors of the Federal Reserve Bank,''[77] i.e., approximately 3%. Changing the interest rate retroactively on refunds dating back almost a decade for such a specific group of taxpayers is likely to spawn further litigation at the local level.[78]

To assist Marylanders seeking refunds, the Comptroller's Office issued guidance in the form of frequently asked questions.[79] First, for the approximately 10,000 taxpayers[80] who filed protective claims to keep the statute of limitations open pending resolu-

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[67] *Id.* at 1811.

[68] The majority opinion states: ''We are unaware of records showing, for example, that it was common in 1787 for workers to commute to Manhattan from New Jersey by row boat or from Connecticut by stage coach.'' *Id.* 1807.

[69] *Id.* at 1813.

[70] Springuel, *Letters Clear Way for Maryland Tax Refund Under High Court 'Wynne' Ruling*, 109 Daily Tax Rep. H-2 (June 8, 2015).

[71] Springuel, *'Wynne' Ruling Prompts Maryland County Budget Cutting*, 2015 Tax Mgmt. Weekly State Tax Rep. 10 (July 17, 2015).

[72] Md. H.B. 72 (2015).

[73] Letter of Attorney General Brian E. Frosh to Peter V.R. Franchot, Comptroller of Maryland, May 29, 2015.

[74] *Id.*, quoting *Wynne* at 1806.

[75] Md. H.B. 72 §4 and §26 (2015), amending Md. Code Ann. Tax-Gen §10-703. Section 4 provides for a credit against the local tax for taxes paid to another state, assuming the total allowable credit is not used against the state tax. Section 26 states that §4 only becomes effective if the *Wynne* decision invalidates Maryland law only permitting a credit against the state tax.

[76] *Id.* Section 27 provides that the state's reserve fund be used to pay *Wynne* refunds and requires the counties to reimburse the state based on each county's proportionate share of the refunds issued. For jurisdictions that do not reimburse the reserve fund the Comptroller is to withhold the reimbursement ratably over the next nine quarterly income tax distributions those localities receive from the state.

[77] Md. S.B. 172 (2014), amending Md. Code Ann. Tax-Gen §13-604.

[78] In a letter to then Maryland Governor Martin O'Malley dated May 14, 2014, then Attorney General Douglas Gansler stated that the limited application of the reduced interest rate is constitutional and legally sufficient because the Maryland Court of Appeals has stated on numerous occasions that the entitlement to interest on a tax refund is a matter of grace which can only be authorized by legislative enactment and thus determining the interest rate is perfectly acceptable exercise of legislative power.

[79] *Comptroller v. Wynne*, FAQs, Maryland Comptroller's Office, July 3, 2015.

[80] *See* Springuel, *Maryland Governor, Comptroller Laud 'Wynne' as Taxpayer Win*, 189 Daily Tax Rep. H-2 (Sept. 30, 2015).

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tion of the case,[81] the Comptroller will process the refund requests with no further action required by taxpayers.

Others seeking a refund must file an amended return attaching a newly created Form 502LC (State and Local Tax Credit for Income Taxes paid to Other States and Localities) to calculate the credit offsetting the county tax. Amended returns must be filed within the normal statute of limitations period, i.e., three years from the time a return was filed or two years from the time the tax was paid, whichever is later.[82] A separate claim must be filed for each year a refund is requested. Thus, an individual who previously filed a Maryland individual income tax return (Form 502) would in addition to an amended return (Form 502X) attach a revised credit form (Form 502CR) and the new Form 502LC. If a credit is being claimed for taxes paid to more than one state or locality, a separate Form 502LC must be completed for each state or locality, as well as a summary Form 502LC totaling the state and local credits being claimed. The Comptroller's guidance makes clear that the credit is available for income taxes paid to local jurisdictions in other states, as well as the income tax paid to other states.

IMPACT OF DECISION UPON OTHER STATES

In making clear that to be constitutional a state's tax must be internally consistent, the Court in *Wynne* takes a step forward in distinguishing the permissible exercise of tax sovereignty from impermissible tax discrimination. Most recently, the Court on October 13, 2015, granted certiorari to *First Marblehead Corporation v. Massachusetts Commissioner of Revenue*[83] regarding whether the state's financial institution excise tax violates the dormant Commerce Clause. However, the Court promptly vacated and remanded the case back to the Supreme Judicial Court of Massachusetts for further consideration in light of *Wynne*. Massachusetts denied Marblehead the ability to apportion certain purchased loan portfolios to a state other than Massachusetts for purposes of computing its property factor in deriving its Massachusetts tax base. While the Massachusetts high court applied the internal consistency test to determine if the tax violated the dormant Commerce Clause, it concluded there was internal consistency simply because there was no double taxation. *Wynne* now makes clear that the internal consistency test requires a hypothetical replication of the Massachusetts tax in every state, a test that goes beyond whether actual double taxation results from the tax in question.

While the Due Process Clause does not forbid multiple taxation of personal income, the dormant Commerce Clause prohibits multiple taxation unless the tax is internally consistent, a test met by most states through the grant of a credit for out-of-state income tax conditioned upon the other state granting a similar credit for their residents, i.e., reciprocity.[84] Credit is only granted with regard to income taxed in both states and the credit is limited to the lesser of out-of-state tax or the resident state's tax on the out-of-state income.[85]

However, there are many states and counties that do not grant a dollar-for-dollar credit to their residents for all income taxes paid in other jurisdictions. An amicus brief in *Wynne* filed by the International Municipal Lawyers Association cite the following examples:

- Wisconsin and North Carolina both provide credits for state-level nonresident income taxes but not credits for city, county and local income taxes imposed on nonresidents;
- In 2011, the Tennessee Court of Appeals denied a credit for income taxes paid to South Carolina by a Tennessee resident on Subchapter S income reasoning that Tennessee and South Carolina did not have tax reciprocity;[86]
- Massachusetts disallows any deduction for out-of-state gross receipt taxes paid;
- Nonresidents of Pennsylvania cannot credit against the Philadelphia earnings tax income taxes paid to any other state or political subdivision;
- Ohio municipal income taxes provide no credit for any personal income tax paid to other states or localities.

Although *Wynne* does not address the validity of other taxes beyond the Maryland county income tax, it raises an issue about the constitutionality of the above taxes as well as any other state and local income tax based on residence that does not permit a credit for out-of-state taxes based on source.

An additional issue arises where two states each consider an individual to be a resident and whether one or the other must recede taxing jurisdiction or grant a credit for taxes paid to the other state. For example, New York defines a resident not only as someone domiciled in the state but also an individual who has a ''permanent place of abode'' in New York and spends more than 183 days in the state during the year.[87] Consequently, an individual may be a resident of New York under the 183-day test and at the same

[81] Pursuant to Maryland Administrative Release No. 20, Sept. 2009, taxpayers filed protective claims by filing an amended return claiming the credit against the county tax but then request the Comptroller to delay action on the refund claim until resolution of the *Wynne* case.

[82] Md. Code Ann. Tax-Gen §13-1101(a).

[83] 470 Mass. 497 (2015).

[84] CCH All States Guide ¶16-825.

[85] Hellerstein, *et al.*, *State Taxation*, 3d ¶20.10.

[86] *Boone v. Chumley*, 372 S.W.3d 104 (Tenn. Ct. App. 2011).

[87] N.Y. Tax Law §605(b)(1)(B). See Tax Bulletin IT-690, Dec. 15, 2011, describing the meaning of ''permanent place of abode.''

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time be a resident in his or her state of domicile, potentially exposing the person to tax on his or her worldwide income in both states. New York addresses this problem by granting a credit to a dual resident if the other state of residency does not grant such a credit to its residents.[88] But if the other state also adopts this rule it remains unclear on which state return the credit should be claimed.

An additional problem arises where a state only grants the credit when the double taxed income is actually earned from activities in the state of nonresidency. For example, New York grants a credit to its residents for taxes paid to other states, but the income on which those taxes are paid must be ''derived'' from those states.[89] Therefore, a credit is unavailable for taxes paid to another state on income received from stock, bonds and other investment property because such income cannot be identified as derived from activities in any specific state. The disallowance of a credit for out-of-state taxes on such intangible property was addressed by New York's Court of Appeals in *In the Matter of John Tamagni v. Tax Appeals Tribunal of the State of New York*.[90] Relying on the dicta of *Goldberg v. Sweet*[91] the Court of Appeals held the dormant Commerce Clause did not apply to income taxes based on an individual's residence because such taxes were not imposed on any interstate activity but rather on a purely ''local'' circumstance of the taxpayer being a New York resident.[92] With *Wynne* rejecting the dicta in *Goldberg v. Sweet* and holding that the dormant Commerce Clause applies to personal income taxes based on residency, the *Tamagni* decision is now questionable.

Tamagni also held that even if the dormant Commerce Clause applied to New York's tax scheme the internal consistency test was not applicable because the tax at issue was imposed on a purely ''local'' activity, not implicating the Commerce Clause and the tests of *Complete Auto* including internal consistency. Given that New York's denial of a credit for out-of-state taxes paid by its residents mirrors Maryland's law that *Wynne* held was, in fact, subject to the internal consistency test, the *Tamagni* decision denying such credits may soon be challenged.

Finally, *Wynne* affirms the principle that for constitutional purposes there is no distinction between state and local taxes.[93] Thus, cities and other localities that impose an income tax on the worldwide income of their residents without giving credit for income taxes paid by their residents to other states are likely in violation of the dormant Commerce Clause and its internal consistency test. For example, while residents of New York City are subject to the city's income tax on their worldwide income, no credit is permitted for taxes paid to other jurisdictions. Like New York State, New York City defines a resident to include both those domiciled in the city as well as those with a permanent abode and present in the city for more than 183 days.[94] Therefore, New York City residents, like New York state residents, may be taxed twice if they are residents of the city and another jurisdiction. But, unlike Maryland and New York State, New York City does not tax nonresidents so that the ruling in *Wynne* is not directly applicable. Therefore, because nonresidents of the city are not subject to the city tax, the city's tax regime, unlike the state's, is more likely to be internally consistent.[95]

CONCLUSION

Wynne makes clear that while the Constitution requires state taxes to be internally consistent, there is no mandate that this test be met by an order of priority where a state basing its tax on residence recede its taxing jurisdiction to a state basing its tax on source. Nevertheless, as illustrated by Maryland immediately after the decision amending its law to permit a credit for out-of-state taxes against the county tax, it is highly unlikely states will choose any other alternative to bring their tax regimes into compliance with the internal consistency test.

Wynne also discards any distinction between taxes on gross receipts and taxes on net income for purposes of meeting the dormant Commerce Clause as well as any contention that the dormant Commerce Clause provides less protection to individuals than corporations. Finally, *Wynne* repudiates any notion that the Commerce Clause does not protect residents from their own state taxes.

Like so many constitutional cases, *Wynne* addresses the limits of governmental authority over citizens, in this case interpreting the limits of state taxing authority over residents of a state. The Ginsburg dissent, based more on policy than law and the Scalia and Thomas dissents, based on an originalist approach to constitutional interpretation, fail, in the authors' opinion, to appreciate the majority's reliance on well-established precedents that call for deference in the absence of compelling societal needs. In short, Justice Alito and the majority got it right and prevented the economic chaos that might have erupted if states, desperate for revenue, could have repealed their credits for out-of-state taxes.

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[88] See Instructions for N.Y. Form IT-112-R, New York State Resident Credit, stating that for dual state residents, New York does not allow a credit if the other jurisdiction allows a credit against its tax for the total resident tax paid to New York.

[89] N.Y. Tax Law §620(a).

[90] 91 N.Y.2d 530, 695 N.E.2d 1125 (N.Y. 1998).

[91] 488 U.S. 252 (1989).

[92] Similarly, the Supreme Court of Connecticut has held that the dormant Commerce Clause does not invalidate Connecticut's failure to allow a credit for income taxes paid out of state. *Chase Manhattan Bank v. Gavin*, 733 A.2d 782 (Conn. 1999).

[93] *Frey v. Comptroller of the Treasury*, 29 A.3d 475 (Md. 2011). *See* Hellerstein, *et al.*, *State Taxation* 3d ed. ¶19.02[9].

[94] *See* Instructions for N.Y. Form IT-201, Full-Year Resident Income Tax Return, p. 35, stating the definition of a New York City resident is the same as for a New York State resident.

[95] For a general discussion of *Wynne's* impact on New York's tax regime, *see* Rosen, *Wynne, Cloud Computing and a States Deference to Another*, State Tax Notes (June 8, 2015) 745.

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