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 *AMICUS CURIAE* OF COUNCIL ON STATE TAXATION IN SUPPORT OF RESPONDENT

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TABLE OF CONTENTS

TABLE OF CONTENTS—Continued

TABLE OF AUTHORITIES

CASES Page(s)

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

TABLE OF AUTHORITIES—Continued

Page(s)

INTEREST OF *AMICUS CURIAE* [1]

Council On State Taxation ("COST") is a non-profit trade association formed in 1969 to promote equitable and nondiscriminatory state and local taxation of multijurisdictional business entities. COST represents nearly 600 multistate businesses in the United States, including companies in numerous industries. As *amicus*, COST has participated in many of the significant tax cases to come before this Court in recent years, including: *Direct Marketing Association v. Brohl*, 735 F.3d 904 (2013), *petition for cert. granted*, No. 13-1032 (Jul. 1, 2014); *Levin v. Commerce Energy*, 560 U.S. 413 (2010); *CSX Transportation, Inc. v. Alabama Dep't of Rev.*, 131 S.Ct. 1101 (2010); *Polar Tankers, Inc. v. City of Valdez*, 557 U.S. 1 (2009); and *MeadWestvacoCorp. v. Illinois Department of Rev.*, 553 U.S. 16 (2008). COST has also advocated for federal legislation, the Mobile Workforce State Income Tax Simplification Act of 2013 (S. 1645/H.R. 1129), to mitigate the issues facing both employees and their employers when employees earn income in multiple states.

COST's membership has a vital interest in ensuring states do not impede the rights of all businesses to engage in commerce in the national market. To that end, it is important to COST members that states provide fair apportionment or credits for taxes paid to their resident businesses for income earned and taxed

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity other than *amicus curiae* has made a monetary contribution to the preparation or submission of this brief. The parties received timely notice of *amicus's* intent to file this brief. Written consent of all parties to the filing of this brief has been filed with the Clerk of this Court.

in other states. Maryland's denial of credits for the county portion of its income tax on resident taxpayers who paid taxes on the same income in other states creates a regime of double taxation and impedes businesses from participating in the national market. The Commerce Clause prohibits multiple or discriminatory taxation of interstate commerce. *Amicus* believes resident taxpayers should not suffer double taxation on income earned out of state.

STATEMENT OF THE CASE

This case concerns a decision by the Maryland Court of Appeals holding the State's income tax law discriminates against interstate commerce in violation of the Commerce Clause of the U.S. Constitution.[2] *Maryland State Comptroller of Treasury v. Wynne*, 64 A.3d 453 (2013).

Respondents Brian and Karen Wynne (the Wynnes) are Maryland residents that filed a joint income tax return in Maryland for the year at issue. Pet. for Cert. 3. Mr. Wynne is a shareholder of an S corporation, Maxim Health Services Inc. (Maxim). In the year at issue, the Wynnes earned income from two sources: their salaries and Mr. Wynne's flow-through share of Maxim's income based on his 2.4 percent ownership of the company. Pet. for Cert. App. 56, 86. As residents, the Wynnes paid Maryland income tax in full on their salary income (without credits). They did not pay an income tax on it to any other state.

Maryland follows federal law and treats this income from Maxim (and other pass-through entities) as though the owners "realized [the income] directly from the source from which [it was] realized by the

[2] U.S. CONST. art. I, § 8, cl. 3.

corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C. § 1366(b), MD. CODE ANN., TAX-GEN. § 10-107. When filing their joint return in Maryland, the Wynnes claimed credits for taxes paid in 38 other states on income earned by Maxim in those states. Pet'r Br. 5 (hereafter "Comptroller's Br."); Resp't's Br. in Opp. 7 (hereafter "Wynne Br."). Nonresident owners of a pass-through entity doing business in Maryland are taxed on their pass-through income sourced to Maryland based on the entity's (Maxim's) apportionment formula.[3] However, for residents, Maryland taxes 100 percent of their share of a pass-through entity's income on a non-apportioned basis. Maryland provides a partial income tax credit to resident taxpayers who pay income tax to another state. MD. CODE ANN., TAX-GEN. § 10-703.

When claiming a credit for taxes paid in other states, the Wynnes were only allowed to claim a credit against Maryland's state tax rate of 4.75%, but not the 3.2% county portion of the tax. The Comptroller asserts Maryland has no duty to provide a tax credit to its residents, but rather Maryland's law provides the state-level credit merely as a matter of legislative grace. Comptroller's Br. 23-24. The result is that income earned out of state is potentially taxed 40% higher than income earned in Maryland.

The Wynnes challenge the constitutionality of the Comptroller's practice of assessing state income tax without providing a credit for taxes paid in other

[3] Nonresident owners of a pass-through entity doing business in Maryland are subject to tax based on a three-factor apportionment formula including property, payroll, and double-weighted sales. MD. CODE REGS. § 03.04.03.08.

states. The Wynnes argue this double taxation violates the Commerce Clause by discriminating against interstate commerce. The Maryland Tax Court ruled in favor of the Comptroller. Pet. for Cert. App. 140-41. The Circuit Court reversed. The Maryland Court of Appeals upheld that reversal, finding Maryland's failure to provide the Wynnes with full credit against income previously taxed in another state "violates the dormant Commerce Clause and the federal Constitution." *Id*. at 32.

SUMMARY OF THE ARGUMENT

This case provides this Court with an opportunity to reinforce the Commerce Clause's prohibition on purposeful multiple taxation of income earned in more than one state. Under the Due Process Clause, a state may impose an income tax on 100 percent of its resident's income. However, this authority must withstand Commerce Clause scrutiny—intrastate commerce cannot be favored to the detriment of interstate commerce under the test set forth in *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977).

For purposes of a state corporate income tax, states commonly adopt formulary apportionment to avoid double taxation of income earned in more than one state. In contrast, states that impose an individual income tax uniformly offer a credit for taxes paid to other states to avoid double taxation of income earned in more than one state. However, Maryland allows only a partial credit for taxes paid to other states—which in this case only provided a credit for approximately three-fifths of the taxes paid to other states. This outcome violates the Commerce Clause by imposing a greater tax on income derived from interstate commerce than from intrastate income. The

Maryland partial tax credit system utterly fails the second and third prongs of the *Complete Auto* test.

The Commerce Clause protection against multiple taxation is not dependent on: 1) the taxpayer's choice of business entity, or 2) the type of income tax a state chooses to employ. To hold otherwise in this case means there are two Commerce Clauses—one for entities subject to a state's corporate income tax and another for entities subject to a state's individual income tax. In the case of the former, the Commerce Clause would prohibit discrimination against interstate commerce, but in the case of the latter, the Commerce Clause would offer no such prohibition.

Given the rapid growth of business taxation under the individual income tax over the last three decades, this disparity in treatment would leave over 90 percent of all business entities (*e.g*., S corporations, partnerships and sole proprietorships)—which account for over 40 percent of all income taxes on business income[4]—outside the protection of the Commerce Clause's prohibition against double taxation.

This result would unravel one of the primary reasons why the Commerce Clause was included in the U.S. Constitution—to prevent states from favoring local commerce over interstate commerce.

[4] Annette Nellen, *Data on Different Types of Business Entities*, http://www.cob.sjsu.edu/facstaff/nellen_a/Data_Different_Types_Business_Entities.pdf (Based on IRS, Integrated Business Data).

ARGUMENT

I. THE DORMANT COMMERCE CLAUSE'S PROHIBITION AGAINST DISCRIMINATORY TAXATION OF INTERSTATE COMMERCE APPLIES TO THE STATES' INDIVIDUAL INCOME TAXES

In invoking the formalism of the line of cases from *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1951), the Comptroller repeatedly claims that the "Maryland tax scheme is based on the status of residency, not on any particular income earning activity in Maryland." Comptroller's Br. at 9 and 16, citing *Freeman v. Hewit*, 329 U.S. 249, 255 (1946). Maryland's controversial individual income tax system is not a tax on an individual's "status" as a resident of the State. Both Maryland residents and nonresidents earning income sourced to Maryland are subject to Maryland's individual income tax. Simply put, the "income tax" is measured by income. As this Court observed, "[a] tax on sleeping measured by the number of pairs of shoes you have in your closet is a tax on shoes." *Trinova Corp. v. Mich. Dep't of Treasury*, 498 U.S. 358, 374 (1991) (internal citation omitted).

"Residence" is a meaningless concept for the Commerce Clause. The Comptroller and his *amici* maintain there should be a difference between the state taxation of individuals and corporations based on overruled and archaic authorities. However, this view is inconsistent with this Court's repeated renunciation of the formalism espoused by those cases.

A. The Due Process Clause Does Not Restrain States from Taxing Their Residents

Under *International Shoe Co. v. Wash.*, 326 U.S. 310 (1945), the test for Due Process Clause purposes is "minimum contacts," not "residence." This means a party may be subject to a state's jurisdiction if it has minimum contacts with that state. Focusing on the "minimum contacts" test, there is no doubt Maryland possesses sufficient Due Process Clause nexus with the Wynnes.

In *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), this Court clarified the Due Process Clause and Commerce Clause are "two constitutional requirements [that] differ fundamentally, in several ways." *Id*. at 305. "[W]hile Congress has plenary power to regulate commerce among the States . . ., *see International Shoe Co. v. Washington*, 326 U.S. 310 (1945), it does not similarly have the power to authorize violations of the Due Process Clause." *Id*. Additionally, "[t]here may be more than sufficient factual connections, with economic and legal effects, between the transaction and the taxing state to sustain the tax as against due process objections. Yet it may fall because of its burdening effect upon the commerce." *Id*. at 305-06, citing *International Harvester Co. v. Department of Treasury*, 322 U.S. 340 (1944).

In *Quill*, this Court had no problem finding Quill had sufficient contacts with North Dakota for Due Process Clause purposes, but held the State's authority to impose a collection and remittance responsibility on Quill for its sales/use tax was *not* constitutionally sustainable under the Commerce Clause. *Quill* at 318. The Comptroller and his *amici* cite *Okla. Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450 (1995), for the proposition a state can tax its residents on all of their income. However, that case does nothing other than support the notion that Maryland's income tax on its residents is sustainable under the Due Process Clause. That case addressed members of an Indian tribe living outside of tribal lands and conducting their tribal business within the territorial confines of Oklahoma who alleged they were immune to Oklahoma's individual income tax by virtue of tribal tax immunity. The Court specifically held "that Oklahoma may tax the income (including wages from tribal employment) of all persons, Indian and non-Indian alike, residing in the State outside Indian country." *Id*. at 453. *Chickasaw Nation*, however, was devoid of any Commerce Clause analysis and says nothing about whether the Commerce Clause protects the act of generating income across state lines.[5]

While modern Due Process Clause jurisprudence answers the question of whether Maryland *may* tax its residents, it says nothing about *how much* Maryland may tax its residents. To answer the question of "how much?" this Court in *MeadWestvaco Corp. v. Ill. Dep't*

[5] Two other cases cited by the Comptroller, *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937) and *Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932), also do nothing but sustain a tax under the Due Process Clause and *not* the Commerce Clause. In *Cohn*, a New York resident was denied a refund of New York income taxes on rental income derived from New Jersey. The parties stipulated that New Jersey did not tax that income—a situation very different from the case at hand. *Cohn* at 311. This Court in *Lawrence* specifically held a state's unrestricted power to tax *cannot* be "palpably arbitrary or unreasonable as to infringe the Fourteenth Amendment." *Lawrence* at 280.

of Rev., 553 U.S. 16 (2008), properly looked to the Commerce Clause.

> The Commerce Clause and the Due Process Clause impose distinct but parallel limitations on a State's power to tax out-of-state activities . . . Where, as here, there is no dispute that the taxpayer has done some business in the taxing State, *the inquiry shifts from whether the State may tax to what it may tax*.

Id. at 24-25 (italics added).[6]

Finding no infirmity with the Due Process Clause, the next step is to review the restrictions imposed by the Commerce Clause.

B. The Commerce Clause Is Applicable to *All* State Taxes Affecting Interstate Commerce

The Commerce Clause does not distinguish between state taxes, whether levied upon individuals or corporate entities:

> *Complete Auto* emphasized the importance of looking past 'the formal language of the tax statute [to] its practical effect,' and set forth a four-part test that continues to govern the

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[6] *See also Nippert v. Richmond,* 327 U.S. 416, 423-424 (1946): "But beyond the presence of a sufficient connection in a due process or 'jurisdictional' sense, whether or not a 'local incident' related to or affecting commerce may be made the subject of state taxation *depends upon other considerations of constitutional policy having reference to the substantial effects, actual or potential, of the particular tax in suppressing or burdening unduly the commerce"* (italics added).

> validity of state taxes under the Commerce Clause.

Quill Corp. at 310.

When this Court said *Complete Auto* governs the "validity of state taxes," it did not mean *Complete Auto* applies to all state taxes *except* taxes levied upon individuals. It should come as no surprise that Commerce Clause protection has been applied to a wide variety of state taxes, including taxes that individuals must pay. *See e.g.*, *Camps Newfound/ Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (local property taxes); *Quill Corp*., 504 U.S. 298 (1992) (sales taxes); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (intangibles tax); and *Tyler Pipe Indus. v. Dep't of Rev*., 483 U.S. 232 (1987) (gross receipts tax).

Fulton effectively rebuts the Comptroller's contention that taxes paid by a state's residents are somehow immune to a Commerce Clause challenge. *Fulton* involved a successful Commerce Clause challenge to a North Carolina intangibles tax imposed upon *residents* of North Carolina. *Fulton* at 327. The Comptroller's reliance upon a line of *Spector*-era cases is fatal to his novel proposition that the Commerce Clause applies to all manner of state taxes except individual income taxes. This Court has made it clear: "*Spector* is an anachronism." *Complete Auto* at 287.

The Comptroller's and his *amici*'s repeated refrain from *Goldberg* that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes" grossly misses the mark. *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989); Comptroller's Br. at 42; Br. for the United States as *Amicus Curiae* Supp. Pet'r 5-6, 18; Br. Multistate Tax Commission as *Amicus Curiae* Supp. Pet'r 8. The Wynnes' complaint relates to Maryland imposing its tax on income earned outside the State at an effectively higher rate than income earned in Maryland. Clearly, the purpose of the Commerce Clause is to protect economic activity subject to taxation in multiple states. As Professor Hellerstein observed, this Court has since repudiated its remark:

> [I]n an unfortunate dictum, the Court declared that '[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes.' In fact, the Court could not have meant what it said. If a state imposes a tax on state residents' purchases of out-of-state but not in-state goods, the tax would be struck down in short order. A more blatant discrimination against interstate commerce in violation of the 'free trade' principles underlying the Commerce Clause is difficult to imagine. *It is a cardinal purpose of the Commerce Clause to protect state residents from their own state taxes when those taxes discriminate against interstate commerce*. Fortunately, in 1994 the Court repudiated its ill-considered dictum (at least implicitly) by observing that '[s]tate taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional.

HELLERSTEIN, STATE TAXATION ¶ 4.14 (WG&L 2014), citing *Goldberg* at 266 and *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 203 (1994) (italics added).

It is clear the Commerce Clause protects interstate commerce, whether engaged in by residents or nonresidents, corporations or individuals. After all, this Court struck down a tax that operated against local interests when that tax discriminated against interstate commerce. *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977); *see also Fulton*.

As this Court stated in *Complete Auto*,

> There is no economic consequence that follows necessarily from the use of the particular words, 'privilege of doing business,' and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect. Simply put, the Spector rule does not address the problems with which the Commerce Clause is concerned.

Complete Auto at 288.

This is exactly the question at bar. Does the formalism of "residency" obscure the question of whether the Maryland tax produces a forbidden effect? In striking down *Spector*, the Court made plain in *Complete Auto* that talismans of "privilege" no longer animate the Commerce Clause. Instead of focusing on *substance*, the Comptroller and his *amici* make strenuous arguments for respect of *form*. However, form does not hide the fact that Maryland's income tax discriminates against interstate commerce. The Comptroller's adherence to form is fatal to his case. Like the Equal Protection Clause cases of *Darnell v. Indiana*, 226 U.S. 390 (1912), and *Kidd v. Alabama*, 188 U.S. 730 (1903), the cases cited by Comptroller and *amici* have "been bypassed by later Commerce Clause decisions." *Fulton* at 326 (internal citations omitted).

The Comptroller maintains there should be a difference between the state taxation of individuals and corporations based on overruled and archaic authorities. However, this position is inconsistent with this Court's message in *Jefferson Lines*, where this Court noted that its modern four-part test in *Complete Auto* has broadly been used in the following cases:

> *Goldberg v. Sweet*, 488 U.S. 252 (1989) (tax on telephone calls); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24 (1988) (use tax); *Container Corp. v. Franchise Tax Board*, 463 U.S. 159 (1983) (franchise tax); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) (severance tax). We apply its criteria to the tax before us today [(sales tax)].

Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 183 (1995).

All this is not to say residency (or the domiciliary state) does not have any importance; however, it does not remove a tax from the Commerce Clause's protection. For example, the domiciliary state may impose a tax on the value of property if that property has not obtained a taxable situs in any other state. *See Standard Oil Co. v. Peck*, 342 U.S. 382, 384 (1952). In contrast, if the property is subject to taxation in two or more states, that precludes the domicile state from taxing 100% of the property. *Id*. Thus, *amicus* is not asserting Maryland cannot tax 100% of its residents' income, but if such income is subject to tax in two or more states, the State's tax structure must prevent duplicative taxation. For income tax purposes, a state may accomplish this by: (1) apportioning multi-jurisdictional income of a business or, alternatively, (2) by providing a credit for the income taxed by another state(s). "Otherwise there would be multiple taxation of interstate operations." *Id*. at 385.[7]

The provision of a credit for taxes paid to other states satisfies Commerce Clause requirements against double taxation, not just for income taxes, but for sales and use taxes as well. When this Court reviewed Louisiana's use tax, it noted the state reduced the risk of multiple taxation by providing a credit. *D.H. Holmes* at 31. The same has been said when this Court reviewed an Illinois telecommunication excise tax: "To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation." *Goldberg* at 264.

In many ways the method Maryland and other states employ to tax individuals' income is similar to the states' sales and use tax systems. With sales tax, the state where the sale took place is the first to be entitled to impose a sales or use tax on the transaction. The states, when imposing their income tax on nonresidents, do not look to a sale, but instead impose tax on the individual's income earned in that state (the "source" state of income). A subsequent state—be it the state of subsequent "use" for purposes of the sales and use tax or the resident state for purposes of the income tax—may only impose its "use" or "income" tax

[7] Residency (or the domiciliary state) is also important for determining which state can tax income that does not have a business purpose. This Court refused to extend the apportionment of all income earned by a business in *Allied-Signal, Inc. v. Director, Division of Taxation*, 504 U.S. 768 (1992). As with corporate income taxes, the same holds true here with Maryland's income tax; its residents' income from nonbusiness sources would be subject to the State's income tax.

on the differential rate. *See Jefferson Lines* at 194 citing *KSS Transportation Corp. v. Baldwin*, 9 N.J. Tax 273, 285 (1987). The risk of multiple taxation is eliminated because a taxpayer knows any subsequent state will have to provide a credit for the taxes paid to prior states. *Jefferson Lines* at 194. Maryland's individual income tax with its partial credit mechanism fails to satisfy the requirement for a full credit for income taxes paid to other states on the same income.

The Comptroller's and his *amici*'s contentions that the Commerce Clause is not applicable to this case must fail. The decision of the Maryland Court of Appeals must stand.

C. Voting Rights Do Not Mitigate a State's Constitutional Limitations to Tax Residents

Instead of viewing double taxation as a constitutional infirmity, the Comptroller advises the Wynnes to seek a political fix. Comptroller's Br. at 24. However, since the State created the problem with its tax laws, the burden of fixing the problem should rest with the State, not with the taxpayer.

Claiming this is only a political issue for Maryland's voters to decide is contrary to this Court's decision in *Associated Indus. v. Lohman*, 511 U.S. 641 (1994). Applying the Commerce Clause, this Court rightly held Missouri's imposition of a use tax exceeding the local sales tax was discriminatory. If residents in Missouri elect legislators that tell the residents and its businesses in Missouri to pay more tax on purchases from sellers located outside of Missouri, what is wrong with that? Clearly, as this Court noted, it provides an unconstitutional advantage to in-state sellers.

Maryland's income tax scheme is no different; it provides preferential treatment for income earned and subject to tax solely within the state to income earned and subject to tax outside of the state. To treat this as a political question contravenes the inclusion of the Commerce Clause in the U.S. Constitution. Voters, and the representatives they place in office, do not have the right to enact laws contrary to the U.S. Constitution. To hold otherwise would allow states to favor in-state economic activity and local interests over foreign economic activity or interests. *Cf. Camps Newfound/Owatonna, Inc.* (how would Maine's property tax exemption favoring camps that served mostly the state's residents be found unconstitutional?).[8]

The Comptroller's position is rooted in the principle that individuals are in a class of their own based on their ability to vote, and with that power, they do not need protections afforded by the Commerce Clause. Because of this, the Comptroller contends that while corporations may enjoy all of the constitutional protections of credits and apportionment, individuals do not. This Court recently addressed questions of whether corporations are entitled to fewer rights than individuals. *See Burwell v. Hobby Lobby Stores, Inc*.,

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[8] *Amicus* acknowledges that a state can tax its residents' purely instate activity greater than their interstate activity. *See Allied Stores v. Bowers*, 358 U.S. 522 (1959) (sustaining a property tax exemption for goods only stored in the state for export by a nonresident under an Equal Protection Clause challenge). Because intrastate commerce was burdened with a greater tax than interstate commerce, there was no Commerce Clause issue. Maryland's taxing scheme violates the dormant Commerce Clause because it does just the opposite, it taxes income earned solely within the state at a lower rate than the same income if earned in interstate commerce.

134 S. Ct. 2751 (2014); *Citizens United v. FEC*, 558 U.S. 310 (2010). It is ironic the Comptroller and his *amici* now urge this Court to answer the question: Do individuals have fewer constitutional rights than corporations?

Neither the Wynnes, nor *amicus*, are asserting that residents are entitled to a tax credit for *all* taxes paid to another state. Clearly, if the resident state does not tax the income taxed by another state, the resident state may, but is not required, to provide a credit in that circumstance. (For example, if a nonresident state taxes lottery winnings not subject to tax in an individual's resident state, the resident state is not required to provide a tax credit for taxes paid on those lottery winnings against other income earned by the resident in that state.) In addition, the credit can be limited to not exceed the tax rate imposed by the resident state. States retain their sovereignty to tax within constitutional limits. When a state like Maryland imposes an income tax on both residents and nonresidents, it must provide a credit to avoid multiple taxation of the same income.[9]

Nothing about this case will prevent states from imposing different types of taxes on business activity

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[9] The same holds true with a state using a different tax scheme for taxing the income of pass-through entities from that at the federal level. If a state imposes the tax only on a pass-through entity (*e.g.,* limited liability company, general or limited partnership, S Corporations, etc.), similar to how many states tax C Corporations, an individual may be prevented by the state from claiming a tax credit on the tax *owed* by the pass-through entity. However, that is not the situation in this case. Maryland, like the vast majority of other states, has elected to tax the owners of pass-through entities—deciding not to impose an income tax directly on the entities themselves.

in a state. States are free to continue to tax C Corporations using an apportionment formula and individuals (residents and nonresidents) on all their income. Alternatively, as done in Ohio, Texas and Washington, they can subject businesses to a gross receipts tax that may or may not have some deductions.[10] States may also impose separate taxes on communication services, public utility services, and insurance. There is no erosion of a State's sovereignty; the Wynnes and *amicus* only assert all these taxes continue to be subject to the scrutiny of the Commerce Clause.

Voting is a right given to state residents, but such right does not serve to invalidate those residents' Commerce Clause protections against discriminatory taxation.

D. Maryland's Partial Tax Credit Mechanism Violates the Dormant Commerce Clause Under the *Complete Auto* Test

Having established the Commerce Clause applies and cannot be bypassed by voting, *amicus* will now show how Maryland's tax credit system fails to meet the test set forth in *Complete Auto*. In *Complete Auto*, this Court held a state tax does not run afoul of the dormant Commerce Clause if the tax: 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. *Complete Auto* at 279. The Court of Appeals

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[10] Ohio Rev. Code Ann. § 5751.03; Tex. Tax Code Ann. § 151.054; Wash. Rev. Code Ann. § 82.04.240.

correctly held Maryland's partial tax credit mechanism violates the second and third prongs of the test. Pet. for Cert. App. 17-32.

(i) The Partial Tax Credit Mechanism Is Not Fairly Apportioned, Failing the Second Prong of the *Complete Auto* Test

The second prong of the *Complete Auto* test requires a state tax to be fairly apportioned. *Complete Auto* at 279. "It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. In order to prevent multiple taxation of interstate commerce, the Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 424, 446-47 (1979).

To determine whether a state tax is fairly apportioned, it must be both internally consistent and externally consistent. *Goldberg* at 261. Internal consistency requires a tax to be structured in a way that if every state imposed an identical tax, no multiple taxation would result. *Id*. If every state provided a Maryland-type partial credit against its income tax, taxpayers earning income from sources outside their resident state would be taxed at higher rates than those taxpayers only earning income within the state.[11]

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[11] The Court of Appeals provided a good example of how Maryland's credit system is internally inconsistent. *See* Pet. for Cert. App. 20-22.

The Comptroller asserts he can tax a resident on all of the resident's income regardless of the source of income or the fact that the income is subject to tax in other states. The Comptroller advocates this outcome at the same time he acknowledges that Maryland taxes nonresidents on their income from sources within Maryland. Pet. for Cert. App. 20-23.

There is no question that Maryland's taxing scheme violates the internal consistency test. Here, Maryland clearly imposes a 100 percent tax on its residents—without giving a full credit for taxes paid to other states on the same income. And Maryland also taxes nonresidents on their income earned in Maryland. If every state had the same law, the resident with income subject to tax in another state would be subject to multiple taxation.

This Court has held numerous times that states can satisfy internal consistency and prevent multiple taxation on unapportioned tax by providing credits. *See*, *e.g*., *Goldberg* at 264 ("To the extent that other States' telecommunications taxes pose a risk of multiple taxation, the credit provision contained in the Tax Act operates to avoid actual multiple taxation."); *Jefferson Lines* at 193 ("True, it is not Oklahoma that has offered to provide a credit for related taxes paid elsewhere, but in taxing sales Oklahoma may rely upon use-taxing States to do so. This is merely a practical consequence of the structure of use taxes . . . use of goods is taxed only to the extent that their prior sale has escaped taxation.") *See also Maryland v. Louisiana*, 451 U.S. 725 (1981) (finding Louisiana's use tax discriminated against interstate commerce in favor of local interests).

Nevertheless, the Comptroller maintains that Maryland's system of not providing full credits should stand. If Maryland does not fully credit income taxes paid in other states, then why should it, or any other state, be required to credit sales taxes paid to other states against its use tax? *Cf. Associated Indus. v. Lohman*, 511 U.S. 641 (1994). For that matter, why should a corporate entity be entitled to apportion its multistate income? According to the Comptroller, so long as the subject of the tax is a "resident" of—or "domiciled" in—Maryland, nothing else matters.

External consistency requires a state to only tax the "portion of revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg* at 262, citing *Container Corp*. at 169-70. As the Court of Appeals correctly noted, the county portion of the tax is externally inconsistent "[b]ecause no credit is given with respect to the county tax for income earned out-of-state . . . when income sourced to out-of-state activities is subject to the county tax, there is a potential for multiple taxation of the same income." Pet. for Cert. App. 26.

Clearly, the Comptroller's contention that the tax is fairly apportioned fails the internal and external consistency tests.

(ii) The Maryland Tax Credit Mechanism Discriminates Against Interstate Commerce, Failing the Third Prong of the *Complete Auto* Test

Maryland's income is not only deficient under the second prong, it also violates the third prong of *Complete Auto*. A state tax cannot discriminate against interstate or foreign commerce. *Complete Auto* at 279. "Even if a tax is fairly apportioned, it may discriminate against interstate commerce [and] violate the Commerce Clause if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce." *Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66, 75 (1989). Without Commerce Clause protection, the Maryland partial credit favors Maryland residents that only generate income in the State over those that generate income in other states. The Commerce Clause protects against this type of discriminatory state taxation. *See Fulton; Camps Newfound/Owatonna*.

In *Fulton*, this Court struck down North Carolina's intangibles tax as facially discriminatory because it discouraged "domestic corporations from plying their trades in interstate commerce." *Fulton* at 333. The similarities between *Fulton* and this case are striking. Applying the county portion of the tax to out-of-state income without applying a credit for out-of-state taxes paid on the same income causes this income to be taxed at a higher rate than income earned through in-state activities. Based on the denial of a credit for the county portion (3.2% out of the 7.95% tax) a taxpayer with out of state income can pay as much as 40% more than a taxpayer with only intrastate income. As such, by failing to provide a credit against the county portion of the state tax the Wynnes paid to other states, the Maryland tax scheme is facially discriminatory.

In *Camps Newfound/Owatonna*, this Court found a state property tax violates the Commerce Clause if its exemption for property owned by charitable institutions excludes those institutions which primarily serve nonresidents. *Id*. at 565. That case involved a state tax exemption for charitable institutions that principally served residents more than nonresidents.

In finding the tax statute facially discriminatory, this Court stated the statute "expressly distinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market . . . such laws are virtually *per se* invalid." *Id.* at 565 (italics in original). "By encouraging isolationism, prohibitions on out-of-state access to in-state resources serve the very evil that the dormant Commerce Clause was designed to prevent." *Id.* at 578.

The same economic isolationism is implicated in this case. By failing to provide a full credit to residents for income earned and taxed out of state, Maryland is taxing income earned in interstate commerce more heavily than income earned in intrastate commerce.

Such in-state favoritism stifles interstate commerce and cannot be upheld under the U.S. Constitution.

II. A CREDIT MECHANISM IS CONSISTENT WITH THE FRAMEWORK USED BY THE STATES WHEN TAXING RESIDENTS WITH INCOME IN MORE THAN ONE STATE

Amicus believes the credit mechanism is consistent with the current individual income tax framework used by the states when taxing multijurisdictional income. The credit mechanism is one of several options permitted under the Commerce Clause to avoid the risk of multiple taxation of business income in interstate commerce. Having failed to find support within this Court's precedent for carving out income earned by a business but taxed under the individual income tax from Commerce Clause protections against multiple taxation of interstate commerce, the Comptroller and his *amici* posit a number of disparate arguments for why a credit system is not required or does not work. These include arguments by the Comptroller and his *amici* that the credit system: 1) interferes with the sovereignty of a state over its tax system, 2) is too complex to be workable, and 3) unduly deprives the state of revenues needed to fund public service.

Amicus disagrees with the Comptroller on each of these assertions and find them to be diversionary efforts to obfuscate the real issues here. There is nothing in over 200 years of Commerce Clause jurisprudence suggesting that it only applies to a narrow spectrum of business activity that states have chosen to tax under their corporate income tax systems. Rather, it is clear the Commerce Clause protects interstate commerce in all its forms, however it is taxed.

A. The Comptroller's Sovereignty Argument Is Misplaced

The Comptroller and his *amici* spend much time fretting that Maryland's taxing power, indeed its very sovereignty, would be beholden to the whims of other states should the Maryland Court of Appeals decision stand. Comptroller's Br. 2, 13, 27, 32; Br. Int'l Municipal Lawyers Ass'n as *Amici Curiae* Supp. of Pet'r 6, 12, 18. They complain about the encroachment on state sovereignty for individual income taxes—stating those taxes need not be held to the same Commerce Clause standard as other income taxes imposed on corporations. As the Comptroller states in his brief, "By requiring Maryland to grant a full credit for income taxes paid to other states . . . the lower court's ruling wrongly demands that Maryland yield in the exercise of its taxing power to other sovereigns . . . ." Comptroller's Br. 17.

Similarly, the United States bemoans the impact of other states' actions on Maryland:

> It would make little sense for a State's power to collect an income tax from its own residents, in order to fund the services and protection those residents receive, to be circumscribed by the independent actions of another State with a less significant connection to those persons.

Br. for the United States as *Amicus Curiae* Supp. Pet'r 11.

The Comptroller's stance on state sovereignty might be more principled if Maryland chose to tax 100 percent of its residents income and none of the income of nonresidents. However, the Comptroller wants to have it both ways. He wants the freedom to tax all of the income of Maryland's own taxpayers under the "residency" principle, *and* also the authority to tax nonresidents (including nonresident shareholders of Maxim) under the "source" principle. Instead of occupying high ground, the Comptroller's position is hypocritical.

Apportionment and credits are modest limitations placed on state sovereignty to avoid "multiple" taxation. As discussed above, a state can tax its residents on 100 percent of their income, but when another state taxes some of the same income that was earned and appropriately sourced to that second state, then the "residence" principle must give way to the "source" principle (through a credit mechanism) to avoid a constitutional impairment. This has nothing to do with turning the controls of one state's tax system over to another state, but simply reflects accommodations that need to be made to nurture a national market where business entities operate in multiple states.

Another variation of the "sovereignty" argument floated by the Comptroller and his *amici* is the assertion that a mandatory credit system would be overly complex and unworkable. As the Multistate Tax Commission ("MTC") states in its *amicus* brief,

> The Maryland Court of Appeal's holding that residency-based income taxes must yield to source-based taxes would have far-reaching effects on state and local governments if affirmed by this Court . . . [It] would involve the state courts in a never-ending task of determining whether particular taxes imposed on an individual as a resident should be reduced or eliminated because another state or local government also has jurisdiction to impose a tax on the individual as a nonresident.

Br. Multistate Tax Commission as *Amicus Curiae* Supp. Pet'r 3.

Similarly, the Comptroller weighs in on the intractability of a mandatory credit system:

> Equally important, the acknowledgement that sovereigns may independently exercise their valid taxing powers resolves—or, more precisely, eliminates—the otherwise intractable problem of deciding which of two legitimate states taxes should take precedence over the other. Nothing in the Due Process Clause or the Commerce Clause provides tools for answering that question.

Comptroller's Br. 30

Given these dire descriptions of a credit system, one would think such a mechanism would be alien to state and local taxes. However, quite the opposite is true—every state with a broad-based individual income tax provides a credit for taxes paid to other states.[12] Similarly, every state with a sales and use tax has a credit mechanism for similar taxes paid to other states.[13]

[12] **Individual Income Tax**: Ala. Code § 40-18-21; Ariz. Rev. Stat. Ann § 43-1071; Ark. Code Ann. § 26-51-504; Cal. Rev. & Tax Code § 180001; Col. Rev. Stat. § 39-22-108; Conn. Gen. Stat. Ann. § 12-704; Del. Code Ann. tit. 30 § 1111(a); D.C. Code § 47-1806.04; Ga. Code Ann. § 48-7-28; Haw. Rev. Stat. § 235-55; Idaho Code Ann. § 63-3029; Ill. Admin. Code tit. 86, § 100.2197; Ind. Code Ann. § 6-3-3-3; Iowa Admin. Code r. 701-42.6-422; Kan. Stat. Ann. § 79-32, 111; Ky. Rev. Stat. Ann. § 141.070; La. Rev. Stat Ann. § 47:33; Me. Rev. Stat. Ann. tit. 36 § 5217-A; Md. Code Ann., Tax-Gen. § 10-703; Mass. Gen. L. ch. 62, § 6(a); Mich. Comp. Laws § 206.255; Minn. Stat. § 290.06(22); Miss. Code R. 35.III-1.12.100; Mo. Rev. Stat. § 143.081; Mont. Code Ann. § 15-30-2302(1); Neb. Rev. Stat. § 77-2730(1); N.J. Rev. Stat. § 54A:4-1; N.M. Stat. Ann. § 7-2-13; N.Y. Tax Law § 620(a); N.C. Gen. Stat. Ann. § 105-153.9; N.D. Cent. Code § 57-38-30.3(4); Ohio Rev. Code Ann. § 5747.05(B); Okla. Stat. Ann. tit. 68, § 2357; Or. Rev. Stat. § 316.082(1); 61 Pa. Code § 111.3; R.I. Gen. Laws 44-30-18; S.C. Code Ann. § 12-6-3400(A)(1); Utah Code Ann. § 59-10-1003; Vt. Stat. Ann. tit. 32 § 5825; Va. Code Ann. § 58.1-332(A); W. Va. Code § 11-21-20; Wis. Admin. Code Tax § 2.955(2).

[13] **Sales and Use**: Ala. Code § 40-23-65; Ariz. Rev. Stat. Ann. § 42-5159(2); Ark. Code Ann. § 26-53-131(a)(1)(A)(i); Cal. Rev. & Tax. Code § 6406; 39 Colo. Code Regs. § 26-713.2(f); Conn. Gen. Stat. Ann. § 12-430(5); D.C. Code Ann. § 47-2206; Fl. Stat. § 212.06(7); Ga. Code Ann. § 48-8-42; Haw. Rev. Stat. § 238-3(i); Idaho Code § 63-3621(j); 35 Ill. Comp. Stat. Ann. 105/3-55(d); Ind. Code Ann. § 6-2.5-3-5; Iowa Admin. Code r. 701-223.2(423); Kan. Admin. Regs. 92-20-15; Ky. Rev. Stat. Ann. 139.510(1); La. Rev. Stat. Ann. § 47:303(A)(3); Me. Rev. Stat. Ann. Tit. 36, § 1862; Md. Code Ann. Tax-Gen § 11-221(c); Mass. Gen. Laws ch. 641, § 7(c); Mich. Stat. Ann. § 205.94(1)(e); Minn. Stat. § 297A.80; Miss. Code

To be sure, there are varying restrictions on these credits, including: 1) resident state sourcing rules, 2) whether the tax paid in one state is similar to the tax paid in another state, and 3) whether the tax is paid by the same taxpayer in the same period on the same type of income. Nonetheless, these credit mechanisms are strikingly similar state by state, and in no way represent an intractable model of federalism or an unwarranted intrusion on state sovereignty as the Comptroller and his *amici* would lead the Court to believe.

B. Maryland Receives a Fair Return for the Services It Provides Without Double Taxation

The Comptroller does not deny Maryland's system results in double taxation of resident individuals and businesses taxed under the individual income tax. The Comptroller seeks to justify his denial of Commerce Clause protections by noting that the States "provide their residents with a host of financial benefits" for which they can ask for a "fair return". Comptroller's Br. 14, 20.

Ann. § 27-67-7(a); Mo. Rev. Stat. § 32.200, Art. V; Neb. Rev. Stat. § 77-2704.31; Nev. Admin. Code § 372.055; N.J. Rev. Stat. § 54:32B-11(6); N.M. Stat. Ann. § 7-9-79(A); N.Y. Tax Law § 1118(7); N.C. Gen. Stat. § 105-164.6(c); N.D. Cent. Code § 57-40.2-11; Ohio Rev. Code Ann. § 5741.02(C)(5); Okla. Stat. Ann. Tit. 68, § 1404(3); 72 Pa. Stat. § 7206(a); R.I. Code R. 60-1-33:1; S.C. Code Ann. § 12-36-1310(C); S.D. Codified Law Ann. § 10-46-6.1; Tenn. Code Ann. § 67-6-507(a); Tex. Tax Code Ann. § 151.303(c); Utah Code Ann. § 59-12-104(26); Vt. Stat. Ann. tit. 32, § 9744(a)(3); Va. Code Ann. § 58.1-611; Wash. Rev. Code § 82.12.035; W. Va. Code § 11-15A-10a(a); Wis. Stat. § 77.53(16); Wyo. Stat. § 39-16-109(d)(iii).

In determining what constitutes a "fair return," the Comptroller opines that Maryland's legislature can craft its own "compromise" solution to balance the state's need for revenue with the requirements of the Commerce Clause. According to the Comptroller, "Here, Maryland has chosen to steer a middle course." Comptroller's Br. 23.

Leaving aside the Comptroller's unilateral action in reinterpreting what is required under the Commerce Clause prohibition against multiple taxation of interstate commerce, his argument ignores the actual facts in this case. In the year at issue, the Wynnes earned income from two sources: their salaries (including Mr. Wynne's salary as president of Maxim) and his flow-through share of Maxim's income, based on his 2.4 percent ownership of the company. Pet. for Cert. App. 56, 86. The Wynnes paid Maryland income tax in full on their salary income, as no other state taxed that income. The only credits taken were for Mr. Wynnes' flow-through income from Maxim, which both parties concur was earned and subject to tax in 38 other states. Comptroller's Br. 5; Wynne Br. 7.

The Wynnes in the year at issue paid more than $126,000 in Maryland income taxes on their salary income and their distributive share of Maxim's income. Pet. for Cert. 4. In addition, they paid other taxes in Maryland (*e.g.*, property and sales/ use taxes). It is difficult to fathom how the Comptroller thinks the Wynnes get a "free ride" unless they are double taxed on their share of the business income earned by Maxim in 39 states. Comptroller's Br. 26.

Nothing in the record suggests the Wynnes or Maxim made any efforts to structure their tax affairs to take advantage of any tax "loopholes." This is just a plain vanilla case of taxpayers who fully complied with the laws of their home state and 38 other states—only to have their home state of Maryland seek to double tax them while reaping the benefit of taxes received from nonresidents on their Maryland source income (including nonresident shareholders of Maxim itself).

In making a determination of what constitutes a "fair return" from a multistate taxpayer, the Comptroller misses one of the central points of business taxation in today's system—that most of it comes from taxes other than income tax. In FY2013, individual income taxes on business income and corporate income taxes accounted for only 13.4 percent of all state and local business taxes. Ernst & Young/COST, *Total State and Local Business Taxes* 3 (Aug. 2014). Property taxes on business property (36.1 percent) and general sales taxes on business inputs (20.8 percent) made up a much larger share of total state and local business taxes. *Id*. Furthermore, in FY2013, business taxes (*e.g*., property, sales, income, unemployment insurance, excise, business license) accounted for 44.9 percent of all state and local taxes—a far cry from the "free ride" suggested by the Comptroller in terms of business support for the cost of government services. *Id*. at 1, 12.

C. A Reversal of the Decision Below Would Create a Discriminatory Two-Tier System for Taxing Interstate Commerce

In the final analysis, the problem confronting this Court is not an unworkable and intractable "credit" framework that denies a state sovereignty over its tax system and an adequate revenue base; rather, it is the discriminatory two-tier system that could develop if the Maryland Court of Appeals decision is overturned.

If this Court decides the Commerce Clause protection against multiple and discriminatory taxation does not apply to the taxation of business income earned by S corporations or other entities taxed under the individual income tax, the floodgates will open. This Court will allow states to create bifurcated systems whereby business entities taxed under a corporate income tax would have constitutional protections against double taxation but business entities taxed under the individual income tax would not.

This outcome is particularly disturbing given the significant shift of business activity over the last three decades away from C corporations taxed under the corporate income tax towards S corporations, partnerships and sole proprietors taxed under the individual income tax. In 1980, 11 percent of all state and local taxes paid on business income were collected under the individual income tax (*e.g.*, S Corporations, partnerships and sole proprietors) compared to 89 percent collected under the corporate income tax.[14] By contrast, in 2013, 41 percent of all taxes paid on business income was collected under the individual income tax compared to 59 percent under the corporate income tax.[15] Stated in dollar amounts, $1.7 billion in taxes on business income was collected under the individual income tax in 1980, compared to $36.6 billion in 2013.[16]

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[14] Ernst & Young/COST, *Total State and Local Business Taxes: State-by-State Estimates for Fiscal Year 2013*, http://www.cost.org/WorkArea/DownloadAsset.aspx?id=87982 (1980 numbers based on Ernst & Young analysis of IRS Statistics of Income data).

[15] *Id.*

[16] *Id.*

In 2007, only 1.9 million businesses in the U.S. were C corporations, compared to 30.2 million S corporations, partnerships, and sole proprietorships.[17] Moreover, as with tax revenues, the share of C corporations as a percentage of all business entities has been steadily declining for several decades, dropping from 16.6 percent of all businesses in 1980 to 5.8 percent of all businesses in 2007.[18]

Thus, the outcome argued for by the Comptroller—that the Commerce Clause be limited to businesses taxed under the corporate income tax and not be applied to individuals and businesses taxed under the individual income tax—would result in a huge disparity in the treatment of taxpayers. Over 90 percent of all business entities could be denied Commerce Clause protection from double taxation on income earned in multiple states.

Maryland is currently an outlier among the states in denying a full credit for taxes paid to other states, but a ruling by this Court in favor of the Comptroller may encourage other states to similarly protect their revenue base and favor intrastate commerce by denying credits for taxes paid to other states.

Whether a business chooses to operate as a C corporation, S corporation, partnership, sole proprietorship or some new form of entity created in the future does not remove it from the protections of the U.S. Constitution. Similarly, whether a state chooses to tax business income under a corporate income tax, a corporate franchise tax, a gross income tax, a

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[17] Annette Nellen, *Data on Different Types of Business Entities*, http://www.cob.sjsu.edu/facstaff/nellen_a/Data_Different_Types_Business_Entities.pdf (Based on IRS, Integrated Business Data).

[18] *Id.*

margins tax or an individual income tax is not of constitutional import. All come within the embrace of the Commerce Clause. To hold otherwise, and reverse the Maryland Court of Appeals decision, would turn Commerce Clause case law upside down and upset decades of conventional wisdom on the limits of a state's taxing power in situations involving income earned and taxed in multiple jurisdictions.

As discussed above, this outcome would ironically provide larger corporations taxed under the corporate income tax more protection than smaller businesses and sole proprietorships taxed on their business income under an individual income tax.

CONCLUSION

To ensure the Commerce Clause protections against double taxation apply to all income taxes, this Court should affirm the Maryland Court of Appeals decision.

Respectfully submitted,

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