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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 Maryland Court of Appeals

BRIEF OF *AMICUS CURIAE* AMERICAN ASSOCIATION OF ATTORNEY-CERTIFIED PUBLIC ACCOUNTANTS, INC. SUPPORTING RESPONDENTS

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INTEREST OF *AMICUS CURIAE* [1]

Amicus is the American Association of Attorney-Certified Public Accountants, Inc. ("AAA-CPA"), a not-for-profit corporation, formed in 1964 and now headquartered in Virginia. The AAA-CPA has members located throughout the United States. Every "regular member" has been licensed as both an attorney and a certified public accountant.

AAA-CPA members, with both accounting and law backgrounds, have unique perspectives on business and taxes. A significant percentage of the AAA-CPA members have devoted their careers to the field of tax law, both federal taxes and state and local taxes, and represent a very wide variety of industries. As such, the AAA-CPA membership is in a unique position to view how Maryland's income tax and credit structure affects individuals who reside in Maryland but who receive source income from other states.

SUMMARY OF ARGUMENT

Maryland's failure to offer a full credit to its residents against the individual's state income tax, specifically the local component, violates the Commerce Clause of the U.S. Constitution.

While a corporation as a taxable entity is protected by an apportionment mechanism from an undue tax burden in Maryland and elsewhere, Maryland fails to accord proper protection to resident individuals with

[1] Counsel for *amicus* represent that they authored this brief in its entirety and that none of the parties nor their counsel, nor any other person or entity other than *amicus*, its members, or its counsel have made a monetary contribution intended to fund the preparation or submission of this brief. Counsel of record for all parties have given blanket consent to the filing of *amicus* briefs.

income having a source in other states, proffering that it is taxing its residents rather than taxing their income and that any mitigation is gratuitous.

As set forth in the Argument below, the right of a state to tax the income of its residents is not beyond constraints of the Commerce Clause. Maryland must fairly apportion the income tax burden of its residents to avoid discrimination against professionals and other businesses where an owner resides in Maryland but chooses to engage in interstate commerce.

ARGUMENT

I. MARYLAND'S "PIGGYBACK" COUNTY INCOME TAX IS A STATE TAX FACILITATING REVENUE TO BE SHARED WITH ITS COUNTIES AND ITS INDEPENDENT CITY.

Intergovernmental transfers to local governments constitute approximately half a trillion dollars in annual disbursements and make up about 38 percent of local government revenues. *See* David E. Wildasin, *Intergovernmental Transfers to Local Governments* 1 (Inst. for Federalism & Intergovernmental Relations, Working Paper No. 2009-11 (2009)). In the case of most states, the amount of any income tax revenues to be transferred to localities is not separately stated as it is in Maryland.

However, given the tax structure in Maryland, the separately stated "piggyback"[2] tax is effectively

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[2] A "piggyback" is defined by Merriam-Webster as "up on the back and shoulders." MERRIAM-WEBSTER DICTIONARY 374–75 (2005). Despite a 1999 statutory modification so that the county tax was no longer a percentage of the State tax, the county tax in

indistinguishable from state aid to counties and/or revenue sharing that is more common. As published by Howard County, Maryland, residence of the Respondents, "[d]istributions of revenue [from the income tax] are made to the counties throughout the year based upon collection deadlines." HOWARD CNTY, MD. FISCAL YEAR 2015 APPROVED OPERATING BUDGET 15 (2014).[3]

Each county in Maryland is required to have a county income tax. MD. CODE ANN. TAX- GEN. § 10-103. Notwithstanding the nomenclature, it is truly a state tax. In *Frey v. Comptroller of the Treasury*, 29 A.3d 475 (Md. 2013), the Maryland Court of Appeals reiterated that, despite a statutory change at *Maryland Annotated Code, Tax General*, Section 10-703(a) purporting to prohibit a credit for taxes paid to another state against the county tax, that tax is not administered by local political subdivisions and is part of a State-administered income tax scheme and is, in fact, a state tax.[4] *Id*. at 492.

Maryland is still commonly referred to as a "piggyback" tax. *See, e.g.,* MD. ASS'N OF CNTYS, FISCAL YEAR 2013, REPORT OF COUNTY BUDGETS, TAX RATES & SELECTED STATISTICS 39 (2013).

[3] Including Maryland, seventeen states had a separately stated local income tax in 2011 but a majority were applicable to only certain localities therein. *See* JOSEPH HENCHMAN & JASON SAPIA, TAX FOUND., FISCAL FACT, NO. 280 (2011).

[4] That the "piggyback" tax for the benefit of Maryland counties and the independent city of Baltimore (considered a county for taxing purposes per Maryland Annotated Code, Tax General, Section 1-101(f)) is in actuality a state tax was first set forth by the Maryland Court of Appeals in *Stern v. Comptroller of the Treasury*, 316 A.2d 240, 240–41 (Md. 1974), prior to the 1975 change in the law designed to prohibit application of the credit against the county tax.

The Comptroller concedes that the county tax is one of two basic components of the State personal income tax.[5] Br. 3. However, Maryland offers its residents only a partial credit against tax on income sourced from another state that is taxed by that source state at a rate higher than that of the "non-piggyback" portion of the Maryland income tax. The failure to offer a full credit violates the dormant Commerce Clause.[6]

II. THE AUTHORITY OF A STATE OR ANY OF ITS POLITICAL SUBDIVISIONS TO TAX THE INCOME OF ITS OWN RESIDENTS IS SUBJECT TO COMMERCE CLAUSE LIMITATIONS.

It is a well-established principle under the Due Process Clause that an individual who avails himself or herself of the services provided by a state, whether by residing in or conducting business within the state, may justifiably be subject to taxation by that state on income derived therein. *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 462–63 (1995); *Lawrence v. State Tax Comm'n*, 286 U.S. 276, 279–80 (1932). This is true, provided that there is substantial nexus with the state and that the tax is fairly related

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[5] Notwithstanding that the "county" tax is properly a state tax, quotation marks are avoided herein.

[6] The term "dormant" Commerce Clause, also known as the "negative" Commerce Clause arose from the inference that with the power of Congress to regulate commerce "among the several states" pursuant to Article I, Section 8, Clause 3, of the Constitution came a restriction prohibiting a state from passing legislation that improperly burdens or discriminates against interstate commerce. A doctrine now, the term "dormant" was first used by Chief Justice John Marshall in *Gibbons v. Ogden*, 22 U.S. 1, 189 (1824).

to the services provided by that state. *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 183–84 (1995); *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977). The rationale behind this is that individuals may fairly be expected to contribute to the services and privileges provided to them as a result of residing within a state's borders. *See Chickasaw Nation*, 515 U.S. at 450 (1995).

As a matter of due process, it is without question that the State of Maryland may tax all of the income of its residents (as well as income of nonresidents derived from activities conducted within the State). *See id.*; *Lawrence*, 286 U.S. at 279. This is uncontested in the instant case; the taxpayers in *Wynne* clearly reside within the State of Maryland and surely take advantage of the various services accompanying such residence so that Maryland may fairly collect taxes in order to, in part, pay for those services. While this may be so, it is also true that a state's right to tax the income of its residents based on due process principles is subject to certain limitations.

A state-imposed tax may pass muster under Due Process Clause standards and yet may still unduly burden interstate commerce in a manner that causes it to be unconstitutional under the dormant Commerce Clause. *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 note 7 (1992). Such is the case in *Wynne*.

The Commerce Clause, in affording Congress the right to regulate interstate commerce, has long been held to include a negative component with regard to the rights of individual states. *See Brown v. Maryland*, 25 U.S. 419 (1827). Through its grant of the right to Congress to regulate interstate commerce, the Commerce Clause in turn creates an implicit restraint on the individual states' taxing authority

when the application of a state's tax places an undue burden on interstate commerce. *United Haulers Ass'n v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330 (2007).

Maryland argues that Commerce Clause limitations should not be applied when the county tax is collected from residents of the State of Maryland, from which it has a right to collect taxes as a result of the services it provides. However, the tax, as applied, negatively impacts interstate commerce. This is so because Maryland places a higher tax burden on its residents who engage in business outside of the State than that imposed on those residents conducting business solely within the State. This encourages Marylanders to keep their business endeavors within the State and "penalizes" those who do not. Such is the type of disproportionate tax treatment that the Commerce Clause is designed to prevent.

By effectively discouraging the resident, or a flow-through entity[7] in which the resident owns an interest, from conducting business outside of the State, the Maryland county tax is indeed negatively impacting the interstate market. As a result, Maryland's county tax places a burden "on the flow of commerce across its borders that commerce wholly within those borders

[7] Flowthrough entities are those in which income is normally taxed not at the entity level but in which distributive shares of income are taxed to the owners on their own returns. In a business context, partnerships and S corporations are examples of flowthrough entities. *See* Title 26 U.S.C. §§ 701-777, 1361-1379. A multiple owner limited liability company may choose to be taxed as a partnership or S corporation (also as a C corporation), and a single owner limited liability company may choose to be taxed as an S corporation (also as an individual sole proprietorship or C corporation). *See* 26 C.F.R. § 301.7701-3.

would not bear", which is counter to the purpose of the Commerce Clause. *See Fulton Corp. v. Faulkner*, 516 U.S. 325, 331 (1996) (quoting *Jefferson Lines*, 514 U.S. at 180). This unequal burden amounts to facial discrimination for dormant Commerce Clause purposes. *See id*.

Maryland would like us to believe that no discrimination exists or that it is irrelevant because it has due process rights to tax its residents. However, this is an oversimplification, as it ignores both the overarching impact of the county tax as well as the limitations to which the State's due process rights are subject under the dormant Commerce Clause when the exercise of those rights interfere with interstate commerce. As a result of this interference, and the facial discrimination that this tax creates, the dormant Commerce Clause is applicable and, thus, the Maryland county tax is subject to dormant Commerce Clause scrutiny.

Even if Maryland's county tax were a true local tax and not a state tax, it would still not be immune from the limitations of the dormant Commerce Clause under the prior holdings of this Court which have recognized that the dormant Commerce Clause applies to local taxes.[8] To illustrate, the most purely local of local taxes in the United States is commonly known as a "property tax" and is imposed on the value of property located within a county, city or other state subdivision. The tax is imposed directly by the local taxing jurisdiction for the benefit of that particular locality. It has been argued that, inasmuch as a

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[8] This Court has also recognized that local taxes are subject to dormant Commerce Clause scrutiny to determine if they interfere with the power of Congress to regulate commerce with foreign nations. *Japan Line, Ltd v. Cnty. of Los Angeles*, 441 U.S. 434, 451–57 (1979).

property tax is imposed at the local level, by the locality, only on property located within that state subdivision taxing jurisdiction, it could not be subject to limitations imposed on interstate commerce. This Court has long seen through this fiction, recognizing that purely local taxes can, and do, have a substantial impact on interstate commerce in this country.

For example, *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Me*., 520 U.S. 564 (1997), involved a church camp for children in the Town of Harrison. The town, like most other towns in this country, imposed a local property tax. Most charities in the Town of Harrison were allowed an exemption from the tax. However, the exemption was only allowed in full if the charity principally benefited residents of Maine. For charities, such as Camps Newfound, that primarily attracted campers from outside of Maine, there was a much more limited exemption from the tax. The Town argued to this Court that the Commerce Clause should not apply to a local real estate tax. This Court responded that "[a] tax on real estate, like any other tax, may impermissibly burden interstate commerce." *Id*. at 574. Emphatically, the Court observed that "[t]he history of our Commerce Clause jurisprudence has shown that even the smallest scale of discrimination can interfere with the project of our federal Union." *Id*. at 595. Similarly, an income tax for the benefit of localities may burden interstate commerce, as in the instant case.

Thus, by any reasoning, Maryland's argument that its county income tax is free from Commerce Clause limitations is seriously misguided. The potential for a disproportionate tax burden being placed on interstate versus intrastate commerce dictates Commerce Clause analysis. This holds true even though the

statute is designed by the State as a county tax, inasmuch as the same activities are also taxed outside of Maryland. The overall effect significantly impacts interstate commerce. *See Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981).

Once it is determined that the dormant Commerce Clause applies to a state tax, the four-part analysis articulated in *Complete Auto Transit* must be applied to determine whether an otherwise acceptable state tax violates the dormant Commerce Clause by placing an undue burden on interstate commerce. 430 U.S. at 279. This test requires that the tax (1) be applied to an activity with a substantial nexus to the taxing state, (2) be fairly apportioned to that activity, (3) is not discriminatory towards interstate or foreign commerce, and (4) is fairly related to services provided by the State. *Id*.

As discussed in further detail below, Maryland's county tax passes the first and fourth requirements but fails with regard to the second and third requisites.

III. THE FAILURE OF MARYLAND TO APPLY THE CREDIT FOR TAXES PAID TO OTHER STATES AGAINST THE "PIGGYBACK" COUNTY INCOME TAX VIOLATES THE COMMERCE CLAUSE BY FAILING TO FAIRLY APPORTION THE INCOME TAX BURDEN AND SUBJECTS MARYLAND RESIDENTS TO SIGNIFICANT DOUBLE TAXATION.

The rationale behind fair apportionment is "to ensure that each State taxes only its fair share of an interstate transaction." *Jefferson Lines*, 514 U.S. at 184; *Goldberg v. Sweet*, 488 U.S. 252, 260–61 (1989).

As far back as the nineteenth century, this Court has upheld the proposition that states cannot burden interstate commerce by taxing gross receipts of an entity that operates in interstate commerce and has suggested that fair apportionment of tax is a constitutional necessity. *See In re State Freight Tax*, 82 U.S. 232 (1872).

In *Maine v. Grand Trunk Railway Co.*, 142 U.S. 217 (1891), the state of Maine was taxing the gross receipts of a railroad that operated among several states. The State was using a formula to compute the value of the tax by multiplying the railway's total receipts by a fraction to estimate the amount of revenue attributable to the state. *Id*. This court upheld the use of a formula as a means of apportioning the tax, identifying "[t]he rule of apportioning the charge to the receipts of the business would seem to be eminently reasonable, and likely to produce the most satisfactory results, both to the State and the corporation taxed." *Id*. at 228.

This Court has further refined the requirement of fair apportionment through the tests of "internal consistency" and "external consistency." The internal and external consistency requirements of the "fair apportionment" test stand for the proposition that the Constitution safeguards residents of a state from multiple taxation stemming from interstate commerce, and that states may only tax the component of the transaction which occurs within that state. *Goldberg*, 488 U.S. at 262.

Internal consistency requires taxes not burden interstate commerce any more than intrastate commerce, and that result must be the same if every state were to impose a tax identical to the tax being

called into question.[9] *Jefferson Lines*, 514 U.S. at 185. The requirement "asks nothing about the degree of 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 commerce intrastate." *Id*. Thus, the feasibility of the apportionment model is not called into question in the analysis of whether the tax complies with the Commerce Clause requirements. Rather, the fairness of the tax on a national scale is at issue in reviewing internal consistency.

If a state determines its share of the tax base in a manner that is internally consistent, there should be no burden on those operating interstate that is not borne by those who are purely intrastate. *Goldberg*, 488 U.S. at 261. While, in theory, fair apportionment is designed to prevent "multiple taxation", that is to say taxation by multiple states on the same income, this is not always the economic reality. While some risk of duplicate taxation may exist when a taxpayer is taxed by multiple states in which it operates, so long as the state's method of apportionment is fair, it will be upheld. *Moorman Mfg. Co. v. Blair*, 437 U.S. 267 (1978). However, this is limited by the proposition that, while not all burdens on commerce are forbidden, those which are discriminatory will not be upheld. *Nippert v. City of Richmond*, 327 U.S. 416, 425 (1946). The Court there held that:

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[9] 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.

> [t]here is no lack of power in the state or its municipalities to see that interstate commerce bears with local trade its fair share of the cost of local government . . . . But this does not mean, and the trends do not signify, that the state or municipal governments may devise a tax applicable to all commerce alike, which strikes down or discriminates against large volumes of that commerce . . . .

Id at 431.

The Maryland tax scheme fails the internal consistency test. Individuals operating purely intrastate pay tax on their entire income, a single time, at the Maryland rate. Those operating in interstate commerce are subject to the tax of both the state where the income is earned as well as the state of residence. This creates a duplicate burden for those operating in interstate commerce, which is not a burden to those operating purely intrastate. Imagined over all fifty states, as the internal consistency test requires, this means any individual operating in interstate commerce would pay tax on 100 percent of his or her income derived in each state—both in the state where the income was earned and then again in the state of residence. Thus, the Maryland tax is not fairly apportioned because it is not internally consistent.

While the limited possibility of a tax creating multiple taxation is not enough to invalidate the tax, that is not the issue with Maryland's county tax. The Maryland county tax allows for no credits to be applied for tax paid on income earned outside Maryland while intending to tax transactions arising from business in other states.

The Maryland tax with its failure to apportion places a burden on those operating in interstate commerce to pay state tax in those states in which the business transactions occur as well as an additional tax on those transactions solely based on the privilege of being residents of the state of Maryland. This tax runs afoul of the often cited rule that a state may not tax value earned outside its borders. *See Exxon Corp. v. Wisconsin Dep't of Revenue*, 447 U.S. 207, 223 (1980); *McLeod v. J.E. Dilworth Co.*, 322 U.S. 327, 330 (1944).

IV. THE FAILURE OF MARYLAND TO APPLY THE CREDIT FOR TAXES PAID TO OTHER STATES AGAINST THE "PIGGY-BACK" COUNTY INCOME TAX HAS A CHILLING EFFECT ON MULTI-STATE PROFESSIONALS AND OTHER BUSINESSES AND DISCRIMINATES AGAINST INTERSTATE COMMERCE IN VIOLATION OF THE COMMERCE CLAUSE.

The failure to apply the full credit for taxes paid to other states on income that Maryland is taxing increases the costs of doing business in interstate commerce. This increased cost of doing business across state lines makes doing such business less profitable and therefore less attractive to investors. The result of this additional cost of doing business in more than one state has a chilling effect on individuals involved in multi-state businesses.

Consider the effect on a professional (engineer, certified public accountant, attorney, medical provider, etc.) who is setting up a new business. Assume he or she lives in Maryland but wants to do business in other states as well. That professional, or

the flowthrough entity used, will need to charge higher prices for the work that will be done in other states than practitioners in those states in order to earn the same profit that would be made if doing business only in Maryland. Charging higher prices, just to make the same amount of profit, will tend to reduce the attractiveness of providing those services in the other states. This will tend to discourage people from doing business in more than one state and thus will have a chilling effect on interstate commerce.

The arguments made in Maryland's Reply Brief in its Petition for a Writ of Certiorari at pages 4–6 and in the Solicitor General's Amicus Brief at pages 2–3 that any credits given for taxes paid to another state are gratuitous grants of the State further emphasize that interstate commerce is unduly burdened by the failure of Maryland to give full credit to taxes paid to another state. If that position were upheld by this Court, and other states reacted to eliminate their current systems of granting credits for taxes paid to other states, the impact on interstate commerce could be devastating. The rule against discrimination is to prohibit laws that would "excite those jealousies and retaliatory measures the Constitution was designed to prevent." *C&A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 390 (1994).

So long as some method of ameliorating the detriment of double taxation is employed, the Constitutional bar against undue burden on interstate commerce would not be breached. Credits are not the only means of avoiding discrimination against interstate commerce in the case of multi-state professionals and other businesses. When income is earned in interstate commerce by a "regular" or

C corporation[10] taxed at the entity level, discrimination is avoided by apportioning the income among the states involved.[11] When income is earned in interstate commerce by an individual (either directly or through a flowthrough entity), discrimination is avoided by the state of residence granting a credit for the tax paid to the other states.[12]

It should not matter as to what type of entity earned the interstate income, whether a C corporation, a flowthrough entity or an individual. The earner is entitled to enjoy protection from discrimination under the Commerce Clause.

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[10] *See* Title 26 U.S.C. §§ 301-385.

[11] Individuals taxed as sole proprietors and those receiving income from flowthrough entities enjoy protection from discrimination by apportionment of income among all states other than that of residence.

[12] States of corporate domicile do not seek to tax all income of a corporation as do states of individual residence.

CONCLUSION

For the foregoing reasons, the Court should affirm the decision of the Maryland Court of Appeals.

Respectfully submitted,

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