No. 13-485

IN THE
Supreme Court of the United States

COMPTROLLER OF THE TREASURY OF MARYLAND,
Petitioner,
v.

ROBERT WYNNE, ET UX.,
Respondent.

On Writ of Certiorari to the Court of Appeals of Maryland

BRIEF OF TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF RESPONDENT

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INTEREST OF *AMICUS CURIAE*[1]

Tax Foundation submits this brief as *amicus*

[1] Pursuant to Supreme Court Rule 37.6, counsel for *Amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *Amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *Amicus* represents both that all parties were provided notice of *Amicus*'s intention to file this brief at least 10 days before its due date and that all parties have filed letters with the clerk of the Court granting blanket consent to the filing of *amicus* briefs.

curiae in support of Respondent in the above-captioned matter.

The Tax Foundation is a non-partisan, non-profit research organization founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., we seek to make information about government finance more accessible to the general public. Our analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. The Tax Foundation's Center for Legal Reform furthers these goals by educating the legal community about economics and principled tax policy.

This Court's decision will provide guidance on the line between states' power to shape their tax systems and the limits on that power guarded by the Commerce Clause. Because *Amicus* has testified and written extensively on the scope of state tax authority and because this Court's decision may impact tax policy developments in other states, *Amicus* has an institutional interest in this Court's ruling.

SUMMARY OF ARGUMENT

Maryland's failure to allow a full credit for taxes paid to other states violates the *Complete Auto* four-part test and substantially burdens interstate commerce. There are also substantial reliance interests at stake in this case because tax practitioners and experts have long understood that states are required to offer a credit for taxes paid to other states as a matter of constitutional compliance, and businesses have been entering into interstate transactions for decades based on this assumption.

Maryland's argument that S Corporations are not protected by the dormant Commerce Clause when the

income is taxed by the taxpayer's state of residence would have wide-ranging, devastating consequences for the business community. There is no constitutional reason why the constitutional limitations on states' authority to tax interstate transactions should be suspended for S corporations, particularly as S Corporations have been the largest business entity type in the United States since 1997.

ARGUMENT

I. STATE TAXATION OF INTERSTATE INCOME WITHOUT A CREDIT FOR TAXES PAID TO OTHER STATES RESULTS IN DISCRIMINATORY TAXATION OF INTERSTATE INCOME AND UNDERMINES SIGNIFICANT RELIANCE INTERESTS.

Taxpayers and states rely on this Court's four-part *Complete Auto* test to evaluate whether a state tax practice violates the Commerce Clause. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). *Complete Auto* held that a tax will survive a Commerce Clause challenge if the "tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State." *See id.* at 279. If a tax violates any of the four prongs, then the tax violates the Commerce Clause and is unconstitutional.

Tax practitioners and experts have long understood that if two or more states tax the same income, then the states have to offer a credit for taxes paid to the other state, since otherwise taxpayers will face multiple taxation on interstate income but not in-state income in violation of *Complete Auto*'s third

prong. As just one example, the preeminent authority in State and Local Tax, Professor Walter Hellerstein, writes in his textbook that the Commerce Clause requires a credit for taxes paid to other states since otherwise multiple taxation would result, with interstate activity being taxed more than intrastate activity. *See* WALTER HELLERSTEIN, STATE TAXATION ¶ 20.10 (3d ed. 2014). Every state with a broad-based income tax consequently offers a credit for income taxes paid to other states, not out of an altruistic willingness to forego taxes on income taxed by sister states, but grudgingly in the belief that it is constitutionally required to prevent multiple taxation.[2]

A. Maryland's Failure to Provide a Local Income Tax Credit for Taxes Paid to Another State Violates the Commerce Clause.

Maryland's tax law punishes taxpayers for earning income in other states instead of earning it wholly in Maryland. Maryland wants its subordinate political creations (counties and one city, Baltimore) to tax a Maryland resident's income in a manner

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[2] While this case involves county and city income taxes, the counties' taxes are authorized and defined by state statute, collected on the state tax form, and administered by state officials. Further, the counties and cities themselves are creations of the state government, with their revenue powers defined by the state constitution and state law. More to the point, there is no workable or justifiable reason why state-authorized but county-level income taxes would be permitted to use taxation to punish interstate investment but states cannot. States will certainly construe a decision by this Court as applying to state taxes. It should make no constitutional difference that the tax at issue is technically a county income tax.

whereby interstate income is taxed multiple times by both the Maryland entity and by sister states. A Maryland resident earning otherwise identical income wholly within Maryland is taxed only once. A non-resident who earns income in another state is taxed only once. A non-resident who earns income in more than one state is taxed only once, since other states provide a credit for taxes paid to another state. Maryland's statute uniquely disadvantages Maryland residents who earn interstate income. Had the Wynnes' income been earned purely in-state, they would have paid less in taxes to Maryland and not been subject to multiple taxation on the same dollar of income.

The Commerce Clause prohibits states from imposing a tax on activity out-of-state while leaving identical activity in-state untaxed. *See Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977) (invalidating a New York tax imposed solely on activity out-of-state while leaving identical activity in-state untaxed); *Westinghouse Elec. Co. v. Tully*, 466 U.S. 388 (1984) (invalidating a New York scheme exempting activity in-state while simultaneously imposed a tax on identical activity out-of-state); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating a Hawaii tax imposed on a category of products but exempting activity in-state); *Am. Trucking Ass'n v. Scheiner*, 483 U.S. 266 (1987) (invalidating a Pennsylvania scheme imposing fees on all trucks while reducing other taxes for trucks in-state only); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988) (invalidating an Ohio tax credit to all ethanol producers but disallowed for non-Ohio producers); *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) (invalidating a Massachusetts general

tax on dairy producers where the revenue was then distributed to domestic dairy producers); *Camps/Newfound/Owatanna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (invalidating Maine's denial of the general charitable deduction to organizations that primarily serve non-Maine residents). *But see Dep't. of Revenue of Ky. v. Davis*, 553 U.S. 328 (2008) (upholding Kentucky's exclusion from tax of interest earned from its state bonds, but not other states bonds, on the grounds that Kentucky is acting as a market participant no different from any other bond issuer).

States certainly have a desire to encourage in-state investment but the Commerce Clause forbids states from achieving these ends by punishing with multiple taxation those who choose to participate in the interstate economy. Individuals and businesses have been working across state lines and entering into large, complicated business arrangements for decades believing that they are safe from multiple taxation. If Maryland's tax law is upheld, then it would open the flood gates to allow every state with a broad-based income tax to deny its residents a credit for taxes paid to other states.

The Comptroller argues that since the Wynne's are Maryland residents, Maryland may tax their income earned both in-state and out of state without offering a credit for taxes paid to other states. The Comptroller's argument would effectively nullify the dormant Commerce Clause when the tax law at issue discriminates against a state's own resident. This argument confuses the dormant Commerce Clause, which protects interstate commerce from discrimination by the states, with the Privileges and Immunities Clause, which protects nonresidents from

discrimination. The primary inquiry for the dormant Commerce Clause is whether *interstate commerce* is burdened, not whether the law in question discriminates against a resident or nonresident of a state. Here, the Maryland law discriminates against interstate commerce because the Wynnes' business income was taxed at a higher effective rate due solely to the fact that it was earned out of state.

B. Maryland Power to Tax Residents' Income Earned in Other States is, and Ought to Be, Limited.

The Comptroller argues that mandating a credit for taxes paid to other states in this case leads to "the perverse effect" of allowing some taxpayers to get all the benefits of being a Maryland resident without paying any income taxes. *See* Pet. at 12. First, this is not factually true in this case since the Wynnes pay substantial Maryland taxes, nor in general because Maryland's power to tax Maryland-sourced income would be unthreatened. What is at issue in this case is Maryland's taxation of income sourced *to other states* without offering a credit to mitigate multiple taxation. States should not be constitutionally permitted to subject interstate commerce to multiple taxation simply because the person being taxed is a resident of the state. Second, Maryland along with every state and the federal government allow certain taxpayers to receive benefits without necessarily paying income taxes. In 2011, 37 percent of all federal tax filers in the United States owed no federal income taxes after deductions and credits. *See* TAX FOUNDATION, PUTTING A FACE ON AMERICA'S TAX RETURNS 22 (2013), http://taxfoundation.org/slideshow/putting-face-americas-tax-returns. This a common policy decision that allows some individuals

to reap the benefits of government while also granting them a break on income taxes.

This Court should take this opportunity to affirm the decision below and send a message to other states that *Complete Auto* means what it says and that a state cannot violate the dormant Commerce Clause solely because the person or business being taxed is a resident of the state.

C. The Relevant Inquiry is Not Whether the Taxpayer is a Resident, but Whether the Tax is on Interstate Income.

The Comptroller asserts that the internal consistency prong of the *Complete Auto* test has not previously been applied to the individual income taxes of residents before the Maryland Court of Appeals' decision. *See* Pet. at 9. Therefore, the Comptroller argues, the application of the internal consistency test was unprecedented. The Comptroller's argument ignores the fact that this Court has applied the internal consistency test wherever interstate transactions are at issue. *See, e.g.*, *Amer. Trucking Assocs. v. Mich. Public Serv.*, 545 U.S. 429, 437 (2005).

What the Comptroller misunderstands is that the Court of Appeals did not apply the internal consistency test because Maryland fully taxed a resident, it applied the test because Maryland fully taxed a resident *on business income earned in 39 states*. Credits and deductions are certainly a matter of legislative grace with respect to Maryland's taxation of income earned wholly within Maryland by Maryland residents with no interstate implications. *See* Pet. at 9 (arguing that the Commerce Clause does not protect residents from discriminatory taxation of their in-state income by their state of residence). But

when Maryland taxes income that *all other states would properly source as being earned outside Maryland*, the internal consistency inquiry is warranted.

D. Income Earned via S Corporations is Not Excluded from Commerce Clause Protections.

The Comptroller argues that the owners of S Corporations are not protected from discriminatory taxation by their state of residence under the dormant Commerce Clause. *See* Pet. at 9. This is an important point because S Corporations now account for the vast majority of business entities in this country. S Corporations became the most common corporate entity back in 1997 and now account for at least 3.3 million income tax returns filed. *See, e.g.*, Internal Revenue Service, *S Corporation Returns*, http://www.irs.gov/uac/SOI-Tax-Stats-S-Corporation-Statistics.

If the Comptroller's argument were to win the day, it would open the door for every state in the country to tax S Corporation income at a higher rate than intrastate C Corporation income simply because the income flows through to the individual rather than being taxed at the corporate level. This Court should make it clear that states may not discriminate against interstate commerce simply because an S Corporation's income flows through to an individual.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court affirm the decision of the Maryland Court of Appeals.

Respectfully submitted,

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