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No. 13-485

IN THE

Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,

v.

BRIAN WYNNE, *ET UX*.
Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF THE AMERICAN LEGISLATIVE EXCHANGE COUNCIL AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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STATEMENT OF INTEREST [1]

The American Legislative Exchange Council (ALEC) is the nation's largest non-partisan individual membership association of state legislators. ALEC has approximately 2,000 members in state legislatures across the United States. The American Legislative Exchange Council works to advance limited government, free markets and federalism at the state level through a nonpartisan public-private partnership of America's state legislators, members of the private sector and the general public.

ALEC believes that power dynamics between states require careful consideration. This includes the fundamental principle of equal state sovereignty. The power to tax is a necessary incident of state sovereignty. When interstate commercial transactions are at issue, a principled approach is needed that affirms sovereign equality of states to tax while reconciling potential conflicts between state taxing powers and preventing undue burdens on such transactions.

According to the *ALEC Principles of Taxation*, states that follow certain fundamentals of tax policy are more likely to produce economic growth while minimizing political favoritism by state taxing authorities. Among other things, "[a]n effective tax system should be broad-based, utilize a low overall tax rate with few loopholes, and avoid multiple layers of taxation

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[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from amicus curiae, their members, and their counsel, made any monetary contribution toward the preparation or submission of this brief. Counsel of record for all parties have consented to this filing in letters on file with the Clerk's office.

through tax pyramiding."[2] A tax system premised on equity and fairness should not be used to "engage in discriminatory or multiple taxation, nor should it be used to bestow special favors on any particular group of taxpayers."[3]

ALEC believes state tax policy should also be guided by the principle of competitiveness:

> A low tax burden can be a tool for a state's private sector economic development by retaining and attracting productive business activity. A high-quality revenue system will be responsive to competition from other states. Effective competitiveness is best achieved through economically neutral tax policies.[4]

ALEC recognizes that states are rivals in an interstate competition for jobs and growth. As ALEC policy acknowledges, "state legislatures have designed their individual state tax structure to meet the needs of their in-state businesses, thereby distinguishing their state from, and competing directly with, other states."[5] ALEC has also published *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index* to

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[2] ALEC, *ALEC Principles of Taxation* (2010), *available at*: http://www.alec.org/model-legislation/statement-alec-principles-of-taxation/.

[3] *Id.*

[4] *Id.*

[5] ALEC, *Resolution to Oppose the Multistate Tax Commission's Effort to Rewrite the Uniform Division of Income for Tax Purposes Act* (2014), *available at*: http://www.alec.org/model-legislation/resolution-oppose-multistate-tax-commissions-effort-rewrite-uniform-division-income-tax-purposes-act/.

highlight the importance of state taxation policy in assessing state economic competitiveness. [6]

It is ALEC's view that a fair apportionment requirement, such as the one expressed in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), is necessary to protect the taxing power of equal sovereign states. Fair apportionment also safeguards interstate tax competition by limiting multiple taxation of interstate commerce and by checking unjustifiable extraterritorial state taxation.

The purpose behind fair apportionment is *not* to limit the taxing powers of states as such. Nor is the purpose to reduce taxing powers in the states vis-à-vis the federal government. Ultimately, the purpose of fair apportionment is to reconcile the concurrent taxing authority of all states regarding interstate commercial transactions.

SUMMARY OF ARGUMENT

The American Legislative Exchange Council believes the Court of Appeals of Maryland correctly applied the requirement that a state's taxation of interstate commercial transactions be fairly apportioned to those activities in the state taxing jurisdiction. *See Maryland State Comptroller of Treasury v. Wynne*, 64 A.3d 453 (Md. 2013). *Amicus* offers this brief to address how federalism's system of political sovereignty and political economy is implicated in the fair apportionment requirement set

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[6] *See* Arthur B. Laffer, Stephen Moore & Jonathan Williams, *Rich States Poor States: ALEC-Laffer State Economic Competitiveness Index* (7th ed.) (2014), *available at*: http://alec.org/docs/RSPS_7th_Edition.pdf.

out by this Court in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

First, fair apportionment comports with federalism's system of political sovereignty by ensuring the harmonious concurrent exercise of state taxing power over interstate commerce. The Constitution's structure and this Court's jurisprudence recognize the fundamental principle of equal sovereignty among states. *Shelby County, Alabama v. Holder*, — U.S. —, 133 S.Ct. 2612, 2623 (2013). The equal sovereignty of the states generally prohibits states from imposing their own laws and taxes on their sister states. *See, e.g.*, *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982). This fundamental principle is an underpinning of the Court's dormant Commerce Clause jurisprudence, in particular. *Healy v. Beer Institute*, 491 U.S. 324, 335-336 (1989). An unfair apportionment of taxing revenue from interstate commercial transactions to one state at the expense of another state constitutes a particularly odious burden on interstate commerce. In important respects, the fundamental principle of equal state sovereignty is safeguarded by the requirement of fair apportionment of state taxation of interstate commerce. Fair apportionment reconciles the sovereign taxing power of states over interstate commerce by prohibiting impermissible extraterritorial state taxation. Fair apportionment also restricts excessive, multiple taxation of interstate transactions.

Second, fair apportionment comports with federalism's system of political economy by safeguarding interstate tax competition. In today's dynamic world of increasingly mobile capital, businesses, and people, states are in competition with one another to provide the best economic climate possible to foster economic

growth. This economic competition between the states is one of the ingenious by-products of our federalist system.

States frequently vie with one another to have the most tax friendly environment to attract new residents and businesses to move to or conduct business in their state. This is especially true for those states with structural disadvantages such as poor climate, limited natural resources, or no access to ports, for whom the tax code is an invaluable tool to compete with other states. Over the years, the differentiation in state tax rates has had a staggering influence on our nation's demographics and the state's economic growth.

The Court's "external consistency" test for analyzing fair apportionment of state taxation of interstate commerce properly limits states taxing powers to their own respective jurisdictions. *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 US. 175, 185 (1995). Under the external consistency test, the Court considers whether the state has taxed only that portion of revenues from interstate activity that reasonably reflects its in-state component. *Id*. It ensures states only tax the value of interstate commercial transactions properly attributable to them. Under the external consistency test, taxation of an amount beyond the state's fair share of the interstate commercial activity involved is an impermissible form of extraterritorial taxation. By restricting states from making unwarranted tax grabs from interstate commerce, the fair apportionment requirement helps preserve the ability of states to establish their own competitive marketplaces.

In addition, the Court's "internal consistency" test for analyzing fair apportionment, directed at multiple taxation on interstate commerce, safeguards

interstate tax competition. *Id*. Under the internal consistency test, the Court considers whether the tax at issue, if applied by every state, would disadvantage interstate commerce. *Id*. Multiple taxation harms both states with economically hospitable tax environments and those that do not impose double taxation. The competitiveness of tax-friendly states is undermined to the extent their sister states impose multiple taxes on interstate commercial activities and show favoritism toward in-state commerce.

ARGUMENT

I. THE REQUIREMENT THAT TAXES ON INTERSTATE COMMMERCE BE FAIRLY APPORTIONED TO TAXPAYERS' ACTIVITIES IN THE TAXING STATE SAFEGUARDS STATE EQUALITY AND STATE TAX COMPETITION

Important federalism concerns of both a constitutional and practical nature are implicated by the requirement that a state's taxation of interstate commercial transactions be fairly apportioned to those activities in the state taxing jurisdiction.

Under the test set out in the leading case of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, (1977), a state tax will survive a challenge under the dormant Commerce Clause if it: (1) applies to an activity with a substantial nexus with the taxing state; (2) is fairly apportioned; (3) is not discriminatory towards interstate or foreign commerce; and (4) is fairly related to the services provided by the State. *Id*. at 279.

As will be briefly explored below, fair apportionment comports with federalism's system of political

sovereignty by ensuring the harmonious concurrent exercise of state taxing power over interstate commerce. In addition, fair apportionment comports with federalism's system of political economy by ensuring interstate tax competition through limits on multiple taxation and extraterritorial taxation.

A. The Doctrine of State Equality Implies that States May Only Tax Their Fair Share of Interstate Commercial Transactions

1. The Equal Sovereignty of States is a Fundamental Principle of the Constitution

"[T]he Constitution, in all of its provisions, looks to an indestructible Union, composed of indestructible States." *Texas v. White*, 74 U.S. (7 Wall.) 700, 725 (1869). The States entered the Union as equal sovereigns, and they retain their equal status under the Constitution. "'This Union' was and is a union of States, equal in power, dignity and authority, each competent to exert that residuum of sovereignty not delegated to the United States by the Constitution itself." *Coyle v. Smith*, 221 U.S. 559, 567 (1911).

Implied in the Constitution's basic structure and reflected in this Court's jurisprudence is the "'fundamental principle of *equal* sovereignty'" among the States." *Shelby County, Alabama v. Holder*, — U.S. —, 133 S.Ct. 2612, 2623 (2013); *Northwest Austin Municipal Utility Dist. Number One v. Holder*, 557 U.S. 193, 203, (2009) (citing *United States v. Louisiana*, 363 U.S. 1, 16, (1960); *Lessee of Pollard v. Hagan*, 44 U.S. (3 How.) 212, 223, (1845); and *White*, 74 U.S. (7 Wall.) at 725-726) (emphasis added). Indeed, "the constitutional equality of the States is

essential to the harmonious operation of the scheme upon which the Republic was organized." *Shelby County*, 133 S.Ct. at 2623; *Coyle*, 22 U.S. at 580.

On the one hand, the equal sovereignty of states generally prohibits federal legislation that differentiates between the states. *Holder*, 557 U.S. at 203; *South Carolina v. Katzenbach*, 383 U.S. 301 328-329 (1966). Justification must therefore be supplied for departing from the requirement that states be treated alike, since "the fundamental principle of equal sovereignty [is] highly pertinent in assessing subsequent disparate treatment of States." *Shelby County*, 133 S.Ct. at 2623; *Holder*, 557 U.S. at 203.

On the other hand, the equal sovereignty of the states generally prohibits states from imposing their own laws and taxes on their sister states. *See*, *e.g*., *BMW of N. Am. Inc. v. Gore*, 517 U.S. 559, 571 (1996) ("No state could . . . impose its own policy choice on neighboring states."); *Bonaparte v. Tax Court*, 104 U.S. 592, 594 (1881) ("No state can legislate except with reference to its own jurisdiction . . . Each state is independent of all the others in this particular"); *ASARCO, Inc. v. Idaho State Tax Comm'n*, 458 U.S. 307, 315 (1982) ("As a general principle, a state may not tax value earned outside its borders").

2. The Equal Sovereignty of States Informs Dormant Commerce Clause Limits on State Taxation

This case turns upon principles and considerations addressed by this Court's dormant Commerce Clause jurisprudence. The Constitution's fundamental principle of equal state sovereignty is an underpinning of that jurisprudence. *Healy v. Beer Institute*, 491 U.S. 324, 335-336 (1989) (the Constitution has a "special

concern with both the maintenance of a national economic union unfettered by state-imposed limitations on interstate commerce and with autonomy of the individual States within their respective spheres"); *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 775 (1945) (striking down a state law on Commerce Clause grounds where the "practical effect of such regulation is to control [conduct] beyond the boundaries of the state…"). Whenever State A asserts its taxing authority over interstate commercial transactions in which State B already has an equal or stronger connection for taxing purposes, there is a risk of State A encroaching upon the sovereignty of State B. An unfair apportionment of taxing revenue from interstate commercial transactions to one state at the expense of another state constitutes a particularly odious burden on interstate commerce.

3. *Fair Apportionment is Necessary to Reconcile Potentially Conflicting Exercises of Taxing Power by Equal Sovereign States*

When interstate commerce is involved, the sovereign powers of states to tax may clash. The power to tax is an inherent incident of state sovereignty. *See M'Culloch v. Maryland* at 4 (Wheat) U.S. 316, 329 (1819). The equal sovereignty of states therefore requires that each continue to exercise their own respective powers to tax while nonetheless remaining free from undue interference by other states' tax policies. In important respects, the fundamental principle of equal state sovereignty is safeguarded by the requirement of fair apportionment of state taxation of interstate commerce.

"The central purpose behind the apportionment requirement is to ensure that each State taxes only its

fair share of an interstate transaction." *Goldberg v. Sweet*, 488 U.S. 252, 260-261 (1989) (citing *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983)). As the Court explained in *Trinova Corp. v. Dept. of Treasury*, the Commerce Clause prohibits the "competitive mischief" posed by "the opportunity for a state to export tax burdens and import tax revenues" where no justification for apportionment exists. 498 U.S. 358 374 (1991). Fair apportionment thereby reconciles the sovereign taxing power of states over interstate commerce by prohibiting impermissible extraterritorial state taxation. Fair apportionment also restricts excessive, multiple taxation of interstate transactions. Indeed, "[t]his principle of fair share is the lineal descendant of *Western Live Stock* [*v. Bureau of Rev.*]'s prohibition of multiple taxation, which is threatened whenever one State's act of overreaching combines with the possibility that another State will claim its fair share of the value taxed: the portion of value by which one State exceeded its fair share would be taxed again by a State properly laying claim to it." *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 US. 175, 184-185 (1995) (citing 303 U.S. 250 (1938)). The fair share principle ensures each equal sovereign state receives nothing more or less than its fair share of tax revenues.

Accordingly, to the extent certain *amici* contend that the test set out in *Complete Auto Transit* does not apply, Multistate Tax Comm'n Br. at 7, 10-11; Int'l Municipal Lawyers Assoc. *et al*. Br. at 24-26, ALEC believes they are mistaken in their reading of this Court's jurisprudence and doubly mistaken in disregarding the principle of sovereign state equality that is safeguarded by the fair apportionment

requirement. *See*, *e.g.*, Int'l Municipal Lawyers Assoc. *et al*. Br. at 6, 21-22.

Finally, ALEC is aware of thoughtful skepticism that has been voiced with respect to this Court's dormant Commerce Clause jurisprudence, and it formulation of the *Complete Auto Transit* test. *See*, *e.g.*, *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 610-620 (1997) (Thomas, J., dissenting); *Jefferson Lines*, 514 US. at 200-201 (Scalia, J., concurring in judgment). To the extent that skepticism over all or parts of this Court's dormant Commerce Clause jurisprudence remains, ALEC respectfully submits that the fundamental principle of state sovereign equality offers a stand-alone basis for a workable fair apportionment requirement of state taxation of interstate commerce.

B. The Ability of States to Pursue Competitive, Tax-Friendly Economic Climates Requires that States Only Tax Their Fair Share of Interstate Commercial Transactions

1. Interstate Tax Competition is a Critical Aspect of Interstate Commerce

In today's dynamic world of increasingly mobile capital, businesses and people, states are in competition with one another to provide the best economic climate possible to foster economic growth. This economic competition between the states is one of the ingenious by-products of our federalist system.

States frequently vie with one another to have the most tax-friendly environment to attract new residents and businesses to move to or conduct business in their state. This is especially true for those states with structural disadvantages such as poor

climate, limited natural resources or no access to ports, for whom the tax code is an invaluable tool to compete with other states. Over the years, the differentiation in state tax rates has had a staggering influence on our nation's demographics and the state's economic growth.

In *Rich States, Poor States: ALEC-Laffer State Economic Competitiveness Index*, Arthur B. Laffer, Stephen Moore and Jonathan Williams examined population movements across state boarders by a number of measures and also examined how those movements related to state economic climates and pro-growth tax and fiscal policies. Looking at adjusted gross income figures, for example, the authors cited Travis Brown, author of *How Money Walks*. According to Brown, $2.2 trillion dollars in adjusted gross income has migrated from one state to another from 1992 to 2011.[7] In addition, according to IRS tax return filing data regarding net domestic migration, during that same time period roughly 62 million taxpayers moved from one state to another.[8] By means of extensive statistical analysis, the authoring economists of *Rich States, Poor States* demonstrate that these migrations are strongly connected with tax policy, and that billions of dollars and millions of Americans have fled higher tax states for those with more tax-friendly climates.

Although there are many factors contributing to a state's economy which cannot be managed, tax and fiscal policy factors are solidly in the control of the state's policymakers. A state cannot vote for warmer weather, more oil reserves or a nice coastline, but

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[7] *Id.* at 22.

[8] *Id.*

policymakers can make sure that there is more capital in the hands of businesses and citizens, and can make it easier for them to save, earn and invest.

2. *Interstate Tax Competition is Safeguarded by Fair Apportionment Restrictions on Multiple and Extraterritorial Taxation*

The requirement that state taxation of interstate commercial transactions be fairly apportioned to activities within the taxing state safeguards interstate tax competition. This can be most readily seen with regards to the fair apportionment analytical test for external consistency, which addresses impermissible exterritorial taxation.

This Court "determine[s] whether a tax is fairly apportioned by examining whether it is internally and externally consistent." *Goldberg*, 488 U.S. at 261. The "internal consistency" test, "simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate." *Jefferson Lines*, 514 U.S. at 185.

"The external consistency test asks whether the state has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 462. In analyzing whether a state tax on interstate commerce is externally consistent, the Court "looks not to the logical consequences of cloning, but to 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 economic activity

within the taxing state." *Jefferson Lines*, 514 U.S. at 185.

In effect, the external consistency test confines the states' taxing powers to their own respective jurisdictions. It ensures that states will only tax the value of interstate commercial transactions to the extent that they are properly attributable to them. Under the external consistency test, taxation of an amount beyond the state's fair share of the interstate commercial activity involved is an impermissible form of extraterritorial taxation.

The viability of interstate tax competition depends upon states' autonomy to pursue pro-growth, tax-friendly policies without having that autonomy being subverted by foreign state taxing authorities seeking lucrative sources of revenue. Extraterritorial state taxation undermines the ability of other states to exercise their own taxing powers in ways that attract capital investors, entrepreneurs, innovators and other growth and job creators.

By restricting states from making unwarranted tax grabs from interstate commerce, the fair apportionment requirement helps preserve the ability of states to establish their own competitive marketplaces. The external consistency test helps guarantee states may pursue pro-growth, tax-friendly policies free from undue interference by extraterritorial state tax adventurism.

Of course, the "internal consistency" test, which is directed at multiple taxation on interstate commerce, also provides a safeguard function for interstate tax competition. As mentioned above, under the internal consistency test, the Court considers whether the tax at issue, if applied by every state, would put

interstate commerce at a disadvantage vis-à-vis intrastate commerce. *See Jefferson Lines*, 514 U.S. at 185.

If every state were to tax its residents full income, wherever earned, without a *full* tax credit for income taxes already paid to other states, as Maryland does, interstate commerce would be placed at a significant disadvantage compared to intrastate commerce. This would result in a profound negative effect on the national economy. In the absence of such double taxation, individual workers and owners of S corporations are unhindered from operating in their home state, or in other states, as they find to be most productive, while taking into account the various tax rates on personal income that states offer to compete for their labor and business. This efficiency maximizes their benefit to society in terms of goods and services provided to the public, their personal income and, for S corporations, their profitability and potential for job creation.

However, if every state provided less than full tax credits for personal income paid to other states, workers and owners of S corporations would face double taxation whenever they engage in interstate commerce. The incentive would be for them to keep their activities within the confines of their state and avoid double taxation, producing a chilling effect on interstate commerce. Decisions to work across state lines or open new locations in other states would all carry significant additional tax penalties that would artificially divert workers and S corporations from making what would otherwise be the best economic decisions. As an effect, profitability would decrease, job creation would be slowed and the availability of out of state labor, products and services to those living in the rest of the country would be diminished. This

reduction in competition in the national marketplace will lead to less choice for consumers and increased costs of products and services.

In short, the adoption of Maryland's double taxation nationwide would result in much more intrastate commerce, at the expense of far less interstate commerce, and lead to tremendous economic disruption and inefficiency. This would be devastating for all Americans because all Americans benefit from interstate commerce, not just those who earn income from multi-state S corporations like the Wynne's.

On a state level, multiple taxation harms both those states that have adopted economically hospitable tax environments and those that do not themselves double tax resident income by failing to provide a full tax credit for income taxes paid to other states. Where commerce is subject to extra taxation simply because it crosses state lines, tax-friendly states lose out of state workers and business opportunities from other states. Some who used to drive across state lines to do some work in another state will stop, certain businesses that wanted to open a branch in the neighboring state won't, and the tax friendly state will suffer the ill effects of its neighbor's double taxation.

While citizens and businesses can and do "vote with their feet" and re-locate to states with more hospitable tax climates, the competitiveness of those tax-friendly states is undermined to the extent their sister states impose multiple taxes on interstate commercial activities and thereby act with favoritism toward in-state commerce. *See New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-274 (1988) ("[t]he modern law of what has come to be called the dormant Commerce Clause is driven by concern about

'economic protectionism'—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.")

CONCLUSION

For the reasons set forth above, *amicus curiae* American Legislative Exchange Council respectfully requests that the Court affirm the decision of the Maryland Court of Appeals.

Respectfully submitted,

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