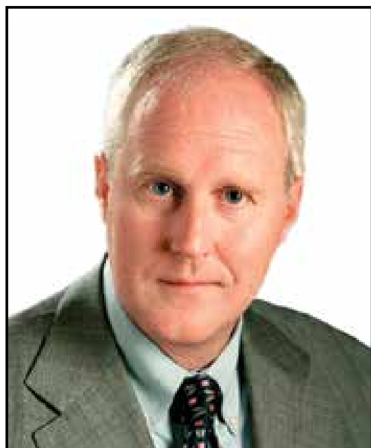
Discriminatory Taxation and Internal Consistency After Comptroller of the *Treasury of Maryland v. Brian Wynne et ux.*



Robert S. Schwartz, Esq.
is a shareholder in Lindabury, McCormick, Estabrook & Cooper, P.C. working in Westfield, New Jersey. He is past chair of the New Jersey State Bar Association Taxation Section, and member of the bars of the states of New York, New Jersey, Florida and Pennsylvania. He is a frequent contributor to The Practical Tax Lawyer.

Robert S. Schwartz, Esq.

THIS ARTICLE discusses discriminatory state taxation, the internal consistency test, and related matters under the dormant Commerce Clause doctrine in the aftermath of *Comptroller of the Treasury of Maryland v. Brian Wynne et ux.*, 135 S.Ct. 1787 (2015). *Wynne* presents a substantial judicial paradigm noticeably changing the grounds for legal controversy in all situations to which its rationale is arguably applicable: whether the challenged state tax scheme is discriminatory against interstate commerce after taking into account the *economic* concept of competitive neutrality. The necessary fact patterns are those that present at least the risk of multiple taxation on one group of state taxpayers compared to some other group of state taxpayers.[1] The *Wynne* rationale applies to all kinds of state taxes or imposts regardless of legislative labels.

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[1] Professors Knoll and Mason define "competitive neutrality" in *What is Tax Discrimination?* 121 Yale L.J. 1014 (2012). A state's tax scheme is competitively neutral as applicable to labor if, isolating the scheme for market responses to it, it is not possible for labor to increase interstate productivity by people shifting jobs among state jurisdictions, and as applicable to owners of capital (e.g., S corporation shareholders), if, again isolating the scheme for market responses to it, it is not possible for such owners to increase interstate productivity by shifting capital among state jurisdictions. The authors demonstrate that violations of competitive neutrality occur when a state tax scheme has non-uniform source base taxes or non-uniform residence base taxes. Residence taxes are non-uniform if they do not apply on the same basis to all residents no matter the source of their incomes. Source taxes are non-uniform it they do not apply on the same basis to all persons within the jurisdiction of the state's taxing power, both residents and non-residents.

Within this fundamental context the accountants will grapple with the correct tax adjustments. The fact pattern of an accountant first computing the amount of a state or political subdivision tax refund claim or the amount of taxes to be paid with the state or political subdivision tax return (based upon a return position) will be the *sine qua non* of future cases. Otherwise, the dormant Commerce Clause doctrine and the internal consistency test would be of purely academic interest both to taxpayers and to state legislatures and revenue agencies.

Meanwhile, *Wynne* should be viewed by tax attorneys as the bellwether decision sharpening, deepening and broadening the limitations of the dormant Commerce Clause doctrine on state taxation of interstate commerce. It should turn out to be a seminal Supreme Court tax case, like *Eisner v. Macomber*, 252 U.S.189 (1920) (explicated the concept of realization as the basis of imposition of federal income taxes). But for the rationale of *Wynne*, there would not be much to write about. Following internal consistency test precedent the case was a proverbial "open and shut" case as the opinion plainly shows.[2] However, understanding the import of the rationale makes for a worthwhile article. The case facts are but an example of the application of the underlying *economic* concept of competitive neutrality, as well as a straightforward application of the internal consistency test.

Before *Wynne* the internal consistency test had been formulated by the Supreme Court as follows: would the adoption by every other state of the same tax scheme as the tax scheme of the state being challenged result in a taxation burden to persons involved in interstate commerce that persons involved only in intrastate commerce (in the challenged state) would not similarly bear?[3] This formulation still stands. There follows an example cited by the *Wynne* Court.

The facts in *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) were Armco, Inc. manufactured in Ohio and sold its product at wholesale in West Virginia and other states. It contested a West Virginia gross receipts tax scheme that imposed a .27% tax on the gross sale prices of wholesale sales of tangible personal property within West Virginia, like some of Armco's sales. The .27% tax applied to both residents and non-residents selling at wholesale in West Virginia. But, West Virginia manufacturing resident companies were exempted *per se*. Another aspect of the tax scheme imposed an .88% tax on the selling price of tangible personal property manufactured in West Virginia by resident companies and sold in or out of the state.

Over state objections no tax discrimination could possibly have taken place because the more intrastate focused .88% gross receipts tax far exceeded the deliberately cross border .27% tax, the Court applied the internal consistency test, hypothesizing that had Ohio (and other states) had the same tax scheme intrastate sellers would always pay .88% while interstate sellers would pay 1.15%. When combined with a .27% tax on cross-border sales, a .88% tax on goods manufactured in state and sold out of state makes the tax burden on interstate commerce 1.15%. Meanwhile, tangible property manufactured and wholesaled solely within the state would be taxed at the lower .88%. owing to the resident manufacturers exemption. The Court quoted its precedent that a state tax scheme "… must have what might be called internal consistency—that is the [tax scheme] must be such that

[2] "Our existing dormant Commerce Clause cases all but dictate the result reached in this case by Maryland's highest court." *Wynne,* supra, 135 S.Ct. at 1794.

[3] *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995).

if applied by every jurisdiction there would be no impermissible interference with free trade".

The *Wynne* Court several times cites *Moorman Mfg. Co. v. Bair,* 437 U.S. 267 (1978). There the Court acknowledged that Iowa's switch to a then unusual sales only, single factor income allocation formula might have resulted in some double taxation to the taxpayer, viz. favor Iowa intrastate businesses over Moorman Mfg. which was an interstate business corporation.[4] For want of proof as to the "overlap" of Illinois and Iowa corporate income taxes on Moorman Mfg.'s *net income* by a demonstration of what portion of *net income* from Illinois sales being taxed in Illinois under its three factor formula also was being allocated to Iowa under its new single factor formula, the Court did not discuss the internal inconsistency test. It was, moreover, unwilling to hold Iowa's single factor violated the commerce clause as discriminatory against interstate commerce on a number of alternative grounds. Ultimately, the Court stated the Commerce Clause does not require the Court to fashion a uniform income allocation formula binding on all states imposing income taxes on corporations in order to eliminate risk of double taxation.

The *Wynne* rationale bothers with *Moorman Mfg. Co.* likely because in retrospect it's evident Iowa's single factor income allocation formula had been internally consistent. It applied to in-state corporations with in-state sales only, in-state corporations with in and out of state sales and out of state corporations with Iowa sales as well as home state and other state sales, and presumably uniform income tax brackets. In light of the Privileges and Immunity Clause of Article IV of the Constitution, I venture the further assumption the same corporate net income tax base applied across the board under Iowa's corporate income tax scheme. If every state had it, all three classes of corporate taxpayers would be treated the same tax wise by all the states without multiple taxation.

By the time of *Wynne,* most everybody believed the internal consistency test had nothing to do with a comparative analysis of the tax scheme of the state being challenged to the tax scheme of one or more other states where a petitioner was also paying a similar tax on all or a part of the same or substantially the same taxation base, whether for example based upon number of truck axles[5] or "income" in all various forms. This almost consensus emerged after cases like *Moorman Mfg. Co.*[6] Yet *Wynne* was in part the result of a widespread perception that the internal consistency test had to do with a comparative analysis of the at least two state tax schemes that had interacted to cause the taxpayer double taxation and hence to file an administrative appeal and lawsuit. Literally following the tax returns' trails, that was the case. There was misunderstanding because the subject matter is complex.

Disagreements should continue after *Wynne* on a case-by-case basis because the subject matter is complex. For example, pass-through entity state taxation schemes are increasingly substituting a "withholding tax" on the pass-through entity instead of a direct personal income tax on the out-of-state owners. Also, the competitive neutrality economic concept embraced by the Court in *Wynne* is difficult. And, why should businesses and individuals be paying multiple or risk paying multiple taxes, the degree of which is correlated to the depth and breadth of a taxpayer's professional tax resources, to multiple jurisdictions on the same dollar of gross or net income or asset value or asset use or other tax base touching multiple non-federal taxing jurisdictions especially now that *Wynne* is the bellwether?

[4] In fact, the switch resulted in a far greater portion of Moorman Mfg.'s corporate taxable income being allocated to Iowa than under Iowa's previous, typical three-factor formula.

[5] *American Trucking Associations v. Scheiner,* 483 U.S. 266 (1987).

[6] The Comptroller and U.S. Solicitor General didn't see any inconsistency, not to mention "internal inconsistency", in Maryland's tax scheme. " . . . Maryland's tax is neutral . . . " *Wynne,* supra, 135 S.Ct. at 1804.

Wynne employs the Brief of the Tax Economists as *amici curiae* focusing on the manner in which professional economists analyze market responses to state personal income taxes based upon a widely accepted free trade model of market responses to tariffs. The internal consistency test as applied by the Court to the Maryland tax scheme fits together with the brief's analysis. The foregoing proposition is not self-evident, but is critical to understanding the *Wynne* rationale and, therefore, needs to be illustrated as per the brief.[7]

State A imposes a 20% tariff upon the import of widgets coming from State B residents. The economic presumption is that the prices for widgets will have to rise in State A in order to preserve unchanged the incentives of buyers and sellers in State A and State B to engage in interstate commerce: State B does not have a tariff, so State B sellers can earn $100 by selling $100 worth of widgets to State B residents; but in order to earn the same $100 post-20% tariff by selling to State A residents State B sellers would have to sell the same quantity of widgets for $125 (80% of $125=$100). However, a price rise would cause State A residents to sell exclusively in State A where they would earn $125 (because the State A sellers are not subject to the tariff) and not sell to State B buyers where prices are only $100. On the other hand, if prices do not rise to $125 in State A, then State B sellers will not sell into State A, but sell to State B residents, as aforesaid. Plainly, the State A tariff places interstate commerce involving states A and B in a discriminated against position relative to State A intrastate commerce. The brief points out, and the Court emphasizes but without explanation, the Maryland's tax scheme operated like the illustrated State A tariff. Here is how.

[7] The internal consistency test turns out to be a heuristic methodology for the economic analysis in both economics focused *amici curiae* briefs that were embraced by the Court.

Maryland's up to 6% tax rate on income earned by non-residents from Maryland sources, plus the up to 7.95% tax rate on residents' incomes from out-of-state sources operates in the same economic way as the illustrated tariff insofar as these 13.95% combined taxes on interstate commerce exceed the only up to 7.95% tax rate Maryland imposes on residents' incomes from intrastate commerce. This "discriminatory" tax scheme has to have effects on free trade prices like the discriminatory 20% rate tariff on goods crossing the State A line compared to the 0% rate or no tariff on goods not crossing over from State B. The Court accepted this economic comparison and that is significant as a matter of legal precedent. A state tax scheme that has the economic effects of a tariff, is "is the paradigmatic example of a law discriminating against interstate commerce."[8] The tax scheme, "…has the same economic effect as a state tariff, the quintessential evil targeted by the dormant Commerce Clause."[9]

The Economists *amici curiae* brief further points out that the internal consistency test is an economically logical and practical means to measure whether a state's tax scheme discriminates against interstate commerce, because the test can compare the tax burden on intrastate transactions to the tax burden on both transactions involving residents' out-of-state activities and non-residents activities within the state. When applied to a challenged tax regime, the key idea (and as best articulated) is if it were copied by every state then each interstate transaction will be taxed as an inbound transaction in one state and an outbound transaction in another state. Hence Maryland's 13.95% combined tax rates on interstate commerce is inconsistent with Maryland's 7.95% purely intrastate commerce tax rate. The Maryland tax scheme is "internally" inconsistent. That the Wynnes also paid personal income taxes to other states because these states taxed non-

[8] *Wynne,* supra, 135 S.Ct. at 1804

[9] *Id.* at 1792.

residents on a state income source basis is beside the legally operative point.[10]

Turning to the internal consistency test in more depth, the Court was best informed by the Brief of Michael S. Knoll and Ruth Mason as *amici curiae.* In fact the Maryland tax scheme was not so blatantly discriminatory against interstate commerce as demonstrated above. The scheme allowed Maryland residents a partial tax credit against their Maryland income taxes for income taxes paid to other states, for up to the amount of their Maryland income taxes. But a legally operative problem was that the tax credit was partial. So, to illustrate, the Maryland tax scheme consisted of a state income tax with rates up to 4.75% and a county-by-county income tax with rates up to 3.20%. It did not allow residents to reduce a top overall 7.95% rate paid on income from interstate commerce to as low as 0%, but only to as low as 3.20%. Maryland residents with income from interstate commerce could pay overall state taxes at rates as high as 11.15% compared to 7.95% on intrastate commerce owing to the fact Maryland did not allow a credit against other states' income taxes for 3.20% "county" taxation.

Professors Knoll and Mason brought to the fore what the Court agreed was a second legally operative problem. Under the Maryland tax scheme, non-residents getting income from Maryland sources were not only subject to the "state" portion of the Maryland tax at up to 4.75% (like residents) but also to a 1.25% flat rate tax substitute for the "county" income tax.[11] However, for purposes of case analysis, this special tax amounts to the same thing as if non-residents pay the county portion of the tax based upon the county in Maryland their Maryland source income came from.[12]

The result of their scholarship was convincing the Court that it is consistent with the internal consistency test reflected in the Court's precedent to incorporate an economic analysis comparing tax rates on an "as if" every other state had the same tax scheme as Maryland from three contact points. The three contact points for economic analysis sanctioned by *Wynne* are: (1) a hypothetical state resident with in-state source income only; (2) a hypothetical state resident with out-of-state source income only; and (3) a hypothetical non-resident of the state with state source income only.

Following this approach, the professors demonstrate "internal inconsistency":

[10] The authors go on to acknowledge, that if Maryland were to allow a full tax credit to its residents for income earned out-of-state, discriminatory effect in the sense of a tariff would not be entirely eliminated strictly speaking, because some source-based income taxing states have income tax rates less than Maryland's up to 7.95% top intrastate income tax rate or no income tax at all. The Court concluded a full credit provides enough relief against the obvious discrimination suffered by interstate commerce, since a full credit to residents on income earned out-of-state could reduce Maryland's effective tax rate on them to zero. Moreover, that is all that is required by the internal consistency test, since the test hypothesizes that other states would have the same tax regime as Maryland, and if Maryland were to allow a full credit so would the other hypothetical states with the result being reduction of the tax rate to zero. The brief's point about other states having zero or lower percent tax rates actually goes to differences in state tax schemes that result in the arguably unfortunate "disparate impact" on interstate commerce. The Court emphasizes interacting states' tax schemes having "disparate impact" viz., multiple taxation consequences to the taxpayer, do not violate the dormant Commerce Clause and never will. *Id* at 1804..

[11] Under state law Maryland counties could set their tax rates at between 1.25% and 3.2%. The special tax rate equaled the lowest county income tax rate set by any of Maryland's counties for the taxable year in question.

[12] "For [dormant] Commerce Clause purposes, it is immaterial that Maryland assigns different labels (i.e., 'county tax' and 'special nonresident tax') to these taxes." *Id.* at 1803 n. 8.

Maryland Personal Income Tax Failing the Internal Consistency Test

(Hypothesize every state has Maryland's county income tax scheme.)

	Maryland Resident	Every Other State Resident
Activity in Maryland	3.20%	4.45%
Activity in Every Other State	4.45%	3.20%

The Maryland "county" tax, which the Court viewed legally as a component of state individual income tax law, is internally inconsistent because the test compares the tax burden on intrastate transactions to the tax burden on both transactions involving residents' out-of-state activities and non-residents activities within the state. Further, allowing for the fact the state portion of the Maryland tax (4.75% rate) is fully creditable for residents and applies to non-residents, thereby neutralizing it as a factor, leaves the fact that the Maryland source income of a resident (intrastate commerce only) (unshaded quadrants) is taxed at a maximum county rate of 3.20%, whereas interstate income (shaded quadrants), that is, the income both of residents and non-residents engaged in interstate commerce (and involving Maryland tax jurisdiction) risks being taxed at a combined maximum 4.45%. Interstate commerce bears a greater tax burden than intrastate commerce, completely aside from the taxes imposed by the non-resident's home state or the other states also taxing Maryland residents.

The Court had no issue with the Maryland Court of Appeals having applied the "external consistency" test evolving from case law beginning with *Complete Auto Transit, Inc. v. Brady,* 430 U.S. 274 (1977). Following precedent, a state tax scheme fails the external consistency test if it merely "creates a risk of multiple taxation."[13] The factual record of the case indicated that the Wynnes paid at least as much income tax to other states as would allow them a credit against the county portion of the tax had the Maryland tax scheme allowed for it. Similarly, the Court had no issue with the Court of Appeals holding that the Maryland tax scheme generally discriminated against interstate commerce, because absent a tax credit for the county portion of the income tax, income from sources in interstate commerce falling within Maryland's constitutionally approved tax jurisdiction would be taxed at a higher Maryland tax rates than income only from Maryland sources. The Court also remarked that the undisputed effect of disallowing a full Maryland income tax credit was that some of the income from sources earned by the Wynnes (and many other Maryland residents) outside the state is taxed at least twice and that as a result it created an incentive for Maryland resident taxpayers to opt for intrastate economic activities rather

[13] Obviously, in a future controversy the taxpayer has got to demonstrate that for the tax years at issue there was in fact at least some multiple taxation of the whole or the part of a taxpayer's tax base. That base ought to be defined by starting with the broadest tax base as among the multiple states in which the taxpayers had been subject to overlapping taxation. Tax base can mean a state's rules for gross income inclusion and allowable deductions to get to the taxable income base or the particular tax base for taxes of other kinds.

than interstate economic activities.[14] The Court is implying a discriminatory effect that violates the dormant Commerce Clause arising from two contact points: Maryland residents' in-state and out-of-state source income being taxed *by Maryland* at different rates because while taxing both at a nominal 3.20% rate it disallows a 3.20% credit for interstate source income. This is important for future cases.

The decision should make the political policy arguments reflected in principal dissent's views, drawn from the Comptroller and those *amici curiae* supporting the Comptroller, such as the U.S. Solicitor General, extraneous in future cases, or put another way, make them "spaghetti against the wall" arguments by states (or their political subdivisions) refusing to concede that a state cannot tax without dormant Commerce Clause constraints.[15] This article does not address these arguments but warns the same arguments and new, imaginative arguments, may be urged in administrative and court contexts in practice in the future.[16]

As pointed out at footnote No. 2, as to resident-based income tax schemes, a way to describe discriminatory effect is lack of a tax scheme's uniformity across all residents no matter the source of their incomes. The principal dissent took the position any state can tax a resident's income from whatever sources however it wants to. An example in the *Wynne* opinion aimed at refuting that proposition stretches one's imagination to understand the point for purposes of future cases: "Imagine that Maryland taxed the income that its residents earned in other States but exempted income [residents'] earned out of State from any business that primarily served Maryland residents. Such a tax [scheme] would violate the dormant Commerce Clause, see *Camps Newfound*, *supra*…"[17], [18]

Wynne is the basis for argument that a state tax scheme that on its surface only affects residents, nevertheless, owing to its lack of uniformity in treatment of interstate and intrastate commerce, unconstitutionally discriminates against interstate commerce compared to intrastate commerce. Although the logic is indisputable, whether for sure all administrative tribunals and lower courts will understand things this way is not guaranteed, given the difficult subject matter. So then, the internal consistency test as developed in *Wynne* ultimately can be described as subtle.[19] In regard to this description, the principal dissenting opinion wryly notes: "The Court's [referring to the *Wynne* decision itself] internal consistency test thus scarcely resembles 'ordinary' discrimination". This view misses the boat.[20] In future cases the key will be educating

[14] *Id.* at 1792.

[15] At footnote 4 of the Opinion the Court observes the following, together with a string citation of precedent: "The Commerce Clause regulates effects, not motives, and does not require courts to inquire into voters' or legislators' reasons for enacting a law that has a discriminatory effect."

[16] For example, it is not concerned with arguments that might be made, like the Yonkers, New York income tax scheme or the Philadelphia wage and net profits tax scheme are not tax laws like the Maryland county tax law, so *ipso facto Wynne* is distinguishable.

[17] *Id.* at 1799.

[18] My imagination led me to imagine a Maryland resident operating a root beer stand a mile across the state line in Delaware who was alerted by his tax advisor Maryland income taxes would not be payable on the business' income if he could substantiate he primarily served only Maryland residents. This led to his root beer stand staff uniformly asking the state of residency of prospective customers and turning away most of those not identifying themselves as residents of Maryland. Turned away residents usually drive to a competing root beer stand 10 miles away in Delaware owned by a Delaware resident. The Maryland tax scheme interferes with the Delaware resident buying root beer from the Maryland resident root beer stand owner—the very picture of a non-uniform tax scheme discriminating against interstate commerce.

[19] Professor Ruth Mason reports the case implicated all aspects of 10 years of research work about tax schemes that discriminate against interstate commerce in favor of intrastate commerce and European Union tax issues of the exact same tenor. http://www.law.virginia.edu/html/news/2015_sum/mason.htm

[20] "The principal dissent[] . . . misunderstands the critical distinction . . . between discriminatory tax schemes and

tax administrative tribunals and courts about competitive neutrality and its subsets, the requirement of uniform resident and uniform source taxation by the states, as well as the internal consistency test which is now recognized as a heuristic methodology. In these regards, thankfully, *Wynne* is a tax rate case; not a tax base case.

It is important to keep in mind that post-*Wynne* state tax schemes may run afoul of the dormant Commerce Clause doctrine by being discriminatory in effect without resort to three (3) contact point economic analysis. The Court provides another two (2) contact point example that it states runs afoul of the dormant Commerce Clause. State A imposes an income tax on residents at 5% of income from in-state sources, but at 10% on income from out-of-state sources. Further, the Court tells us, assume state A allows a tax credit for taxes residents pay to other states on account of income from sources out of state A. I will add to the Court's hypothetical what perhaps the Court implies: further assume state A does not tax non-residents on state A source income. State A has a residence-based only personal income tax scheme. The Court goes on, assume April sells only in-state; her neighbor Bob sells only to state B residents, and state B imposes a 6% tax on Bob's state B source income. After the state A credit, Bob pays 4% to state A but April 5%. Still, economically, state A's tax scheme encourages residents to make intrastate sales rather than or also interstate sales, because they are sure to keep more after tax income that way even after state A's tax credit. Interestingly, that state A allows a tax credit to Bob for state B taxes on his income from sales to state B residents, is not a cure for the fact that state A's tax rate scheme viewed without reference to other states discriminates against Bob's interstate commerce to the tune of twice the taxation whether after tax credit or without a state A tax credit being available. State A's tax scheme is internally inconsistent such that if every other state had it (like state B) taxpayers in all fifty states would opt for intrastate rather than interstate commerce, because interstate commerce then would pay 10% after credit compared to intrastate 5%.[21] State B's tax scheme per se is never at issue; no disparate impact issue arises.[22]

Here is another example of a discriminatory tax scheme involving two contact points drawing upon the Court's case citation. In *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*, 520 U.S. 564 (1997), the facts presented a Maine local personal and real property tax scheme that exempted from these taxes camps operated by non-profit organizations incorporated in Maine, except if the non-profit corporation in question operated principally for the benefit of Maine non-residents. In the latter cases, satisfaction of a number of conditions possibly impacting camp revenues led to partial exemptions. Factually, the camp operated by Camps Newfound/Owatonna, Inc. was a Christian Science children's camp as to which usually approximately 95% of the campers were not Maine residents. As relevant here, the key thought in *Camps Newfound* is as follows: "We are unpersuaded by the Town's argument that the dormant Commerce Clause is not applicable here, either because campers are not 'articles of commerce' or more generally because the camp's 'product is delivered and consumed entirely within Maine". The Court went on to discuss how factually interstate commerce had to be substan-

double taxation that results only from the interaction of two [states'] different but nondiscriminatory tax schemes." *Id.* at 1804.

[21] *Id.* at 1805. ". . . Bob's tax burden to State A is irrelevant; his total tax burden [on interstate commerce] is what matters."

[22] The internal inconsistency test roots out state tax schemes violating the dormant Commerce Clause and leaves alone any and all "double taxation" that results from the interaction of various states' income tax schemes that are not in and of themselves individually considered discriminatory or internally inconsistent. This latter adverse circumstance has been labeled "disparate impact" on interstate commerce, and has been found to pass constitutional muster by multiple Court precedents.

tially affected, in essence because many children attending camps in Maine cross their residence states, state lines to attend camp. The Court cited the well-known civil rights commerce clause-based racial discrimination case, *Heart of Atlanta Motel v. United States,* 379 U.S. 241(1964), to communicate its understanding of how seemingly purely intrastate state laws do in fact discriminate against interstate commerce. The Court stated, "even the slightest [state taxation] discrimination invites inroads on national solidarity."

In the case of a state tax scheme having tax rate differences, including after taking into account the state tax credit scheme for taxes resident's pay to other states, Professors Knoll and Mason (and/or others) have reduced the internal consistency test (as, at least in part, viewed by the Court) to a mathematical formula. The tax rate imposed on intrastate income must equal or exceed the sum of tax rates imposed on residents' out-of-state income plus those imposed on non-resident's in-state income, less the product of those two rates.[23] As applied to Maryland's tax scheme, the following result passes internal consistency muster: 4.41% = (3.2% + 1.25%) – (3.2% x 1.25%). At a 4.41% "county" tax rate on Maryland intrastate commerce, the Maryland tax scheme would not discriminate against interstate commerce, which for Maryland is the combination of the "county" tax on non-residents with Maryland source income and the Maryland county tax on a resident's out-of-state income. This is "leveling up" to borrow the Court's phrase.[24]

Alternatively, Maryland can retain both the lower 3.20% county tax on residents Maryland source income and its special 1.25% county substitute tax on non-residents Maryland source income, but cure its tax scheme's dormant Commerce Clause violation by reducing the county tax on its residents out-of-state income to 1.95% (1.95% + 1.25% = 3.20%). In the words of the Court, this rate reducing alternative represents a "leveling down."

The Court went on to state:

"Whenever a State impermissibly taxes interstate commerce at a higher rate than intrastate commerce, that infirmity could be cured by lowering the higher rate, raising the lower rate, or a combination of the two. For this reason we have [previously] concluded that a State…retains flexibility in responding to this determination."[25]

The decision points to a close alternative – a kind of tax credit: if Maryland law allowed residents a 1.25% credit to account for the other state's special non-resident 1.25% substitute county tax, the effect would be to pass Constitutional muster. A Maryland resident earning only Maryland source income pays 3.20%. A Maryland resident earning only out of state source income pays 1.95% after the hypothetical 1.25% credit (3.20% – 1.25%). Meanwhile, the non-resident pays 1.25% on Maryland source income. 1.95%, after credit, plus 1.25% special tax rate on non-resident Maryland source income, equals the 3.20% rate on resident intrastate income.[26] From three (3) contact points, each involving Maryland tax jurisdiction and interstate commerce, there is no difference in taxation (rate-wise) between intrastate and interstate commerce.

[23] The multiplication of the rates reflects a presumed economic market model fact that the second tax is deemed to be paid only on income that remains after paying the first tax.

[24] *Id.* at 1806.

[25] *Id.*

[26] *Id.* reference to Tax Economists brief p. 32 and Knoll & Mason brief, pp. 28-30. The latter brief (pp. 28-29) states that ". . . we cannot conclusively attribute the distortion caused by Maryland's tax regime exclusively to [its failure to credit the Wynnes' other states' taxes]; nor can we conclusively trace the distortion exclusively to Maryland's inbound taxation in the form of the SNRT. . . Maryland has several options. It can . . . The Supreme Court need not, and should not, choose a particular option for Maryland. . . . it is up to Maryland to decide how to cure its violation." The foregoing observation portends issues in future cases involving state tax schemes not exactly the same as Maryland's tax scheme.

With this fix interstate commerce is not discriminated against and burdened in a way intrastate commerce is not.

The opinion arguably alludes to a fourth alternative: Maryland law is changed to eliminate the special 1.25% substitute county tax applicable to non-residents' Maryland source income.[27] In that event, concerning Maryland residents, Maryland residents engaged solely in Maryland intrastate commerce would pay at a 3.20% county tax rate. Maryland residents engaged solely in interstate commerce pay at a 3.20% county rate on income without a tax credit. Under the new Maryland tax scheme, resident families (like the Wynnes) pay the same 3.20% county rate, whether engaged in intrastate or interstate commerce. The law as so changed would be "internally" consistent. There is no need of interstate commerce consideration of the state's county taxation of non-residents – it's simply not there. The maximum income tax rate on all interstate commerce within the scope of state taxation jurisdiction equals that of its maximum tax on all intrastate commerce.

As a fifth alternative any state may Constitutionally apply tax rates to residents' out-of-state income, so long as its tax scheme avoids simultaneously taxing non-residents in-state income at a rate that, combined with the tax rate on residents out-of-state income, exceeds the tax rate on residents in-state income. Therefore, Maryland's also offering its residents a county income tax, tax credit for taxes paid to other states offers a cure. [28] In that instance, interstate commerce is not discriminated against in a way intrastate commerce is not. As to the Wynnes, since the Maryland Court of Appeals was affirmed, the actual full Maryland tax credit claimed by them against the state and county portion of their Maryland resident income tax must be allowed as the law of the case.

Other states' tax schemes, especially personal income tax schemes, are now vulnerable to dormant Commerce Clause challenge following the Court's cited precedents, its illustrated and suggested workings of the test applied to the Maryland scheme, following internal inconsistency test mathematical formulae or in some other fashion by uniformity analysis. More complexity is involved with mathematical formulae that focuses on the amount of *income retained after state taxation* in an economic model sense as among the relevant contact points of state taxation based upon residence based state tax schemes, source based tax schemes and today's prevalent combined source and residence tax schemes like that of Maryland. This area is not discussed in the opinion, but also lends itself to scrutinizing a given state's apparently inconsistent tax scheme and is implied by the opinion. It is beyond the scope of this article. In a given future case it may be that all means must be directed to the economic effects of the tax scheme under review on interstate commerce compared to intrastate commerce in order to reach the correct result.

Example 1

People resident in New York are subject to tax on all income regardless of source. New York's top state income tax rate is approximately 8.80%. The New York tax scheme mostly (and that observation presents problem beyond the scope of this article) allows its "residents" (as defined) a credit against

[27] *Id.* at 1806.

[28] The Opinion states Maryland's tax scheme can be changed to pass the internal consistency test by giving a full credit. Just recently the Maryland amended its tax law to allow an income tax credit to residents against the county portion of the Maryland income tax beginning with 2015. H.B. 72, Laws 2015. Being a good sport, Maryland is currently (via form 502LC) generally allowing refund claims without taxpayers having to file petitions and then asserting the rationale of *Harper v. Virginia Department of Taxation,* 509 U.S. 86 (1993).

their New York state income tax for income taxes paid to other states. Non-residents, who have New York source income, are subject to the same state tax rates as residents but limited to their New York source income. Further under New York's tax scheme, as to Yonkers, state law provides for a resident income tax surcharge. It amounts to an approximately 1.80% tax on "income," as defined. The New York tax scheme does not allow Yonkers residents to credit against their Yonkers resident tax any and all excess credit amounts for income taxes paid to other states. Lastly, New York non-residents are subject to a special .50% substitute income tax on their Yonkers source income This special tax is labeled as the "City of Yonkers Earnings Tax on Nonresidents Act of 1984." The question is, does this New York tax scheme have a discriminatory effect in favor of intrastate over interstate commerce?

Assume Yonkers resident, Joe G. Billions, paid California income tax based upon being in the top 13.20% bracket on millions of a taxable income share from SF Bay area high tech company, Beam Me Anywhere, LLC, a California entity of which he is a key employee. His accountant claimed a credit against Joe's New York state tax, and discovered unused or excess credit available to reduce his Yonkers resident income tax. Joe takes a *Wynne* based return position to use the excess credit to the max. The Tax Department disallows the excess credit claimed.

Any judge following *Wynne* should apply the dormant Commerce Clause doctrine's internal consistency test to this New York tax scheme via economic analysis employing a three contact points hypothetical, as follows:

New York Yonkers Personal Income Tax Failing the Internal Consistency Test
(Hypothesize every state has the New York Yonkers tax scheme.)

	Yonkers, New York Resident	Every Other State Resident
Activity in Yonkers	1.80%	2.30%
Activity in Every Other State	2.30%	1.80%

Interstate commerce is taxed at a higher rate than intrastate commerce. That is fatal. But the *Wynne* decision does not mandate any particular remedy for New York. However, New York must fashion a remedy that satisfies the dormant Commerce Clause.

A remedy would be amending New York law to allow a tax credit for the other states' hypothetical .50% non-resident tax. That is, actually increase the New York tax credit by .50% to account for Yonkers residents having income from sources out of New York. If New York so increased its tax credit, the effect would be to eliminate the discrimination against interstate commerce. A Yonkers resident earning only New York source income would pay 1.80%. A Yonkers resident earning only out of state source income would pay 1.30% (after enhanced credit). Meanwhile, the non-resident would pay .50% on Yonkers source income. A 1.30% resident tax rate after credit, plus a .50% tax rate on non-resident Yonkers source income equals the 1.80% tax rate on residents' intrastate income. From the three contact points involving New York tax jurisdiction and interstate commerce, the New York tax scheme no longer discriminates against interstate commerce. Another remedy is obviously the law of the case relief for the contesting taxpayer, such as a Tax Tribunal decision stating the refund amount is allowed as per the petitioner's prayer for relief.

A seemingly insufficient remedy *in casu proviso* would be amendment to state law eliminating the Yonker's non-resident .50% earnings surcharge tax.[29]

Example 2

Returning to New York, as stated, people resident in New York are subject to state income tax on all income regardless of source with a top rate of approximately 8.80%. New York City residents pay an additional income tax having a top rate of 3.90% on all income regardless of source. New York has a tax credit scheme that generally works this way: it allows state residents a credit against their New York state income tax for income taxes paid to other states, but does not allow city residents a credit against the city's income tax, assuming there is excess credit for taxes a city resident would pay to other states after reducing his New York state tax to zero. Assume Joe G. Billions with his excess credit for income taxes paid to California resides in the city.

Economically, a city resident appears discriminated against tax rate wise when seeking to derive income out of state compared to the upstate resident seeking the same thing. As to a City resident, the New York tax scheme effects in an economic sense an opting for intrastate commerce over interstate commerce. This economic motivation is of the same genus as the economic motivation of the Maryland residents under the Maryland tax scheme as identified by the Court: Maryland residents would opt for income from intrastate sources, since they do not get the full state income tax credit as would put their interstate income on an equal footing with their intrastate income. In both situations, we are comparing only residents and as between deriving income out-of-state compared to in-state. This economic motivation also is of the same genus as the Court's April and Bob contact points example of a state resident-based tax scheme that discriminates against interstate commerce.[30] All three tax schemes share in common discrimination without regard to the taxes paid to and the tax schemes of other states, and two of these schemes without regard to whether the state tax scheme taxes non-residents on state source income.

[29] See discussion below regarding the NYC personal income tax scheme.

[30] "… because it taxes [residents'] income earned interstate at a higher rate than income earned intrastate." *Wynne,* supra, 113 S.Ct. at 1805.

Very interesting, but a demonstrable fact of double taxation caused by a combination of both the New York City and the income source state taxing the city resident on the same income is necessary in order to have a client and a case. If Joe G. Billions were a city resident and the other facts the same, there would be the client and the case.

It is reasonable to conclude the *Wynne* rationale supports the view that when one looks at New York's resident personal income scheme only, there is an inconsistency effecting interstate commerce in a discriminatory way. The New York residence tax scheme is not uniform. No looking at other states tax schemes is necessary to this dormant Commerce Clause conclusion. No hunt is necessary to make the distinction between "disparate impact" and "internally inconsistent" state taxation. If every other state had this New York tax scheme—city residents paying taxes on out of state income without a city income tax credit—in all the 50 states the city dwellers would opt for intrastate rather than interstate commerce.

The New York state City income tax scheme provides, unlike with the Yonkers income tax scheme, city non-residents are not subject to the city income tax for income derived from city sources. That's nice. But that aspect of the New York tax scheme does not cure the fact that the New York tax scheme viewed without regard to double taxation *per se* or other states tax schemes discriminates against City residents engaged in interstate commerce compared to upstate residents engaged in interstate commerce. The author believes the *Wynne* rationale reaches this example.

So what are the remedies? The New York City tax rate reducing effect of New York state increasing the New York income tax credit to account for taxes paid by city residents to other states, would put City residents on level ground with upstate residents. This remedy is "leveling down," to use the phrase of the Court in *Wynne*. New York state could increase the maximum state wide income tax rate to approximately 12.70% (8.80% + 3.90% = 12.70%), and keep its tax credit scheme as is. This remedy is "leveling up" to borrow the Court's phrase. Albany legislators could disingenuously but unlikely effectively explain to irate taxpayers: "The U.S. Supreme Court made us do it to comply with the Constitution." The Court expressly said it was not going to mandate any particular remedy for states whose tax schemes violate the dormant Commerce Clause doctrine.

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