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 CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENTS

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QUESTION PRESENTED

Whether a state tax that exposes interstate commerce to double taxation is saved from invalidation under the Commerce Clause merely because the State imposes the tax upon its own residents.

TABLE OF CONTENTS

	Page
Interest of *Amicus Curiae*	1
Summary of Argument	2
Argument	5
I. The Maryland Tax Burdens Interstate Commerce in Violation of the Commerce Clause Because It Is Not Fairly Apportioned	7
A. The Commerce Clause Requires States To Fairly Apportion the Tax Base of Multistate Corporations	7
1. State Efforts To Tax Gross Proceeds from Interstate Sources Impermissibly Burden and Discriminate Against Interstate Commerce	7
2. The Court Requires Fair Apportionment To Avoid Impermissible Burdens and Discrimination Against Interstate Commerce	10
B. The Fair Apportionment Requirement Should Apply to S Corporations and Individuals	12
C. Maryland's Tax Scheme Fails To Meet the Fair Apportionment Requirement	15
1. Maryland's Tax Scheme Fails the Internal Consistency Test	15
2. Maryland's Tax Scheme Fails the External Consistency Test	17

TABLE OF CONTENTS—Continued

Page

II. The Rule Urged by the Comptroller Would Threaten Grave Harm to the National Economy 19

A. Maryland's Tax Scheme Obstructs Business and Capital in Interstate Commerce 20

B. The Comptroller's "Residency" Justification Defies Precedent and Reason 22

C. State Penalties on Domestic Businesses for Out-of-State Operations Are of No Less Concern Than State Efforts To Exclude Out-of-State Businesses from In-State Operation 24

Conclusion 25

TABLE OF AUTHORITIES

Page(s)

CASES

Amerada Hess Corp. v. *Dir., Div. of Tax.*, 490 U.S. 66 (1989) 20

American Trucking Assoc., Inc. v. *Scheiner*, 483 U.S. 266 (1987) 11, 21, 24

Baldwin v. *GAF Seelig, Inc.*, 294 U.S. 511 (1935) 12

Best & Co. v. *Maxwell*, 311 U.S. 454 (1940) 12

Brown v. *Maryland*, 25 U.S. (12 Wheat.) 419 (1823) 7

Burwell v. *Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751 (2014) 14

Central Greyhound Lines, Inc. v. *Mealey*, 334 U.S. 653 (1958) 9, 10, 17

Commonwealth Edison Co. v. *Montana*, 453 U.S. 609 (1981) 10

Complete Auto Transit, Inc. v. *Brady*, 430 U.S. 274 (1977) 10, 23

Container Corp. v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) 9, 10

D.H. Holmes Co. v. *McNamara*, 486 U.S. 24 (1988) 10

Frey v. *Comptroller of Treasury*, 29 A.3d 475 (Md. 2011) 15

Goldberg v. *Sweet*, 488 U.S. 252 (1989) .... *passim*

Gwin, White & Prince, Inc. v. *Henneford*, 305 U.S. 434 (1939) 13, 22

H. P. Hood & Sons, Inc. v. *Du Mond*, 336 U.S. 525 (1949) 14

TABLE OF AUTHORITIES—Continued

Page(s)

Hughes v. *Alexandria Scrap Corp.*, 426 U.S. 794 (1976) 14

J.D. Adams Mfg. Co. v. *Storen*, 304 U.S. 307 (1938) 8, 9, 15, 22

Jalbert Leasing, Inc. v. *Massachusetts Port Auth.*, 449 F.3d 1 (1st Cir. 2006) 4

Mobil Oil Corp. v. *Comm'r of Taxes of Vermont*, 445 U.S. 425 (1980) 11

Moorman Mfg. Co. v. *Bair*, 437 U.S. 267 (1978) 10, 11

Oklahoma Tax Comm'n v. *Jefferson Lines*, 514 U.S. 175 (1995) .... *passim*

Schaffer v. *Carter*, 252 U.S. 37 (1920) 9, 18

Standard Oil Co. v. *Peck*, 342 U.S. 382 9

Tyler Pipe Indus. v. *Washington State Dep't of Revenue*, 483 U.S. 232 (1987) 11

Wardair Canada Inc. v. *Florida Dep't of Revenue*, 477 U.S. 1 (1986) 11, 24

Washington Dep't of Revenue v. *Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978) 11

West Lynn Creamery, Inc. v. *Healy*, 512 U.S. 186 (1994) 5, 12, 23

Western Live Stock v. *Bureau of Revenue*, 303 U.S. 250 (1938) .... *passim*

Westinghouse Elec. Corp. v. *Tully*, 466 U.S. 388 (1984) 14, 20

TABLE OF AUTHORITIES—Continued

Page(s)

CONSTITUTIONAL AND STATUTORY PROVISIONS

U.S. Const. art. I, § 8, cl. 3 .... *passim*

26 U.S.C § 1366(b) 18

Md. Code Ann., Econ.-Dev. § 5-540 24

Md. Code Ann., Tax-Gen. § 10-703 16

Md. Code Ann., Tax-Gen. § 10-107 18

OTHER AUTHORITIES

David McCullough, *John Adams* (2001)............. 6

U.S. Census Bureau, *Benchmark Data for Shipments for M3 Industry Categories: 2009-2011*, http://www.census.gov/manufacturing/m3/bench/annualdata.xls 6

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INTEREST OF *AMICUS CURIAE*

The Chamber of Commerce of the United States of America (the "Chamber") is the world's largest business federation.[1] The Chamber represents an underlying

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[1] This brief is filed with the consent of the parties, and letters of consent have been filed with the Court. Pursuant to this Court's Rule 37.6, *amicus* affirms that no counsel for a party authored this brief in whole or in part, that no such counsel or party made a monetary contribution intended to fund the preparation or submission of this brief, and that no person other than *amicus*, its members, or its counsel made such a monetary contribution.

membership of more than three million companies and professional organizations of every size, in every industry sector, and from every region of the country. An important function of the Chamber is to represent the interests of its members in matters before Congress, the Executive Branch, and the courts. To that end, the Chamber regularly files *amicus* briefs in cases that raise issues of vital concern to the Nation's business community.

The Chamber's members are engaged in commerce in and among each of the 50 States and are subject to a wide variety of state taxes and other regulations. As a result, state tax and regulatory schemes can have significant impacts on their business objectives—and, in particular, on their interstate activities. The Chamber has filed *amicus* briefs in other cases involving issues of state taxation and the Commerce Clause. It is, as a result, uniquely suited to offer a business perspective on these issues and keenly interested in ensuring that state taxes and other regulations are consistent with the Commerce Clause.

SUMMARY OF ARGUMENT

The national economy is dependent on the free movement of goods and services throughout the country. That idea is embedded in the Constitution's Commerce Clause and is effectuated, in part, by the prohibition on multiple taxation by different States of income earned through interstate commerce. In order to prevent the "barriers to interstate trade" that such taxation would create, *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 256 (1938), States must fairly apportion taxes levied on residents' out-of-state income. Maryland employs a tax scheme that fails to fairly apportion such taxes and therefore violates the Commerce Clause. Specifically, Mary-

land taxes its residents on income earned in other States but refuses to provide those residents with a full credit for the taxes on that income paid to the other States. That tax scheme is inconsistent with the principle of unimpeded interstate commerce protected by the Commerce Clause.

I. A. This Court has long recognized that Congress's power to regulate interstate commerce limits the ability of multiple States to tax the same interstate transaction. To avoid multiple taxation, States are required to fairly apportion the tax base of multistate corporations among the States in which the corporations do business. Thus, while States have the sovereign power to tax both income earned by their residents and income earned within their borders by residents and nonresidents alike, when a corporation is doing business in multiple States, that power is necessarily limited. States must implement a tax scheme that meets the "double demand that interstate business shall pay its way, and that at the same time it shall not be burdened with cumulative exactions which are not similarly laid on local business." *Western Live Stock*, 303 U.S. at 258. Consistent with this Court's practical, functional approach to the Commerce Clause, a State can meet the fair apportionment requirement in a variety of ways, such as by employing a formula to calculate its fair share of an interstate transaction or providing taxpayers with credits to offset taxes paid to other States.

B. Although this Court's cases developing the fair apportionment requirement involved C Corporations (with separate tax status), that requirement also applies to taxation of S Corporations (with "pass-through" tax status) and individuals. This Court imposed the fair apportionment requirement to minimize the risk of multiple

taxation and to ensure that a State taxes only its fair share of an interstate transaction. Those principles focus on the interstate transaction itself, not the nature of the taxpayer engaged in the transaction, and they are implicated by the taxation of S Corporations and individuals. Moreover, unapportioned taxation of S Corporations and individuals implicates the Commerce Clause's purpose of preventing States from interfering with interstate commerce and reducing economic efficiency. States thus must fairly apportion the tax bases of S Corporations and individuals just as they must do for C Corporations.

C. To determine whether a state tax meets the fair apportionment requirement, this Court assesses whether the tax is both internally and externally consistent. Maryland's tax scheme fails both tests. It is internally inconsistent because, if it were imposed by every State in the country, it would expose interstate commerce to multiple taxation, thereby inhibiting interstate commerce. It is also externally inconsistent because it taxes income earned in other States, "reach[ing] beyond that portion of value that is fairly attributable to economic activity within" its borders. *Oklahoma Tax Comm'n* v. *Jefferson Lines*, 514 U.S. 175, 185 (1995), superseded in part by statute as recognized by *Jalbert Leasing, Inc.* v. *Massachusetts Port Auth.*, 449 F.3d 1, 3 (1st Cir. 2006). Such overreaching both unfairly benefits Maryland, which is taxing income earned in other States that are providing the market and local services that enable the generation of such income, and impermissibly burdens interstate commerce.

II. A. Maryland's tax scheme, and the rule on which the Comptroller relies to defend it, threatens grave harm to the national economy. The tax scheme obstructs the free flow of business and capital across Maryland's bor-

ders, such that nationwide adoption of this scheme would stifle business growth and damage the national economy.

B. The Comptroller's attempt to defend the tax scheme as a tax based on "residency" fails. This Court's precedents show that the residency of the taxpayer is irrelevant when determining whether a tax discriminates against interstate commerce. The Comptroller's argument also employs the sort of formalistic analysis this Court rejected in this context more than thirty-five years ago. A State cannot evade review under the Commerce Clause by labeling a regulation as a mere local price control. *West Lynn Creamery, Inc.* v. *Healy*, 512 U.S. 186, 201-202 (1994). In the same way, a State cannot justify a taxation scheme that inhibits the flow of capital beyond its borders by labeling it a mere tax on residency. More importantly, the logical extension of the Comptroller's reasoning would permit multiple taxation of any interstate transaction so long as the tax imposed is supposedly based on residency, including taxes this Court has previously found to violate the Commerce Clause.

C. Maryland's tax scheme penalizes businesses for seeking to expand outside of the State's borders. That result is akin to, and just as troubling as, States' efforts to block businesses from *entering* their markets that this Court has found violate the Commerce Clause. In both instances, States are prohibited from obstructing commerce from crossing their borders.

ARGUMENT

Every day, millions of Americans and American businesses produce, use, and enjoy goods and services that originated in another State. The Nation's economy, and everyone's economic interests, are more integrated and interdependent than ever before. At the time of the Framing, even prominent Americans like Abigail Adams

of Massachusetts could sensibly think of Pennsylvania as "'that far country,' unimaginably distant." David McCullough, *John Adams* 20 (2001). Back then, travel was arduous and slow; logistical and technological limitations made shipping goods even a short distance a tremendous challenge. Today, by contrast, it passes virtually unnoticed that a Philadelphia business can take orders from customers in Boston and have the product delivered for pickup at its Worcester outlet the next day. Likewise, goods can be manufactured in California, using parts produced in Texas, and shipped to stores in Times Square almost effortlessly. In 2011, $5.5 trillion in goods were shipped in the United States. See U.S. Census Bureau, *Benchmark Data for Shipments for M3 Industry Categories: 2009-2011*, http://www.census.gov/manufacturing/m3/bench/annualdata.xls. And all indications are that the importance of interstate commerce to the national economy will only continue to grow.

That ever-growing integration benefits all Americans. But it brings with it a concomitant danger that state-erected barriers to the free flow of goods, services, and capital will damage the overall health of our economy. The Maryland tax scheme at issue here poses precisely that kind of threat. It subjects Maryland residents to double taxation on income derived from out-of-state sources without any effort to apportion the tax to Maryland's contribution to the income. That regime imposes an impermissible burden on corporations and individuals who do business across State lines and was properly rejected by the decision below.

I. THE MARYLAND TAX BURDENS INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE BECAUSE IT IS NOT FAIRLY APPORTIONED

This Court has repeatedly held that the Commerce Clause prohibits state taxes that burden interstate commerce by imposing multiple taxation on income earned outside a taxpayer's home State. This Court thus requires that state taxes imposed on interstate activities be fairly apportioned to the in-state component of those activities. Maryland's tax scheme fails that requirement.

A. The Commerce Clause Requires States To Fairly Apportion the Tax Base of Multistate Corporations

While the States have undoubted power to tax income, their authority is limited by Congress's exclusive authority over interstate commerce. As this Court explained more than 150 years ago, the Commerce Clause prohibits "the taxing power of the States" from "interfer[ing] with any regulation of commerce." *Brown* v. *Maryland*, 25 U.S. (12 Wheat.) 419, 448-449 (1827). This case concerns one particularly problematic interference with interstate commerce—efforts to subject interstate transactions and income to taxation by multiple States. "[L]ocal taxes, measured by gross receipts from interstate commerce, have often been pronounced unconstitutional" under the Commerce Clause. *Western Live Stock* v. *Bureau of Revenue*, 303 U.S. 250, 255 (1938). The tax at issue here should be no different.

1. *State Efforts To Tax Gross Proceeds from Interstate Sources Impermissibly Burden and Discriminate Against Interstate Commerce*

The threat of multiple taxation arises when multiple States attempt to tax the same transaction by a corporation that does business across state lines. This Court ex-

plained the threat posed by such efforts in *Western Live Stock*. If left unchecked, such taxes would be "imposed * * * with equal right by every state which the commerce touches, merely because interstate commerce is being done, so that without the protection of the commerce clause it would bear cumulative burdens not imposed on local commerce." 303 U.S. at 255-256. Allowing multiple States to tax "the gross receipts from interstate transactions would spell the destruction of interstate commerce and renew the barriers to interstate trade" that the Commerce Clause was designed to tear down. *Ibid.*

As a result, this Court has not hesitated to strike down state tax regimes that, because they act on gross income, expose corporations to duplicate taxation on out-of-state income. For example, in *J.D. Adams Manufacturing Co.* v. *Storen*, 304 U.S. 307 (1938), this Court invalidated an Indiana tax on the "gross income of every resident of the State and the gross income of every nonresident derived from sources within the State." *Id.* at 308. The petitioner, a resident corporation, manufactured and sold road machinery, and most of its customers were outside of Indiana. *Id.* at 308-309. This Court struck down the tax as unconstitutional because it applied to *all* of the corporation's income, no matter its source, thereby exposing income earned out of state to the threat of multiple taxation—once by Indiana and again by the States where the corporation's customers were located. *Id.* at 311-312. The "vice of the statute," this Court held, was "that the tax include[d] in its measure, without apportionment, receipts derived from activities in interstate commerce." *Id.* at 311. Because receipts from interstate sales could be taxed by both the State where the goods were manufactured and the State where the goods were sold, "[i]nterstate commerce would * * * be subjected to the

risk of a double tax burden to which intrastate commerce is not exposed, and which the commerce clause forbids." *Ibid.*

The Court has repeatedly applied that prohibition on multiple taxation to different types of state taxes, including gross receipts taxes, property taxes, and income taxes. See, *e.g.*, *Central Greyhound Lines, Inc.* v. *Mealey*, 334 U.S. 653 (1948) (gross receipts tax); *Standard Oil Co.* v. *Peck*, 342 U.S. 382 (1952) (property tax); *Container Corp.* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983) (income tax). This Court has recognized that States have sovereign power to tax both income earned by their residents (whether earned in or out of state) and income earned within their borders (whether by residents or nonresidents). *Schaffer* v. *Carter*, 252 U.S. 37, 57 (1920). But when a corporation earns income in multiple States, the Commerce Clause prohibits States from subjecting the same corporate income to multiple taxes in different States. In other words, States can require "that interstate business shall pay its way"—the Constitution does not give interstate businesses a "free ride" simply because they operate interstate—but interstate commerce cannot "be burdened with cumulative exactions which are not similarly laid on local business." *Western Live Stock*, 303 U.S. at 258.

Such burdens are particularly damaging in today's integrated economy. Just as consumers have the choice of goods from multiple States, businesses have the choice to establish themselves in multiple States. Even in the field of distinctly local services like restaurants, national enterprises now compete with local business. But with that increase in interstate commerce comes increased risk that States will—intentionally or by neglect—burden interstate commerce to the benefit of local interests. Indis-

criminate taxation of income from out-of-state transactions represents precisely such a threat. The Commerce Clause prevents States from placing a thumb on the scale in favor of local interests, whether through burdens on businesses attempting to enter the State or on those who would take capital out of it.

2. *The Court Requires Fair Apportionment To Avoid Impermissible Burdens and Discrimination Against Interstate Commerce*

To ensure adherence to the prohibition on multiple taxation—while respecting legitimate taxing authority—this Court has upheld state taxes touching on interstate activities where the States "fairly apportion" their taxes to in-state activities. Such apportionment in effect divides multistate corporate tax liability among the States in fair proportion to in-state conduct. See, *e.g.*, *Oklahoma Tax Comm'n* v. *Jefferson Lines, Inc.*, 514 U.S. 175 (1995); *Container Corp.*, 463 U.S. 159; *Moorman Mfg. Co.* v. *Bair*, 437 U.S. 267 (1978); *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274 (1977); *Central Greyhound*, 334 U.S. 653.

In *Complete Auto*, the Court formulated a four-part test to determine whether a state tax violates the Commerce Clause, with the fair apportionment requirement at issue here as the second step. *Complete Auto*, 430 U.S. at 279.[2] The Court has since developed two further in-

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[2] That four-part test is now applied whenever a state tax of almost any kind is challenged on Commerce Clause grounds. See, *e.g.*, *Goldberg* v. *Sweet*, 488 U.S. 252 (1989) (tax on telephone calls); *Container Corp.*, 463 U.S. 159 (franchise tax); *Jefferson Lines*, 514 U.S. 175 (sales tax on bus tickets); *D.H. Holmes Co.* v. *McNamara*, 486 U.S. 24 (1988) (use tax); *Wardair Canada Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1 (1986) (sales tax on fuel used in international commerce); *Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609

quiries to implement the fair apportionment requirement. First, state taxes must be "internally consistent," such that "no multiple taxation would result" if an identical tax were imposed by every State. *Goldberg* v. *Sweet,* 488 U.S. 252, 261 (1989). Second, the state tax must be "externally consistent," such that it reaches only the "value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185.

The Court has declined to prescribe a single approach to fair apportionment. States are free to employ a variety of formulas to divide a corporation's tax liability among the States in which the corporation does business. See *Moorman Mfg.*, 437 U.S. at 276-280 (describing different formulas used by various States). States also avoid impermissible multiple taxation by offering tax credits for taxes paid to other States, see *Tyler Pipe Indus.* v. *Washington State Dep't of Revenue*, 483 U.S. 232, 245 n.13 (1987) (tax credits can "alleviate or eliminate the potential multiple taxation that results when two or more sovereigns have jurisdiction to tax parts of the same chain of commercial events"), or reciprocally recognizing payments made to other States, see *American Trucking Assoc., Inc.* v. *Scheiner*, 483 U.S. 266, 283 (1987) (reciprocal treatment of other States' vehicle registration fees ensures that "the Commerce Clause is not offended" because "state boundaries are economically irrelevant"). States thus have considerable flexibility in meeting the fair apportionment requirement. But they cannot create

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(1981) (severance tax); *Mobil Oil Corp.* v. *Comm'r of Taxes of Vermont,* 445 U.S. 425 (1980) (corporate income tax); *Washington Dep't of Revenue* v. *Ass'n of Washington Stevedoring Cos.*, 435 U.S. 734 (1978) (business and occupation tax).

a scheme that systematically exposes interstate transactions to multiple taxation.

The flexibility of the fair apportionment test flows from the Court's broader Commerce Clause jurisprudence, which has repeatedly emphasized the need for a practical, functional analysis of state regulations. As this Court explained in *West Lynn Creamery, Inc.* v. *Healy*:

> Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce. Rather our cases have eschewed formalism for a sensitive, case-by-case analysis of purposes and effects. As the Court declared over 50 years ago: "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce."

512 U.S. 186, 201-202 (1994) (quoting *Best & Co.* v. *Maxwell*, 311 U.S. 454, 455-456 (1940)); see also *Baldwin* v. *GAF Seelig, Inc.*, 294 U.S. 511, 527 (1935) ("What is ultimate is the principle that one state in its dealings with another may not put itself in a position of economic isolation. Formulas and catchwords are subordinate to this overmastering requirement.").

B. The Fair Apportionment Requirement Should Apply to S Corporations and Individuals

This Court's cases developing the fair apportionment requirement generally involved so-called "C Corporations"—corporations that are subject to taxation separately from their owners. See *Goldberg*, 488 U.S. at 261 (collecting cases). But the same principles that give rise to the prohibition on multiple taxation of C Corporations

also support a rule against multiple taxation of S Corporations and individuals. Such a rule properly applies to all persons and entities engaged in interstate commerce that are threatened with overlapping state taxes that disadvantage their interstate activities.[3]

The Court's prohibition on multiple taxation is based on a recognition of the unassailable fact that multiple taxation "discriminates against interstate commerce." *Gwin, White & Prince, Inc.* v. *Henneford*, 305 U.S. 434, 438 (1939). And a tax does so if "it imposes upon [interstate commerce], merely because interstate commerce is being done, the risk of a multiple burden to which local commerce is not exposed." *Id.* at 439. That disparate burden is, of course, felt acutely by multistate C Corporations, which are themselves subject to taxation. They may confront multiple taxation of a single transaction that a company doing business in only one State would not. But the same is true for interstate S corporations and individuals engaging in the same transactions.

Moreover, because the Commerce Clause prohibits a State from taxing more than "its fair share of an *interstate transaction*," *Goldberg*, 488 U.S. at 261 (emphasis added), this Court should reject any effort to limit the Commerce Clause's protections depending on the nature of the corporate form. The Commerce Clause is implicated by all impediments to interstate transactions, regardless of the identity of the parties involved in the transaction.

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[3] The United States suggests that "[i]t is an open question whether States are constitutionally *required* to apportion the income of" C Corporations. U.S. Br. 31. But that contention conflicts with decades of this Court's holdings. See pp. 7-12, *supra*.

Nor do practical considerations suggest a different result. The chief concern of the Commerce Clause is to prevent States from interfering with interstate commerce and the economic efficiency that accompanies it. See *H. P. Hood & Sons, Inc.* v. *Du Mond*, 336 U.S. 525, 535 (1949) (explaining historical underpinnings of the Commerce Clause). This "Nation is a common market in which state lines cannot be made barriers to the free flow of both raw materials and finished goods in response to the economic laws of supply and demand." *Hughes* v. *Alexandria Scrap Corp.*, 426 U.S. 794, 803 (1976). Indeed, "[t]he very purpose of the Commerce Clause was to create an area of free trade among the several States." *Westinghouse Elec. Corp.* v. *Tully*, 466 U.S. 388, 402 (1984) (quotation marks omitted). The fair apportionment requirement was formulated to further that purpose. See, *e.g.*, *Western Live Stock,* 303 U.S. at 256 (explaining that unapportioned taxes on multistate corporations would "renew the barriers to interstate trade which it was the object of the commerce clause to remove").

The Commerce Clause's prohibition on multiple taxation likewise should focus on the effects on interstate commerce itself. Businesses engaged in interstate commerce—whether incorporated, operating as partnerships or proprietorships, for-profit or charitable causes—owe their existence and operations to individuals. And as this Court recently noted, a "corporation is simply a form of organization used by human beings to achieve desired ends." *Burwell* v. *Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751, 2768 (2014). Individuals operating through a particular corporate form (or operating without such organization) should not be subject to disparate and disfavorable double taxation simply because they operate interstate.

C. Maryland's Tax Scheme Fails To Meet the Fair Apportionment Requirement

As Maryland's highest court recognized, Maryland's tax scheme does not survive the tests of internal and external consistency.

1. *Maryland's Tax Scheme Fails the Internal Consistency Test*

A tax is internally consistent "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." *Jefferson Lines*, 514 U.S. at 185. In other words, a tax is internally consistent if it could be imposed by every State, and "no multiple taxation would result." *Goldberg,* 488 U.S. at 261. But if every State in the country were to apply the same tax scheme and the result would be that interstate commerce suffers a burden that intrastate commerce does not, then the tax scheme is internally inconsistent and invalid under the Commerce Clause. *Jefferson Lines*, 514 U.S. at 185.

The Maryland tax scheme fails the internal consistency test—and blatantly so. A portion of the taxes Maryland imposes applies to the entirety of its residents' income without apportionment and regardless of source, much like the Indiana tax this Court struck down in *J.D. Adams*. 304 U.S. at 307. In particular, Maryland imposes two types of taxes on its residents' income: a "state" tax and a "county" tax.[4] Pet. App. 4-5. Maryland also taxes nonresidents on income earned in Maryland. *Ibid.* If a Maryland resident pays taxes to other States on income earned in those States, Maryland applies (with cer-

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[4] Under Maryland law, both types of taxes are considered state taxes. *Frey* v. *Comptroller of Treasury*, 29 A.3d 475, 492 (Md. 2011).

tain limitations) a credit against that resident's "state" tax liability. Md. Code Ann., Tax-Gen. § 10-703. But Maryland gives no credit against the resident's "county" tax liability. *Ibid.* Thus, a Maryland resident pays a portion of his income tax, levied as a percentage of his entire income, no matter where that income is earned and without regard to whether the income is simultaneously taxed by a different State.

If *every* State (or their municipal subdivisions) were to tax the entirety of resident income regardless of its source, and *every* State (or their municipal subdivisions) taxed the income of nonresidents earned within its borders, taxpayers engaged in interstate commerce would be subjected to multiple taxation. A taxpayer residing in Indiana with income in Ohio, for example, would first pay Ohio taxes on income from Ohio as a nonresident; the taxpayer would then pay Indiana taxes on that same Ohio-based income as an Indiana resident. Conversely, every taxpayer whose income-generating activities occurred entirely within his State of residence would only be subjected to that State's tax. If that same Indiana taxpayer, for example, derived the same income only from sales within Indiana, the income would be taxed only once. As a result, interstate commerce would be burdened in a way that intrastate commerce would not. This "failure of internal consistency shows as a matter of law that a State is attempting to take more than its fair share of taxes from the interstate transaction." *Jefferson Lines*, 514 U.S. at 185. That, in turn, demonstrates that the State's tax scheme imposes a burden on interstate commerce that intrastate commerce does not face, and therefore offends the Commerce Clause. *Ibid.*

Both the Comptroller and the United States argue that the constitutionality of a state tax should not be de-

pendent on the taxing decisions of other States. Comptroller Br. 30-32; U.S. Br. 10-12. That statement is correct, but it does not advance their cause. This Court has held that the fair apportionment requirement applies even if no other State has actually imposed the same tax. *Central Greyhound*, 334 U.S. at 663. To fail the fair apportionment requirement, a law need only create the *possibility* that multiple taxation could occur. *Ibid.* The internal consistency test thus considers the hypothetical situation where every State does impose an identical tax. And the Comptroller and the United States cannot dispute that Maryland's tax scheme, if adopted by every State, would subject interstate commerce (but not intrastate commerce) to double taxation. It thus is not the case that Maryland's power to impose its tax would "vanish and reappear according to how other states choose to tax." Comptroller Br. 32. The tax is unconstitutional regardless of whether Maryland is alone or joined by others in "attempting to take more than its fair share of taxes from the interstate transaction." *Jefferson Lines*, 514 U.S. at 185.

2. *Maryland's Tax Scheme Fails the External Consistency Test*

While failure to meet the internal consistency test is itself fatal, Maryland's tax fails the external consistency test as well. A tax is externally consistent if it applies to "only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262. A state tax fails the external consistency test if it "reaches beyond that portion of value that is fairly attributable to economic activity within the taxing State." *Jefferson Lines*, 514 U.S. at 185.

In this case, much of the Wynnes' income is generated by their S Corporation, Maxim Healthcare, and "passes through" to them. Under both federal and Maryland tax statutes, that income is attributed to them as if it "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); Md. Code Ann., Tax-Gen. § 10-107. Accordingly, the Wynnes' income derives from the States in which Maxim Healthcare does business, including the 39 States to which Maxim Healthcare paid income taxes in 2006. Pet. App. 9. By taxing income earned in other States and providing the Wynnes with no credit against the county tax for taxes paid to other States on that income, Maryland taxes income that is not attributable to economic activity in Maryland.

That is precisely the sort of beggar-thy-neighbor regime the Commerce Clause abhors. The States from which the Wynnes derive income provide enormous benefits to the Wynnes and their businesses, including economic markets conducive to earning that income, local services such as fire and police protection, and infrastructure. As such, those States fairly tax the Wynnes on the income earned in those States. See *Schaffer*, 252 U.S. at 51. Maryland itself recognizes the value States provide to nonresidents, as it taxes nonresidents on income earned in Maryland. Pet. App. 4-5. Such revenue pays for the local services Maryland provides to those nonresidents, and is one way that interstate commerce is made to "pay its way." *Western Live Stock*, 303 U.S. at 254.

Maryland's unapportioned taxation of the Wynnes' out-of-state income cannot be reconciled with that structure. Maryland taxes income that was produced with no assistance or support from Maryland, and places a dis-

proportionate burden of support on the Wynnes. Generating more income from out-of-state sources does not plausibly suggest that they use more local services. If anything, the more income a taxpayer earns out of state, the more likely it is that the taxpayer is using *fewer* services in-state. Nevertheless, in 2006, the Wynnes already funded local services with the more than $81,000 they paid in county taxes on income earned in Maryland. J.A. 19 (line 31). Further, the Wynnes paid over $42,000 in state taxes on income earned in Maryland, a portion of which paid for local services. J.A. 19 (line 30). And they paid thousands more in property taxes. Wynnes' C.A. Br. 46 n.17. By seeking tax revenue derived from income earned in other States, Maryland's tax scheme overreaches, burdening interstate commerce and the Wynnes themselves.

II. THE RULE URGED BY THE COMPTROLLER WOULD THREATEN GRAVE HARM TO THE NATIONAL ECONOMY

The burden imposed by Maryland's tax scheme has particularly troubling implications for the business community. Allowing States to tax the entirety of a resident's income, without accounting for taxes paid to the State where the income was derived, threatens to "renew the barriers to interstate trade which it was the object of the commerce clause to remove." *Western Live Stock*, 303 U.S. at 256. Under this Court's functional approach to the Commerce Clause, those potential effects confirm the infirmity of Maryland's tax scheme. States have no authority to balkanize the Nation's integrated economy by discriminating against goods and services that cross state borders. Nor can they achieve the same result by failing to comply with this Court's well-established requirement that taxes be fairly apportioned.

A. Maryland's Tax Scheme Obstructs Business and Capital in Interstate Commerce

The impact of Maryland's tax scheme is obvious: It encourages Maryland businesses to keep their revenue-generating operations in (or move those operations to) the State to avoid multiple taxation. That is precisely the sort of "pressure on an interstate business to conduct more of its activities" in-state that the Commerce Clause proscribes. *Amerada Hess Corp.* v. *Dir., Div. of Tax.*, 490 U.S. 66, 77-78 (1989).

For example, a Maryland resident with a small business selling high-tech solar panels might find it attractive to expand into nearby Virginia. In the "area of free trade among the several States" the Commerce Clause was designed to create, *Westinghouse Elec. Corp.*, 466 U.S. at 402 (quotation marks omitted), she would base her decision on factors related to revenues and expenses, such as potential customers, potential competitors, and costs associated with providing services in Virginia, including Virginia taxes. If those factors offered better opportunities than comparable expansion within Maryland, she ordinarily would expand into Virginia. But Maryland's tax scheme throws a monkey wrench into that calculation. Under it, the Maryland business owner would determine her expected earnings from Virginia, net of Virginia taxes, and then deduct out *another* unapportioned Maryland county tax on the same revenues. As a result, even if the opportunities were in all other respects equal, the business owner would choose to expand in Maryland rather than Virginia *solely* because expansion into Virginia is burdened not just by Virginia taxes but by Maryland's unapportioned county tax as well.

Indeed, even if the Maryland business market presented a less advantageous opportunity than Virginia's,

Maryland's tax scheme would steer expansion into Maryland whenever the difference in expected profits were less than the marginal Maryland county tax liability. The Maryland business owner would feel precisely the "forbidden impact on interstate commerce" that this Court has condemned in the past, as the Maryland tax scheme "exerts an inexorable hydraulic pressure on interstate businesses to ply their trade within the State that enacted the measure rather than 'among the several States.'" *Scheiner*, 483 U.S. at 286-287 (quoting U.S. Const. art. I, § 8, cl. 3).

That burden is particularly acute for industries that operate on already narrow profit margins (often to consumer benefit). For such businesses, Maryland's tax scheme would make almost *any* interstate expansion a significantly less attractive option. The Commerce Clause forbids that result not because it is poor economic policy (though it undoubtedly is). The Commerce Clause forbids it because it imposes a burden on interstate commerce that intrastate commerce does not have to bear.

Maryland's tax scheme denies benefits to out-of-state consumers who would benefit from the expansion of Maryland businesses into their neighborhoods (in our example, Virginia solar-panel buyers). It also denies out-of-state businesses the ability to attract Maryland investors or business partners. Because of Maryland's unapportioned county income tax, an out-of-state business in neighboring Pennsylvania, for example, may have a harder time obtaining capital from Maryland investors. A Maryland investor looking at a Pennsylvania business opportunity may balk if he knows that he will be taxed multiple times on his share of that company's income—first by Pennsylvania, and then again by Maryland. If the Maryland investor puts his money in a Maryland

business instead, he avoids that double taxation. Unless the Pennsylvania company can outperform its Maryland competitor by the amount of the Maryland county tax liability, Maryland investors would just as soon invest in-state. Maryland may find it advantageous to discourage its residents from investing outside the State in favor of in-state opportunities, but that is the sort of preference the Commerce Clause will not tolerate. And the pursuit of similar policies by all States would dam the flow of capital across state boundaries to the detriment of all. Neither Maryland nor any other State should be permitted to impose such burdens on interstate commerce—the very barriers the Commerce Clause was designed to remove.

B. The Comptroller's "Residency" Justification Defies Precedent and Reason

The Comptroller seeks to avoid the fair apportionment requirement entirely on the theory that, because the tax is based on "residency," only Maryland's own residents will suffer double taxation. Comptroller Br. 37. Under this Court's cases, however, the taxpayer's residence is irrelevant to whether a particular tax scheme impermissibly subjects an interstate transaction to multiple taxation. See, *e.g.*, *J.D. Adams*, 304 U.S. at 308 (striking down an unapportioned Indiana tax as applied to an Indiana corporation); *Gwin*, 305 U.S. at 435 (striking down an unapportioned Washington tax as applied to a Washington corporation). The argument also makes no sense. Taxes that discriminate against Maryland residents for doing business outside that State burden interstate commerce no less than taxes that discriminate against nonresidents who do business inside that State.

The claim that Maryland's tax scheme need not be fairly apportioned because it is based on the "status" of

"being a resident," Comptroller Br. 37-39, also rests on the sort of label-based formalism this Court's Commerce Clause jurisprudence eschews. In *Complete Auto*, the Court rejected the argument that the name or description attached to an otherwise impermissible tax can somehow save it. 430 U.S. at 288. The Court noted that that type of analysis "merely obscures the question of whether the tax produces a forbidden effect." *Ibid.*; see also *West Lynn Creamery*, 512 U.S. at 201 ("Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce."). Whatever label is attached to it, Maryland's tax scheme has the *effect* of exposing the Wynnes' income to the threat of impermissible multiple taxation. It is that effect that renders the tax repugnant to the Commerce Clause.

In any event, it is something of a misnomer to label the tax at issue as "based on residency." Comptroller Br. 37. The tax is imposed on and measured by income—not on some measure of the individual's residency. If every State could tax all of its residents' income from any source on the theory that the tax is based on residency, the Commerce Clause would cease to offer any protection so long as the State chooses appropriate labels. It is clear that Maryland could not, for example, impose a use tax on out-of-state purchases made by its residents, based upon their status as residents, and refuse to provide a credit even when those residents paid a sales tax on that transaction in another State. Such a tax would result in the multiple taxation of an interstate transaction prohibited by the Commerce Clause. *Jefferson Lines*, 514 U.S. at 194-195. The Comptroller's rationale, however, would support precisely that result. No matter how the Maryland tax scheme is described, it subjects out-of-

state transactions and the resulting income to the risk of multiple taxation. Because that offends the Commerce Clause, the judgment of the Maryland Court of Appeals should be affirmed.

C. State Penalties on Domestic Businesses for Out-of-State Operations Are of No Less Concern Than State Efforts To Exclude Out-of-State Businesses from In-State Operation

The Maryland tax scheme impermissibly pressures in-state businesses to remain in-state. That type of interference with interstate commerce is just as troubling as State efforts to exclude out-of-state businesses from their boundaries. Indeed, it raises the same concerns that prompted the adoption of the Commerce Clause to begin with: "tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Jefferson Lines*, 514 U.S. at 180 (quoting *Wardair Canada, Inc.* v. *Florida Dep't of Revenue*, 477 U.S. 1, 7 (1986)).

Maryland's tax scheme imposes a penalty in the form of multiple taxation of *any* income earned in another State that (like Maryland) taxes income derived within its borders. As such, the scheme has the "inevitable effect" of "placing a financial barrier around" Maryland. *Scheiner*, 483 U.S. at 284. If Maryland wishes to promote expansion of local businesses, it has many means at its disposal, including the provision of subsidies. See, *e.g.*, Md. Code Ann., Econ.-Dev. § 5-540 (authorizing financial assistance to small businesses). But penalizing businesses that venture out of state and restricting the free flow of capital beyond Maryland's borders is not among them.

CONCLUSION

For the foregoing reasons, and those stated in respondents' brief, the judgment of the Court of Appeals of Maryland should be affirmed.

Respectfully submitted.

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