No. 13-485

IN THE

Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, ET UX,

Respondents.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF THE MARYLAND CHAMBER OF COMMERCE AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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STATEMENT OF INTEREST

Amicus Curiae Maryland Chamber of Commerce ("the Maryland Chamber") respectfully submits this brief in support of Respondents Brian Wynne *et ux.*, urging this Court to affirm the decision of the Court of Appeals of Maryland.[1] That court appropriately held

[1] No counsel for any party authored this brief in whole or in part and no entity or person, aside from *amicus curiae*, its members, and its 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.

that Maryland's failure to provide full relief against its resident tax for the tax imposed by other states on income earned in those states unduly burdens interstate commerce and thus runs afoul of the dormant Commerce Clause.

The Maryland Chamber, a statewide organization of over 700 businesses of various sizes that employ over 440,000 employees statewide, is devoted to promoting a favorable business climate in Maryland. The organization's mission is to support its members and advance the State of Maryland as a national and global leader in economic growth and job creation. By working with Maryland's executive and legislative branches of government, the Maryland Chamber seeks to make Maryland a better place in which to live, work and do business.

Maryland is truly a small business state. Approximately 98 percent of Maryland employers have fewer than 100 employees. Most of those employers are so-called "pass-through" entities, including S corporations, limited liability corporations, partnerships, and sole proprietorships. And because no point in Maryland is more than 40 miles away from another state, many of those businesses must and do engage in interstate commerce.

The Maryland Chamber's interest in this case is clear. The Maryland personal income tax regime has a direct and adverse impact on those of its members who operate in "pass-through" form and choose to conduct their business across state lines. As our brief will show, the dormant Commerce Clause prohibits a taxing scheme of the type employed by Maryland.

SUMMARY OF ARGUMENT

The dormant Commerce Clause prohibits a state taxing scheme that exposes taxpayers to multiple state taxation on income earned in interstate commerce, thereby placing an undue burden on interstate commerce. U.S. Const., Art. I, § 8, Cl. 3. Maryland's personal income tax regime does just that. Those Maryland residents who are taxed on income earned in interstate commerce are subjected to multiple taxation—a clear undue burden on interstate commerce—because they do not receive full relief from the Maryland resident tax for taxes paid to other states in which their cross-border income is earned. The absence of such relief creates the risk of multiple taxation, something the dormant Commerce Clause prohibits.

Maryland argues that the relationship of individual residents to their state of residence somehow removes all Commerce Clause restraints from the analysis. That is not correct. This Court has never indicated that an individual's residence relieves a state from its obligation to comply with the dormant Commerce Clause. Rather, this Court's jurisprudence clearly demonstrates that the risk of multiple taxation—regardless of on what individual or what entity the risk falls—is forbidden by the dormant Commerce Clause. When the risk of multiple taxation of the same income arises because of conflicting taxation claims made by the state where the taxpayer resides and the state where the income is earned, the dormant Commerce Clause requires that the former must yield to the latter. Such a result is required here. The decision of the Court of Appeals of Maryland should be affirmed.

ARGUMENT

This case is presented as raising the single question whether the dormant Commerce Clause bars a state from taxing its *individual* residents on all of their income without providing full relief against the resident tax for taxes imposed on the same income by other states where the income was earned. As shown more fully below, the answer to that question is clearly "Yes" under this Court's well-settled dormant Commerce Clause doctrine prohibiting a taxing scheme that creates the risk of multiple taxation on income earned in interstate commerce.

A more appropriate question for this Court to address, however, would be whether the dormant Commerce Clause bars a state from taxing all the income earned by a *corporate* resident without providing full relief for taxes imposed on the same income by other states where the income was earned. Again, the answer to that question is "Yes."

In his brief in support of the petition for certiorari in this case, the Solicitor General asserted that "[t]his case does *not* present any question about the dormant Commerce Clause implications of a State directly taxing the income of a domestic corporation." Brief for the United States as Amicus Curiae on Petition for Writ of Certiorari at 16 n.2 (emphasis supplied). As the ensuing discussion demonstrates, however, this case *does* involve direct state taxation of the income earned by a domestic corporation, *i.e.*, the S corporation of which the respondents are shareholders. And the dormant Commerce Clause prohibition on Maryland's power to tax all the income of a domestic corporation without providing full relief for taxes paid to other states is unassailable.

In any event, whether this case is viewed as involving Maryland's taxation of the income earned by a corporate resident or an individual resident, the result should be the same. The well-established dormant Commerce Clause principles protecting interstate commerce from multiple taxation are equally applicable in both situations.

I. THE DORMANT COMMERCE CLAUSE FORBIDS THE MULTIPLE TAXATION CAUSED BY MARYLAND'S TAXING REGIME

A. The Dormant Commerce Clause Forbids the Risk of Multiple Taxation

For more than 75 years, this Court has steadfastly adhered to the doctrine that the dormant Commerce Clause forbids state taxes that expose interstate commerce to a risk of multiple taxation to which intrastate commerce is not exposed. In *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938), the Court first articulated the basic proposition that while interstate commerce must "pay its way," the dormant Commerce Clause protects interstate commerce from "bear[ing] cumulative burdens not imposed on local commerce." *Id.* at 256. Shortly thereafter, in striking down a levy on dormant Commerce Clause grounds, the Court reiterated that fundamental principle: "Interstate commerce would thus be subjected to the risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids." *J.D. Adams Mfg. Co. v. Storen*, 304 U.S. 307, 311 (1938). *See also Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434, 439 (1939) (condemning a tax under the dormant Commerce Clause because it exposed interstate commerce to "the risk of a multiple burden to which local commerce is not exposed").

The Court has never wavered from its commitment to this basic tenet of its dormant Commerce Clause jurisprudence that is indispensable to the protection of free trade from burdensome taxes. *See, e.g.*, *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 446 (1979) ("It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause."); *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 442 (1980) (recognizing and addressing claims that the dormant Commerce Clause bars tax that "imposes a burden on interstate and foreign commerce by subjecting . . . income to a substantial risk of multiple taxation"); *Exxon Corp. v. Wisconsin Dep't. of Revenue*, 447 U.S. 207, 228 (1980) (recognizing and addressing a claim that the dormant Commerce Clause bars tax that "subjects interstate business to an unfair burden of multiple taxation"); *MeadWestvaco Corp. v. Illinois Dep't. of Revenue*, 553 U.S. 16, 24 (2008) ("The Commerce Clause forbids the States to levy taxes that discriminate against interstate commerce or that burden it by subjecting activities to multiple or unfairly apportioned taxation.").

B. When the Risk of Multiple Taxation of Interstate Commerce Is Created by Conflicting Claims of the State of Residence and the State of Source, the Dormant Commerce Clause Requires that the Former Must Yield to the Latter

Over the years, this Court has considered a number of cases addressing the risk of multiple taxation that arises because of the conflicting claims of (a) the state of a taxpayer's residence, seeking to tax 100 percent of a taxpayer's income or property, regardless of its geographical source or location, and (b) the state where the income or property is earned or located, seeking to tax that portion of the income or property with its source or location (hereafter simply "source") in that state.[2] The problem arises because, apart from the dormant Commerce Clause and the interests in free trade that it protects, the claims of both the state of residence and the state of source are legitimate.

This Court has long recognized these basic propositions. Thus, in the context of income taxation on the basis of residence, the Court has observed: "That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation." *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312–13 (1937). Accordingly, "[a]s to residents [a State] may, and does, exert its taxing power over their income from all sources, whether within or without the State[.]" *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). The rationale for allowing states to tax residents on their income without regard to source is "founded upon the protection afforded to the recipient of the income by the state, in his person, in

[2] For ease of exposition, we use the term "source" to mean a location, other than the residence of the taxpayer, where a state may assert the power to tax based on its relationship to the income or property in question. In the context of income taxation, the term "source" is normally used to describe the location where income is earned and thus is taxable by a jurisdiction other than the taxpayer's residence; in the context of movable or intangible property taxation, the term "situs" or "business situs" rather than "source" is typically used to describe the location where such property is situated and is thus taxable by a jurisdiction other than the taxpayer's residence.

his right to receive the income, and in his enjoyment of it when received," *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 281 (1932), as well as his "[e]njoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws." *Cohn*, 300 U.S. at 313.

The states' power to tax on the basis of source is as well recognized as their power to tax on the basis of residence. *Curry v. McCanless*, 307 U.S. 357, 368 (1939) ("[I]ncome may be taxed both by the state where it is earned and by the state of the recipient's domicile. Protection, benefit, and power over the subject matter are not confined to either state."). Because such power derives only from the protection that the states provide to "persons, property, and business transactions *within their borders*," *Shaffer*, 252 U.S. at 57 (emphasis supplied), however, the power to tax at source is necessarily more circumscribed than the power to tax that flows from "[d]omicil itself." *Cohn*, 300 U.S. at 313. Consequently, when states seek to tax nonresident individuals and corporations using source as their sole jurisdictional basis, their power extends only to the nonresidents' "property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources." *Shaffer*, 252 U.S. at 57.

When both the state of residence and the state of source have a legitimate claim to tax income, the state of residence ordinarily yields to the state of source to avoid double taxation. This is true not only as a matter of national and international practice, American Law Institute, Federal Income Tax Project, *International Aspects of United States Income Taxation* 6 (1987) ("[u]nder internationally accepted practice, it is incumbent on the domiciliary jurisdiction to alleviate . . . double taxation by some reasonable means”), but also as a matter of federal constitutional law when the risk of multiple taxation burdens interstate commerce.

If both the state of residence and the state of source could tax income or property associated with interstate commerce activity, the risk of multiple taxation would be inevitable. Accordingly, this Court, in accord with the widespread understanding that the state of source has the stronger tax claim, has consistently interpreted the dormant Commerce Clause as requiring the state of residence to yield to the state of source, whenever allowing both claims to prevail would result in multiple taxation of interstate commerce.

This Court articulated the underlying principle in *Standard Oil Co. v. Peck*, 342 U.S. 382 (1952). The taxpayer, an Ohio-based corporation, owned boats and barges that it employed for the transportation of oil along the Mississippi and Ohio Rivers. The vessels, though registered in Cincinnati, made only occasional stops in Ohio for repairs. Their main terminals were in other states. Ohio assessed an ad valorem personal property tax on 100 percent of the value of the vessels. The Court, however, had recently sustained the power of a nondomiciliary state to impose a source-based tax on an apportioned share of the value of vessels that operated within that state. *Ott v. Mississippi Valley Barge Line Co*., 336 U.S. 169 (1949). Ohio contended that *Ott* did not deprive the domiciliary state of the power to tax the entire value of the vessels, a power the domiciliary state thought it possessed under the Court's earlier doctrine. The Court flatly rejected Ohio's contention, holding that the state of residence had to yield to the state of source to avoid the risk of multiple taxation: "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. Otherwise there would be multiple taxation of interstate operations . . ." *Standard Oil*, 342 U.S. at 384–85 (internal citation omitted).[3]

This Court has faithfully adhered to the view that the dormant Commerce Clause bar against multiple taxation requires that the power of one state to tax all of an interstate enterprise's property or income on a residence basis must yield to the power of other states to tax the same property or income on a source basis. Thus, in *Central R.R. Co. v. Pennsylvania*, 370 U.S. 607 (1962), the Court sustained the power of the domiciliary state to impose a tax on the full value of the taxpayer's rolling stock, but *only* because it had failed to establish that it was subject to an apportioned source-based tax in other states. As the Court observed, "a State casts no forbidden burden upon interstate commerce by subjecting its own corporations, though they be engaged in interstate transport, to nondiscriminatory property taxes." *Id*. at 612. However, the Court squarely reaffirmed the teachings of *Standard Oil*, declaring that "'multiple taxation of interstate operations' . . . offends the Commerce Clause," and that "multiple taxation is possible . . . if there exists some jurisdiction, in addition to the domicile of the taxpayer, which may constitutionally

[3] Although *Standard Oil* technically raised only a due process issue, the language of the Court's opinion plainly speaks to dormant Commerce Clause concerns. This Court has explicitly incorporated the principle of *Standard Oil* into its dormant Commerce Clause doctrine, as the ensuing discussion establishes.

impose an ad valorem tax." *Id*. (internal citations omitted).

Likewise, in *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979), the Court, in delineating the dormant Commerce Clause restraints on state taxation of the instrumentalities of interstate commerce, observed that "[i]n order to prevent multiple taxation of interstate commerce, this Court has required that taxes must be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Id.* at 446–47. Then, reiterating the basic principle that governs this case, the Court declared:

> The corollary of the apportionment principle, of course, is that no jurisdiction may tax the instrumentality in full. "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile. . . . Otherwise there would be multiple taxation of interstate operations." *Standard Oil Co. v. Peck*, 342 U.S. at 384–385.

Id. at 447.

In *Mobil Oil Corp. v. Commissioner of Taxes*, 445 U.S. 425 (1980), the Court reaffirmed, in the income tax context, the dormant Commerce Clause doctrine that precludes one state from taxing all of a taxpayer's income on a residence basis when another state has the power to tax an apportioned share of that income on a source basis. In *Mobil*, the question was whether Vermont could tax on a source basis an apportioned share of the dividends that Mobil Oil Corporation, a New York domiciliary, received from its foreign subsidiaries. One of the arguments advanced by Mobil was that Vermont could not tax an apportioned share of such income because it would expose Mobil to the risk of multiple taxation in light of New York's alleged power as Mobil's commercial domicile to tax the dividends on an unapportioned basis.

This Court rejected the underlying premise of Mobil's argument. The Court first reiterated the basic principle that the dormant Commerce Clause would not tolerate the multiple taxation that would result from imposition of a tax on Mobil's dividends both "by apportionment" on a source basis and "by allocation to a single situs" on a residence basis. As the Court put it, "[t]axation by apportionment and by allocation to a single situs are theoretically incommensurate, and if the latter method is constitutionally preferred, a tax based on the former cannot be sustained." *Id.* at 444–45. While multiple taxation of the same income was constitutionally unacceptable, the Court was nevertheless willing to "assume, for the present purposes, that the State of commercial domicile has the power to lay *some* tax on the appellant's dividend income." *Id.* at 445 (emphasis supplied). However, when it came to the ultimate question whether the state of residence trumps the state of source in the face of conflicting claims to the same income, the Court reaffirmed the rule that residence must yield to source. Thus, although the state of commercial domicile has the power to tax "some" of the appellant's dividend income, "there is no reason in theory why that power should be exclusive when the dividends reflect income from a unitary business, part of which is conducted in other States. In that situation, the income bears relation to benefits and privileges conferred by several States. These are the circumstances in which apportionment is ordinarily the accepted method." *Id.* at 445–46. In short, a residence-based tax allocating a taxpayer's entire income to a single state does not prevail over a source-based tax apportioning a taxpayer's income to the states in which it does business.

C. Maryland's Taxing Regime Creates the Risk of Multiple Taxation of Interstate Commerce Because of the Conflicting Claims of the State of Residence and the State of Source

There can be no dispute over the proposition that Maryland's taxing regime creates precisely the risk of multiple taxation identified in the Court's decisions discussed above.[4] Maryland imposes a tax on all the income earned by its residents and on all the income earned in Maryland by nonresidents. It fails to provide full relief against its resident tax, through a credit, apportionment, or exemption, for taxes imposed by other states when the income it taxes is earned in those states and is also taxable there on a source basis. As a consequence, the risk of multiple taxation for residents who cross state lines to engage in economic activity is indisputable. Accordingly, under the settled law reflected in this Court's dormant Commerce Clause doctrine, Maryland, as the state of residence, must yield to the conflicting claims of the state or

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[4] For purposes of dormant Commerce Clause analysis, it makes no difference whether the taxing power in question is exercised by the State of Maryland or by one of its political subdivisions (*e.g.*, a county). It is well settled that any action by a political subdivision of a state is subject to the same restraints that would be imposed on the state itself if the state itself had taken the challenged action in question. S*ee Frey v. Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011) (county income taxes are part of a single State-imposed income tax scheme).

states of source, in order to avoid the multiple taxation that would otherwise result.[5]

[5] In addition to violating the established dormant Commerce Clause principles described above, the Maryland statute also constitutes a clear violation of the "internal consistency" doctrine that the Court has articulated under the dormant Commerce Clause. Under this doctrine, a state tax will be struck down if it is not "internally consistent." As originally articulated in *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159, 169 (1983), the tax would be internally consistent if its application by every state "would result in no more than all of the unitary business' income being taxed." In other words, there could be no multiple taxation of the same income. As the Court later described the doctrine in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.,* 514 U.S. 175, 185 (1995):

> 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 at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with intrastate commerce.

Maryland's tax regime plainly flunks the "internal consistency" test. For example, if every other state imposed an income tax scheme like Maryland's, at an assumed rate of 6% (of which 1% represented the county tax rate), a resident who crossed state lines to engage in economic activity, earning $10,000 in other states as a result of her efforts, would pay a $600 source-based tax to those states and owe a $600 residence-based tax to Maryland, but would receive a credit of only $500 against her residence-based taxes, because Maryland provides no credit against the tax attributed to the county rate. The resident would thus pay a total of $700 in taxes. By contrast, a Maryland resident who confined her economic activity to Maryland and earned $10,000 from such activity would pay a total tax of only $600. The "internal inconsistency" of the Maryland regime is indisputable

II. THE DORMANT COMMERCE CLAUSE BARS MARYLAND FROM TAXING ITS INDIVIDUAL RESIDENTS ON ALL THEIR INCOME WITHOUT PROVIDING FULL RELIEF FROM TAXES IMPOSED ON THE SAME INCOME BY STATES WHERE THE INCOME WAS EARNED.

On the assumption that this case raises only the question whether the dormant Commerce Clause bars a state from taxing its *individual* residents on all of their income earned in interstate commerce without providing full relief from taxes imposed on the same income by the states where the income was earned, the remaining question is whether dormant Commerce Clause principles apply to this case. Indeed, this case could easily be decided if the dormant Commerce Clause simply does not protect individual residents from their own state taxes.

There is no support for such a radically novel approach to Commerce Clause adjudication except a passing comment in *Goldberg v. Sweet,* 488 U.S. 252 (1989), that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Id.* at 266. But *Goldberg* cannot stand for the proposition that the Commerce Clause does not protect residents from their own state taxes. Indeed, the Court's extended treatment of the dormant Commerce Clause issue in *Goldberg* itself would seem to have been unnecessary if resident taxpayers were deprived of Commerce Clause protections from their

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because "imposition of a tax identical to the one in question by every other State" *would* result in multiple taxation and *would* add a "burden to interstate commerce that intrastate commerce would not also bear."

own state taxes, because the challenged tax in that very case–at least in the vast majority of applications–came to rest on in-state residents.

Moreover, even a moment's reflection demonstrates that this Court's dormant Commerce Clause jurisprudence indisputably protects individual residents from their own state taxes in a wide variety of circumstances. Thus, no one would seriously suggest that the dormant Commerce Clause would not protect state residents from their own state taxes that subject income earned from sources in other states to a higher tax rate than income earned from sources within the residence state. A more blatant discrimination against interstate commerce in violation of the "free trade" principles underlying the dormant Commerce Clause is difficult to imagine. Nor would anyone seriously contend that the dormant Commerce Clause does not protect state residents from their own state taxes that impose a higher tax on products produced outside the state than those produced locally. In fact, this Court explicitly recognized this point, thereby repudiating its earlier dictum, when it declared 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." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 203 (1994).

With the exception of its ill-considered dictum in *Goldberg*, which it subsequently repudiated in *West Lynn Creamery*, this Court has never suggested that the dormant Commerce Clause provides less protection to individual state residents from state-imposed burdens on interstate commerce than it provides to any other persons (natural or juridical). To the contrary, the Court has routinely entertained dormant Commerce Clause claims raised by individual residents regarding their own state laws without any mention of a double Commerce Clause standard applied to individual residents as distinguished from other litigants. *See, e.g., Maine v. Taylor*, 477 U.S. 131 (1986) (entertaining Maine resident's dormant Commerce Clause attack on Maine law); *Sporhase v. Nebraska*, 458 U.S. 941 (1982) (entertaining Nebraska residents' dormant Commerce Clause attack on Nebraska law); *cf. Granholm v. Heald*, 544 U.S. 460, 473 (2005) (entertaining dormant Commerce Clause attack by, among others, Michigan residents against Michigan law limiting shipments of out-of-state wine to in-state consumers and noting that Commerce Clause guarantees "citizens of their right to have access to the markets of other States on equal terms"). Indeed, just six years ago this Court considered a dormant Commerce Clause challenge by individual residents to their own state laws in a situation similar to what we have here. In *Dep't. of Revenue v. Davis*, 553 U.S. 328 (2008), the Court considered two Kentucky residents' dormant Commerce Clause challenges to the application of Kentucky's personal income tax. While the Court ultimately rejected the dormant Commerce Clause claim on the merits,[6] there was no suggestion that the dormant Commerce Clause did not protect residents from their own state income taxes, because, of course, it does.

[6] The Court ruled that a tax exemption that "favors a traditional government function without any differential treatment favoring local entities over similar out-of-state interests" does "not 'discriminate against interstate commerce' for purposes of the dormant Commerce Clause." *Id.* at 343 (citation omitted).

Apart from its errant (and subsequently repudiated) comment in *Goldberg*, there is simply nothing in this Court's dormant Commerce Clause jurisprudence that would ever lead one to conclude that the free trade protection the Commerce Clause provides should be compromised when an individual state resident (as distinguished from some other natural or jural person) bears the multiple burdens that state tax legislation imposes on interstate commerce. Indeed, this Court has made it clear that "the dormant Commerce Clause protects *markets* and *participants in markets*, not taxpayers as such." *General Motors Corp. v. Tracy*, 519 U.S. 278, 300 (1997) (emphasis supplied). For this reason, a taxpayer's status as an individual resident is simply irrelevant to the legitimacy of a Commerce Clause claim, which is directed at burdens imposed on *markets* and on *participants in markets.*

Because the dormant Commerce Clause plainly protects individual residents from their own state personal income taxes, and because Maryland's taxing scheme as applied to its individual residents clearly imposes a burden on interstate commerce that the dormant Commerce Clause forbids by subjecting its residents to multiple taxation on the same income, Maryland's taxing scheme must be held invalid. Maryland may fulfill its constitutional obligation through a full credit against its resident tax for taxes paid to other states, as other states do in the context of state personal income taxation, or through some other mechanism that provides the required relief (*e.g.*, apportionment or exemption).

III. DORMANT COMMERCE CLAUSE RESTRAINTS ON STATE TAXATION OF INCOME EARNED IN INTERSTATE COMMERCE BY DOMESTIC CORPORATIONS ALSO INVALIDATE MARYLAND'S TAXING SCHEME

The income being taxed by Maryland here actually includes income attributed to an individual resident shareholder of an S corporation domiciled in Maryland. The S corporation earned its income not only in Maryland but also in many other states. Its out-of-state income was subject to tax in the states where it was earned.

An S corporation is defined in the Internal Revenue Code as a domestic corporation that meets certain ownership and other technical requirements, includeing a limitation of no more than 100 shareholders, and that elects to be treated as an S corporation. 26 U.S.C. §§ 1361, 1362 (as in effect in 2006 and currently). (All other corporations are referred to as C corporations for federal income tax purposes.)

So far as here pertinent, the consequence of making an S corporation election is that, for federal income tax purposes, the corporate entity is essentially ignored. With some minor exceptions not relevant here, all items of income and expense that the corporation generates in carrying on its business are "passed through" to the shareholders and attributed to them for tax reporting purposes. 26 U.S.C. § 1366. The corporate level tax is thereby eliminated and the net income of the business is taxed to the shareholders as if they had earned it directly. The corporation's specific items of income and expense retain their character at the shareholder level, “as if such item were realized *directly from the source from which realized by the corporation*, or incurred in the same manner as incurred by the corporation.” 26 U.S.C. § 1366(b) (emphasis supplied).

Maryland has adopted the federal tax treatment of S corporations. *See* Md. Code Ann., Tax-General (“Tax-Gen.”) §§ 10-101(l), 10-107 , 10-201 *et. seq.*, 10-104(6). It requires individual resident taxpayers to report the full amount of their “federal adjusted gross income” as the starting point for computing their state taxable income. Tax-Gen. § 10-203 . As a result, the entire amount of S corporation income attributed to a resident shareholder for federal income tax purposes is also attributed to the shareholder for Maryland tax purposes. But, as noted, federal adjusted gross income that includes income attributed from an S corporation reflects the character of that income, as if realized directly from the same source. If the S corporation is engaged in interstate commerce, the S corporation income attributed to a resident shareholder will include income earned in interstate commerce. Contrary to the suggestions made here by the Solicitor General and *amicus* Multistate Tax Commission, the income of an S corporation attributed to its shareholders does not change its character and become “personal income” or “investment income” at the shareholder level. Brief for United States as Amicus Curiae Supporting Petitioner at 30 n.6; Brief for Multistate Tax Commission as Amicus Curiae Supporting Petitioner at 10. There is no basis for either such characterization. Rather, the income attributed to the shareholders remains exactly what it is—business income that was earned by their corporation in interstate commerce. Under the

Maryland scheme, the full amount of such income is included in the individual shareholder's tax base.

By contrast, and consistent with fundamental dormant Commerce Clause principles intended to prevent the multiple taxation of income earned in interstate commerce, Maryland affirmatively disavows any attempt to tax the full amount of net income earned by a *corporate resident* doing business both within and without the State. Instead, like other states, Maryland specifically calls for the apportionment of corporate income so that the State will tax only that portion of the net income "derived from or reasonably attributable to" the portion of the corporation's business carried on in Maryland. Tax-Gen. § 10-402. Maryland's apportionment rule complies with the long-standing dormant Commerce Clause requirement, reflected in this Court's distillation of its dormant Commerce Clause doctrine in *Complete Auto Transit v. Brady*, 430 U.S. 274, 287 (1977), that a State may permissibly tax income derived from interstate commerce only to the extent that the income is, *inter alia,* "fairly apportioned" to the taxing state. Neither *Complete Auto Transit* nor any of the Court's other cases interpreting the dormant Commerce Clause sanctions a different analysis for income earned by a corporation merely because it is an S corporation, rather than a C corporation.

Maryland's corporate apportionment statute does not extend to net income earned by a resident S corporation. Nevertheless, as a constitutional matter, Maryland's ability to tax such income is necessarily governed by dormant Commerce Clause principles. Those principles establish that only the amount of net income fairly apportioned to Maryland may permissibly be taxed by Maryland. That is true whether the corporation earning the income is labeled an S corporation or a C corporation. Without apportionment, Maryland would (and does) tax amounts that reflect value earned outside its borders, thereby producing the risk of multiple taxation on such income that impermissibly burdens interstate commerce.[7]

This case is unusual because, in lieu of a provision calling for apportionment of the income earned by a resident S corporation both within and without the State, Maryland offers the individual resident shareholders of such a corporation what it offers to all other individual resident taxpayers, namely, a credit against its resident tax for taxes paid to other states on income earned in those states. Constitutionally, such a credit could be an effective surrogate for the fair apportionment the dormant Commerce Clause requires here, except for one fact: Maryland offers only a *partial* credit, *i.e.,* a credit only against the "State portion" of its income tax. The "County portion" of the Maryland income tax is not subject to credit for taxes paid to other states.[8]

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[7] While there is no decision of this Court squarely holding that a State may not tax the entire net income of a domiciliary corporation without apportionment, there is also no decision holding that it may. The reasoning of all relevant decisions of this Court consistently points to the conclusion that, whether the taxing state is the domiciliary state or a non-domiciliary state, fair apportionment is required to survive a dormant Commerce Clause challenge to the taxation of net income earned in interstate commerce.

[8] A proper credit for tax paid to another state on the same income is intended to ensure that the total tax paid on such income does not exceed the higher of the two state rates involved. *See Container Corp. v. Franchise Tax Board*, 463 U.S. 159, 191 n.30 (1983).

Maryland's refusal to allow a credit against the County portion of its tax ensures that, in the case of an S corporation doing business in any of the numerous states with a higher tax rate than the Maryland "State rate," resident S corporation shareholders would bear two taxes on the same income: (1) the full tax imposed by the other state on the income earned there, plus (2) a Maryland tax at the County rate on the same interstate income. That additional Maryland tax on the income earned out-of-state produces the very type of multiple taxation prohibited by the dormant Commerce Clause, thereby imposing an undue burden on interstate commerce. [9]

Significantly, when viewed in this light, it becomes clear that Maryland's taxing scheme is also facially discriminatory. Not only does it produce an impermissible double tax in those cases when a Maryland S corporation earns income in a higher-tax state, it also discriminates against shareholders and their corporations seeking to compete in high-tax markets by favoring those who choose to limit their activity to within Maryland's own borders or to other low-tax or no-tax states. Shareholders choosing to have their S corporation engage in activity in a high-tax state will invariably be subjected to multiple taxation. The Maryland scheme hampers free trade in the broadest sense, by placing economic pressure on residents to keep their business activities confined to the local market or certain other markets. That pressure denies them the opportunity to make "tax neutral" decisions

[9] In 2006, more than half of the states imposed a tax rate on both corporations and individuals higher than Maryland's state tax rate. The same is true today. *See* State Individual Income Tax Rates, 2000-2014, *Tax Foundation*, *available at* http://taxfoundation.org/article/state-individual-income-tax-rates.

as to where to carry on business. *See generally, Boston Stock Exchange* v. *State Tax Comm'n*, 429 U.S. 318 (1977)

Put another way, the Maryland taxing scheme unequivocally discourages its residents from engaging in interstate commerce in high-tax markets by placing them at a distinct disadvantage in relation to their local competitors in those markets. Such a taxing scheme produces impermissible discrimination against interstate commerce. Only by allowing a full credit against both the State and County portions of its tax (or by providing equivalent relief through apportionment of the taxpayer's income among the states in which was earned or by exempting income earned in other states) can Maryland alleviate the discrimination in its taxing scheme and thereby afford its residents the "tax neutral" choices required under the dormant Commerce Clause.

* * *

The preceding discussion demonstrates that the dormant Commerce Clause protects individual state residents from their own state personal income taxes when those taxes burden interstate commerce and that the dormant Commerce Clause forbids the multiple tax burden imposed on interstate commerce under Maryland's tax regime. The decision below must therefore be affirmed unless this Court abandons its settled precedent and deprives state residents of the dormant Commerce Clause protection they have long enjoyed.

Adoption of a new rule stripping individual residents of their dormant Commerce Clause protection with respect to their own state personal income taxes would destroy the existing understandings on the limits of state tax power that have given rise to a commendable framework for avoiding multiple taxation in this area. If these understandings are disavowed, it may not be long before other states join Maryland in refusing to provide their residents with a credit for taxes they pay on income earned in other states, with devastating consequences for the national common market that the dormant Commerce Clause was designed to foster.

CONCLUSION

For the foregoing reasons, the judgment of the Court of Appeals of Maryland should be affirmed.

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