No. 13-____

In The
Supreme Court of the United States

MARYLAND STATE COMPTROLLER OF THE TREASURY,

Petitioner,

v.

BRIAN WYNNE, *et ux.*,

Respondents.

On Petition for a Writ of Certiorari to the
Court of Appeals of Maryland

PETITION FOR A WRIT OF CERTIORARI

DOUGLAS F. GANSLER
Attorney General of Maryland

STEVEN M. SULLIVAN
Chief of Litigation

JULIA DOYLE BERNHARDT
Deputy Chief of Litigation

WILLIAM F. BROCKMAN*
Acting Solicitor General
200 St. Paul Place
Baltimore, Maryland 21202
wbrockman@oag.state.md.us
(410) 576-7055

Attorneys for Petitioner

OCTOBER 2013

*Counsel of Record

QUESTION PRESENTED

Does the United States Constitution prohibit a state from taxing all the income of its residents—wherever earned—by mandating a credit for taxes paid on income earned in other states?

PARTIES TO THE PROCEEDINGS

The petitioner is the Comptroller of the Treasury of Maryland, Peter Franchot. The respondents are Brian Wynne and Karen Wynne.

TABLE OF CONTENTS

QUESTION PRESENTED FOR REVIEW i

PARTIES TO THE PROCEEDINGS ii

TABLE OF AUTHORITIES v

PETITION FOR A WRIT OF CERTIORARI 1

OPINIONS BELOW 1

JURISDICTION 1

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED 2

STATEMENT 2

REASONS FOR GRANTING THE PETITION 7

I. THE DECISION BELOW IS DIRECTLY CONTRARY TO NUMEROUS DECISIONS OF THIS COURT . . . 9

II. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER STATE HIGH COURTS AFFIRMING THE AUTHORITY OF A STATE TO TAX ITS RESIDENTS ON INCOME EARNED IN AND TAXED BY OTHER STATES 13

III. THE QUESTION PRESENTED IS OF EXCEPTIONAL IMPORTANCE 15

CONCLUSION 17

APPENDICES

Appendix A: Opinion and Dissenting Opinion in the Court of Appeals of Maryland (January 28, 2013) . . . . App. 1

Appendix B: Opinion on Motion for Reconsideration in the Court of Appeals of Maryland (May 17, 2013) . . . . App. 50

Appendix C: Memorandum and Order in the Circuit Court for Howard County (June 29, 2011) . . . . App. 53

Appendix D: Continued Hearing Transcript in the Maryland Tax Court (December 10, 2009) . . . . App. 130

Appendix E: Order in the Maryland Tax Court (December 29, 2009) . . . . App. 140

Appendix F: Pertinent Statutes: Annotated Code of Maryland, Tax-General Article, §§ 10-102, 10-103, 10-703 . . . . App. 142

TABLE OF AUTHORITIES

CASES

Chase Manhattan Bank v. Gavin,
733 A.2d 782 (Conn. 1999) 13

Comptroller v. Blanton,
390 Md. 528 (2006) 3

Curry v. McCanless,
307 U.S. 357 (1939) 9, 10

Frey v. Comptroller,
422 Md. 111 (2011) 3

Goldberg v. Sweet,
488 U.S. 252 (1989) 8, 12

Guaranty Trust Co. of New York v. Virginia,
305 U.S. 19 (1938) 9

Idaho Tax Comm'n v. Stang,
25 P.3d 113 (Idaho 2001) 13

In re Barton-Dobenin,
9 P.3d 9 (Kan. 2000) 13

Keller v. Department of Revenue,
872 P.2d 414 (Or. 1994) 7, 14

Lawrence v. State Tax Comm'n of Miss.,
286 U.S. 276 (1932) 7, 9, 11, 13

Luther v. Commissioner of Revenue,
588 N.W.2d 502 (Minn. 1999) 7, 14

Maguire v. Trefry,
253 U.S. 12 (1920) 9, 12

McCulloch v. Maryland,
17 U.S. (4 Wheat.) 316 (1819) 10

New York ex rel. Cohn v. Graves,
300 U.S. 308 (1937) 7, 8, 9, 11

Oklahoma Tax Comm'n v. Chickasaw Nation,
515 U.S. 450 (CITE) 3, 7, 9, 11

Shaffer v. Carter,
252 U.S. 37 (1920) 9, 10

State Tax Comm'n of Utah v. Aldrich,
316 U.S. 174 (1942) 9, 10, 12, 15

Stelzner v. Commissioner of Revenue,
621 N.W.2d 736 (Minn. 2001) 7, 13

Tamagni v. Tax Appeals Tribunal,
695 N.E.2d 1125 (N.Y. 1998) 7, 14

Zunamon v. Zehnder,
719 N.E.2d 130 (Ill. App. 1999) 14

CONSTITUTIONAL PROVISIONS

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

U.S. Const. amend. XIV, § 1 2

STATUTES

26 U.S.C. § 1361 4

26 U.S.C. § 1366 4

28 U.S.C. § 1257(a) 1

Md. Code Ann., Tax-Gen. § 10-101(k)(1)(i) 3

Md. Code Ann., Tax-Gen. § 10-102 3

Md. Code Ann., Tax-Gen. § 10-102.1(b) 4

Md. Code Ann., Tax-Gen. § 10-103(a)(1) 3

Md. Code Ann., Tax-Gen. § 10-104(6) 4

Md. Code Ann., Tax-Gen. § 10-105(a)(2) 4

Md. Code Ann., Tax-Gen. § 10-703(a) 3, 5

Md. Code Ann., Tax-Gen. § 10-703(c)(1), (2) 4

Mich. Comp. Laws § 141.612 16

Mich. Comp. Laws § 141.613 16

N.Y. Tax Law § 1301 16

N.Y. Tax Law § 1310 16

N.Y. Tax Law § 601 16

N.Y. Tax Law § 620 16

REGULATIONS

Phila. Income Tax Reg. § 221 16

Phila. Income Tax Reg. § 222 16

OTHER AUTHORITY

Joseph Henchman & Jason Sapia,
Tax Foundation Fiscal Fact No. 280 (2011) . . . 16

PETITION FOR A WRIT OF CERTIORARI

The Maryland State Comptroller of the Treasury respectfully petitions this Court for a writ of certiorari to review the judgment of the Court of Appeals of Maryland.

OPINIONS BELOW

The opinion of the Court of Appeals of Maryland is reported at 431 Md. 147. App. 1-52. The opinion and order of the Circuit Court for Howard County are unreported. App. 53-129. The order and oral ruling of the Maryland Tax Court also are unreported. App. 130-41.

JURISDICTION

The Court of Appeals of Maryland issued its decision on January 28, 2013. App. 1-49. On May 17, 2013, the Court of Appeals issued an opinion clarifying its decision, denying the Comptroller's timely request for rehearing, and staying the effect of the court's judgment pending this Court's disposition of a petition for a writ of certiorari. App. 50-52. On July 30, 2013, the Chief Justice extended the time for filing this petition to and including October 14, 2013. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The Commerce Clause of the United States Constitution provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes. . . .

U.S. Const. art. I, § 8, cl. 3.

The Due Process Clause of the Fourteenth Amendment to the United States Constitution provides:

> [N]or shall any State deprive any person of life, liberty, or property, without due process of law. . . .

U.S. Const. amend. XIV, § 1.

The Maryland statutory provisions that authorize the personal income taxes and the tax credit at issue in this case are reproduced in the appendix. App. 142-44.

STATEMENT

The Maryland Court of Appeals has reached the unprecedented conclusion that a state is constitutionally prohibited from collecting personal income taxes from its own residents to the extent that the income was earned from sources in another state where the income is subject to tax by that state. That holding is directly contrary to numerous decisions of

this Court recognizing "the rule, accepted interstate and internationally, that a sovereign may tax the entire income of its residents." *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S. 450, 453 (1995).

1. Maryland taxes the entire income of its residents by imposing a state income tax with two components: a "State tax," Md. Code Ann., Tax-General ("Tax-Gen.") § 10-102, and a "County tax," Tax-Gen. § 10-103(a)(1). *See Frey v. Comptroller*, 422 Md. 111, 125 (2011) (describing Maryland income tax scheme for individual taxpayers). As relevant here, the State tax "is imposed on the Maryland taxable income of each individual." Tax-Gen. § 10-102 (emphasis added). The County tax rate varies by county; a state resident is taxed at the rate for the county in which the individual "is domiciled" or "maintains a principal residence" on "the last day of the taxable year." Tax-Gen. §§ 10-101(k)(1)(i)-, 10-103(a)(1). State law provides for a tax credit for taxes paid to other states, but this credit applies only to the State tax component; it does not serve to offset a resident's County tax obligation. Tax-Gen. § 10-703(a); *see Comptroller v. Blanton*, 390 Md. 528, 540 (2006).

2. Respondents Brian and Karen Wynne are a married couple with five children residing in Howard County, Maryland. App. 8. In 2006, the tax year at issue, Mr. Wynne held a 2.4% ownership interest in Maxim Healthcare Services, Inc. ("Maxim"), a Maryland Subchapter-S corporation based in Howard County that provides home healthcare, medical staffing, and other services nationwide. App. 8-9, 55-56.

a. On their 2006 joint return, the Wynnes reported taxable net income of approximately $2.7 million, more than half of which represented Mr. Wynne's share of the distributions from Maxim's earnings. App. 56. The State component of the Maryland tax on the Wynnes' net income, before allowance of any credits, was $126,636, *see* Tax-Gen. § 10-105(a)(2). App. 56. However, the Wynnes claimed a credit against this component, in the amount of $84,550, for taxes Maxim had paid to 39 other states on Mr. Wynne's share of Maxim's income earned in those states.[1] Neither Maxim nor the Wynnes reported having paid income taxes to any county or local government outside Maryland, App. 9, and the Wynnes did not claim a credit against the County component of their Maryland taxes, App. 56.

b. The Comptroller determined that the Wynnes had underpaid their 2006 taxes, and issued a deficiency assessment. A hearing officer affirmed the assessment. App. 10.

---

[1] Some of these states recognized Maxim's election to be taxed as an S-corporation and accorded "pass-through" treatment to its income, as the federal government and Maryland do, *see* 26 U.S.C. §§ 1361, 1366; Tax-Gen. §§ 10-102.1(b), 10-104(6); these states required Maxim to file composite returns on behalf of their owners. Other states required Maxim to file a corporate tax return instead of or in addition to the composite return filed on behalf of Maxim's shareholders. The Maryland personal income tax credit invoked by the Wynnes allows a credit for a resident's share of the taxes paid by an S-corporation to another state, regardless of whether the state accords pass-through treatment to the entity. *See* Tax-Gen. § 10-703(c)(1), (2).

c. In October 2008, the Wynnes appealed to the Maryland Tax Court. Initially, the Wynnes disputed only the Comptroller's calculation of the State component of their income tax liability and did not assert that the State's failure to extend the credit to the County component of the tax violated any State or federal constitutional provision. In April 2009, however, the Wynnes amended their appeal petition to assert, as an alternative to their statutory argument, that the tax credit statute, as applied by the Comptroller and as construed by Maryland courts, violates the Commerce Clause of the United State Constitution. The Tax Court rejected both arguments and affirmed the assessment. App. 136, 140.

3.a. In January 2010, the Wynnes sought judicial review of the Tax Court's decision in the Circuit Court for Howard County. App. 54. Abandoning their statutory argument, the Wynnes argued that the dormant Commerce Clause requires Maryland to extend the credit for taxes paid to other states to the County component as well as the State component of the tax. App. 63.

On June 29, 2011, the circuit court ruled that § 10-703(a) of the Tax-General Article violates the Commerce Clause of the United States Constitution by authorizing a credit for taxes paid to other states that offsets a Maryland resident's State income tax liability, but does not offset his or her local income tax liability. The court therefore reversed the Tax Court's ruling upholding the deficiency assessment against the Wynnes. App. 126.

b. The Comptroller appealed. The Wynnes then petitioned for review by the Maryland Court of Appeals before consideration in the intermediate appellate court, and the Court of Appeals granted the petition. 424 Md. 291 (2012).

On January 28, 2013, the Court of Appeals issued a decision holding that "the failure of the Maryland income tax law to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation that arises from activities in another state and that is taxed in that state violates the dormant Commerce Clause of the federal Constitution." App. 32.

The Court of Appeals rejected the Comptroller's assertion that, under this Court's precedent, "the Wynnes are subject to Maryland income taxes because of their status as Maryland residents and not because of their activities in intrastate or interstate commerce"; the Court of Appeals labeled that proposition "a false dichotomy." App. 15. Instead, the court opined, the Wynnes are subject to the State income tax "because they are Maryland residents *and* because they have income derived from intrastate and interstate activities[.]" App. 15 (emphasis in original). The court observed that, since "other states may also tax some of that same income because it derives from activities in those state[s]," the issue before the court "concerns the constitutional constraint on the otherwise overlapping power to tax such income." App. 15.

Based on its belief that the Constitution prohibits "double taxation" of income earned in interstate commerce, the court rejected the Comptroller's

arguments relying on this Court's precedents establishing that a state may tax all the income of its residents, wherever earned; the court also dismissed authority from other state courts of last resort affirming this principle in analogous contexts. App. 4, 15. Those conflicting decisions, the court concluded, "are not persuasive," because they "fail to distinguish the constraints on state taxation imposed by the dormant Commerce Clause from those imposed by the Due Process Clause or . . . are otherwise distinguishable from the case." App. 15 (citing *Stelzner v. Commissioner of Revenue*, 621 N.W.2d 736 (Minn. 2001); *Luther v. Commissioner of Revenue*, 588 N.W.2d 502 (Minn. 1999); *Tamagni v. Tax Appeals Tribunal*, 695 N.E.2d 1125 (N.Y. 1998); *Keller v. Department of Revenue*, 872 P.2d 414 (Or. 1994)).

4. The Comptroller moved for reconsideration and to stay enforcement of the judgment. On May 17, 2013, the Court of Appeals denied reconsideration and issued a brief opinion in which it clarified two points raised by its decision and granted the Comptroller's request for a stay pending this Court's disposition of a petition for a writ of certiorari. App. 50-52.

REASONS FOR GRANTING THE PETITION

For more than 90 years this Court has recognized the "well-established principle" that "a jurisdiction . . . may tax *all* the income of its residents, even income earned outside the taxing jurisdiction." *Chickasaw Nation*, 515 U.S. at 462-63 (emphasis in original); *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 313 (1937); *Lawrence v. State Tax Commission*, 286 U.S. 276, 280-81 (1932). As the Court has explained, a state's broad

taxing power over its residents "is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received," all of which "are rights and privileges which attach to domicil within the state." *Cohn,* 300 U.S. at 313. It is commonly understood that each state assumes special responsibilities for the care and education of its own residents, obligations that are not generally shared by other states where a taxpayer works or conducts business but does not reside. Of course, unlike other persons who might be affected by a state's tax scheme, residents have the political power to relieve themselves of unwarranted tax burdens: if they are displeased with particular tax policies in their home state, they are free "to complain about and change the tax through the [state's] political process." *Goldberg v. Sweet*, 488 U.S. 252, 266 (1989).

The decision below directly conflicts with these fundamental precepts. Drawing on cases involving taxation of nonresidents and multistate business enterprises, the Court of Appeals concluded that the Commerce Clause imposes restrictions on a state's power to tax its own residents; accordingly, the court ruled, Maryland *cannot* tax all of its resident's income if the resident paid taxes on that income to another State. The court made no effort to explain why the contrary decisions of this Court were no longer good law; instead, the Court of Appeals undertook its novel analysis as if it had uncovered a constitutional problem that this Court had somehow repeatedly overlooked. Based on its misunderstanding of established principles, the Court of Appeals has mandated a new tax system under which certain Maryland residents,

including the Wynnes, can obtain all the benefits granted to other Maryland residents, without having to pay their full share of the bill.

Aside from being wrong on the merits, the decision below is also of great importance. As a result of the decision, Maryland faces a significant loss of revenue that will amount to tens of millions of dollars annually. Furthermore, although most states, like Maryland, offer credits for income taxes paid to sister states, other jurisdictions have opted to limit the scope or availability of the credit, based on the historical understanding that the States' taxing power extends to all of their residents' income. The Constitution furnishes no basis for invalidating Maryland's longstanding tax system or casting doubt on the validity of similar regimes maintained in other states. The Court should grant certiorari to review the Court of Appeals' decision.

I. THE DECISION BELOW IS DIRECTLY CONTRARY TO NUMEROUS DECISIONS OF THIS COURT.

In multiple decisions spanning the better part of the Twentieth Century, this Court has established and reaffirmed that a State may tax *all* of the income of its resident taxpayers, wherever earned. *Chickasaw Nation*, 515 U.S. at 462-63; *State Tax Comm'n of Utah v. Aldrich*, 316 U.S. 174, 179 (1942); *Guaranty Trust Co. of New York v. Virginia*, 305 U.S. 19, 23 (1938); *Curry v. McCanless*, 307 U.S. 357, 368 (1939); *Cohn*, 300 U.S. at 313; *Lawrence*, 286 U.S. at 281; *Maguire v. Trefry*, 253 U.S. 12, 17 (1920); *Shaffer v. Carter*, 252 U.S. 37, 57 (1920). The origins of this principle actually extend much further back in the Court's

history. *See*, *e.g.*, *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 429 (1819) ("It is obvious, that [the power to tax] is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a State extends, are objects of taxation.").

In this case involving only a state's taxation of its own residents, the decision of the Maryland Court of Appeals departs from both the letter and the rationale of this Court's established precedent. If left unreviewed, that departure will impose immense costs on the State and its citizens and will deprive the State of the ability to pursue the tax policy that has been chosen by Maryland's legislature and maintained for four decades. Though this Court's precedents recognize that the States possess the authority to tax the income of both residents and nonresidents, *see Curry*, 307 U.S. at 368 ("[I]ncome may be taxed both by the state where it is earned and by the state of the recipient's domicile."), a state's power to tax its own residents is by far the broader of the two prerogatives and has been described as "plenary." *Aldrich*, 316 U.S. at 179. Thus, under the universally-accepted rule, a state "may, and does, exert its taxing power over [residents'] income from all sources, whether within or without the State"; by contrast, the States' taxing power with respect to nonresidents "extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources." *Shaffer*, 252 U.S. at 57.

This Court's precedents further establish that the States' authority to "tax *all* the income of its residents,

even income earned outside the taxing jurisdiction," *Chickasaw Nation*, 515 U.S. at 462-63, is an attribute of the sovereignty they possess in our federalist system, and the Court has explained that this broad taxing power necessarily follows from the unique relationship between a state and its own residents. *See id.* at 463. "'Enjoyment of the privileges of residence in the state and the attendant right to invoke the protection of its laws are inseparable from responsibility for sharing the costs of government.'" *Id.* (quoting *Cohn*, 300 U.S. at 313). The States' power to ensure that these costs of government are shared broadly is "founded upon the protection afforded to the recipient of the income by the state, in his person, on his right to receive the income, and in his enjoyment of it when received," *Lawrence*, 286 U.S. at 281, as well as the person's "[e]njoyment of privileges of residence in the state and the attendant right to invoke the protection of its laws," *Cohn*, 300 U.S. at 312-13.

Although states "sometimes elect not to" exercise the full extent of their "authority to tax all income of their residents" and may instead choose to "credit income taxes paid to other sovereigns," this Court has recognized that the determination to do so "is an independent policy decision," *Chickasaw Nation*, 515 U.S. at 463 n.11; the Court has never suggested that a state must extend such a credit or exemption to its own residents as a matter of constitutional compulsion. Rather, this Court has rejected the notion that the Constitution affords "'immunity from taxation by more than one state'"; thus, "'[a] state is free to pursue its own fiscal policies'" in taxing its own residents, "'unembarrassed by the Constitution,'" notwithstanding the possibility of "double taxation" of

income in more than one jurisdiction. *Aldrich*, 316 U.S. at 176, 178 (citations omitted).

In none of these decisions affirming the states' broad taxing power with respect to their own residents did this Court so much as hint that this power was somehow negated by emanations from the negative Commerce Clause. Indeed, the Court's jurisprudence construing the Commerce Clause suggests that it is an unlikely source for such a restriction on state taxing power. As this Court has instructed, the Commerce Clause does not serve to "protect state residents from their own state taxes." *Goldberg*, 488 U.S. at 266.

The decision below, by focusing only on the Wynnes' income-producing activities, ignores completely the benefits that the Wynnes receive as residents of Maryland. These benefits are nothing less than the very reason for having a state income tax, as a means for furnishing "'the protection afforded to the recipient of the income by the government of the [State] of his residence'"—a government that "'provides for him all the advantages of living in safety and in freedom and of being protected by law" and that "gives security to life, liberty and the other privileges of dwelling in a civilized community.'" *Maguire*, 253 U.S. at 14 (citation omitted). Despite this Court's rejection of the notion of constitutional immunity from "double taxation," *Aldrich*, 316 U.S. at 176, Maryland's Court of Appeals held that "the Commerce Clause of the Federal Constitution sets certain constraints" on "the possibility of what might be termed 'double taxation' when both the state of the taxpayer's residence and the state where the income was generated tax the same income." App. 4. That holding cannot be reconciled

with this Court's numerous precedents recognizing each state's authority to exercise what this Court has deemed "the most plenary of sovereign powers," which is the power to tax the state's own residents. *Lawrence*, 286 U.S. at 279.

II. THE DECISION BELOW CONFLICTS WITH THE DECISIONS OF OTHER STATE HIGH COURTS AFFIRMING THE AUTHORITY OF A STATE TO TAX ITS RESIDENTS ON INCOME EARNED IN AND TAXED BY OTHER STATES.

Numerous state courts of last resort and intermediate appellate courts have issued reported decisions adhering to this Court's precedents instructing that states may tax *all* of the income of their residents wherever earned. *See, e.g., Chase Manhattan Bank v. Gavin*, 733 A.2d 782, 803-804 (Conn. 1999) (holding that state may constitutionally tax entire income of resident trusts, wherever generated); *Idaho Tax Comm'n v. Stang*, 25 P.3d 113, 116-117 (Idaho 2001) (holding that state may constitutionally tax resident's Individual Retirement Account distribution even though it had already been taxed by another state; any "tax credit must come from the legislature, not from the judiciary"); *In re Barton-Dobenin*, 9 P.3d 9, 13-14 (Kan. 2000) (holding that resident taxpayer may be taxed on entire income, without credit for income taxes paid to foreign country because "the tax is a personal income tax imposed on a resident of the state of Kansas for the purpose of reimbursing the state for the protections it affords the individual"); *Stelzner v. Commissioner of Revenue*, 621 N.W.2d 736, 740-742 (Minn. 2001) (holding that state may constitutionally tax the entire income of its non-

domiciliary residents); *Luther v. Commissioner of Revenue*, 588 N.W.2d 502, 511 (Minn. 1999) (holding that state may constitutionally tax the income of non-domiciliary resident); *Keller v. Department of Revenue*, 872 P.2d 414, 416 (Or. 1994) ("Oregon is entitled to tax the income of its residents."); *see also Zunamon v. Zehnder*, 719 N.E.2d 130, 137-138 (Ill. App. 1999) (holding that state may constitutionally tax all the income of its own residents and therefore is not required to grant residents a credit for taxes paid to other states).

In *Tamagni v. Tax Appeals Tribunal*, for example, the taxpayers, like the Wynnes, were taxed because of their status as residents of the taxing state, not as the result of any interstate activities. *See* 695 N.E.2d 1125, 1132 (N.Y. 1998). Relying on the states' broad powers to tax their own residents, the court held that denial of the credit was a constitutional exercise of New York's taxing authority. *See id.* at 1126. Contrary to the reasoning of the Maryland Court of Appeals below, the *Tamagni* court explained that, because "[t]he New York income tax is based upon a taxpayer's resident status, without regard to any specific commercial or economic transaction or activity," and "without regard to their activities in other States," the dormant Commerce Clause was not implicated. *Id*. at 1130, 1134; *see also id*. at 1134 ("The inapplicability of dormant Commerce Clause analysis to State resident income taxation is further supported by both historical precedent and the fundamental State sovereignty interest at stake.").

III. THE QUESTION PRESENTED IS OF EXCEPTIONAL IMPORTANCE.

Though the difference between the amount the Wynnes claimed as a credit against their Maryland income taxes and the amount allowed under Maryland's credit statute is small—slightly more than $25,000—the fiscal consequences of the decision below are profound. According to revenue projections set forth in an affidavit submitted in support of the Comptroller's request for a stay of the lower court's judgment, the more generous tax credits that the Court of Appeals has held to be constitutionally mandated would reduce overall personal income tax collections by $45,000,000 to $50,000,000 annually in future tax years. The retrospective impact of these enlarged tax credits, if claimed and allowed under Maryland's tax refund statute, could potentially amount to $120,000,000 in additional lost revenues that the State will be forced to generate from other sources. For some Maryland counties with large numbers of residents who earn income from out-of-state sources, the projected revenue shortfall is between 2 and 3 percent of total personal income tax collections. Unless this Court grants review, the Court of Appeals' unprecedented and improvident departure from the constitutional principles enunciated by this Court will force Maryland and its local governments to endure that loss of revenue while preventing the State from exercising its heretofore undoubted sovereign authority "to pursue its own fiscal policies'" with respect to its own residents. *Aldrich*, 316 U.S. at 178.

If the decision of the Maryland Court of Appeals were correct, tax schemes in other jurisdictions across

the nation would be rendered constitutionally suspect. For example, the State of New York similarly administers a "piggyback" income tax to fund municipal governments; like Maryland, New York permits its residents to claim a credit for taxes paid to other states, but does not allow a credit to offset the municipal income tax. *See* N.Y. Tax Law §§ 601, 620, 1301, 1310. The premise embraced by the Court of Appeals, if adopted by other courts, would potentially also affect the more than 23 million Americans who reside in nearly 5,000 local jurisdictions that impose an income tax.[2] For example, the Tax Foundation reports that a personal income tax on residents' income is imposed by 91 counties in Indiana, 593 municipalities in Ohio, and 2,469 municipalities in Pennsylvania. Typically, these jurisdictions, like Maryland, assess their tax on residents' entire income, irrespective of its source.[3] In the proceedings below, neither party was able to identify a single one of these jurisdictions that allows its residents a credit against their personal income tax for taxes paid to other states, and the Constitution offers no reason for requiring such a credit.

This Court's review is warranted to prevent the serious threat to the Maryland Treasury posed by the unprecedented decision below and to avoid casting

---

[2] *See* Joseph Henchman & Jason Sapia, *Tax Foundation Fiscal Fact No. 280* (2011), *available at* http://taxfoundation.org/article/local-income-taxes-city-and-county-level-income-and-wage-taxes-continue-wane (last visited Oct. 14, 2013).

[3] *See, e.g.*, Mich. Comp. Laws §§ 141.612, 141.613; Phila. Income Tax Reg. §§ 221, 222.

doubt on the settled expectations of taxing authorities throughout the United States.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

DOUGLAS F. GANSLER
Attorney General of Maryland

STEVEN M. SULLIVAN
Chief of Litigation

JULIA DOYLE BERNHARDT
Deputy Chief of Litigation

WILLIAM F. BROCKMAN
Counsel of Record
Acting Solicitor General
200 Saint Paul Place
Baltimore, Maryland 21202
wbrockman@oag.state.md.us
(410) 576-7055

Attorneys for Petitioner

October 2013

APPENDIX

APPENDIX

TABLE OF CONTENTS

Appendix A: Opinion and Dissenting Opinion in the Court of Appeals of Maryland (January 28, 2013) . . . . App. 1

Appendix B: Opinion on Motion for Reconsideration in the Court of Appeals of Maryland (May 17, 2013) . . . . App. 50

Appendix C: Memorandum and Order in the Circuit Court for Howard County (June 29, 2011) . . . . App. 53

Appendix D: Continued Hearing Transcript in the Maryland Tax Court (December 10, 2009) . . . . App. 130

Appendix E: Order in the Maryland Tax Court (December 29, 2009) . . . . App. 140

Appendix F: Pertinent Statutes: Annotated Code of Maryland, Tax-General Article, §§ 10-102, 10-103, 10-703 . . . . App. 142

APPENDIX A

IN THE COURT OF APPEALS OF MARYLAND

No. 107

September Term, 2011

[Filed January 28, 2013]

MARYLAND STATE COMPTROLLER OF THE TREASURY)
)
v.)
)
BRIAN WYNNE, ET UX.)

Bell, C.J.
Harrell
Battaglia
Greene
Adkins
Barbera
McDonald,

JJ.

Opinion by McDonald, J.
Battaglia and Greene, JJ., dissent.

Federal and Maryland law allow for the attribution of corporate income to the corporation's shareholders – without being taxed at the corporate level – in defined circumstances. In particular, the income of a Subchapter S corporation is deemed to "pass through" to the shareholders who are then directly taxed on that income. Some or all of that income may be generated outside the state in which a shareholder resides.

The Maryland income tax law reaches all of the income of a Maryland resident. The State income tax law allows a credit against an individual's State tax liability for income taxes paid to other states based on the income earned in those states. However, that credit takes no account of, and cannot be taken against, the portion of the Maryland income tax known as the "county income tax."

This case poses the question whether the failure to allow a credit violates the federal Constitution when a portion of a Maryland resident taxpayer's income consists of significant "pass-through" income generated by a Subchapter S corporation in other states, apportioned to the taxpayer, and taxed by the states in which it was generated. The taxpayer has appealed an assessment by the State Comptroller that did not allow a credit against the county income tax portion of the Maryland income tax.

The Comptroller, as he should,[1] defends the tax law as written by the Legislature[2] and interpreted by this Court.[3] The taxpayers accept that interpretation, but assert that it is wanting when measured against the federal Constitution. They rely on a multitude of cases – virtually all of which are subsequent to the 1975 amendment of the Maryland tax law that uncoupled the credit from the county income tax – that assess state taxes against what has come to be known as the "dormant Commerce Clause."

Although the Maryland Tax Court ruled in favor of the Comptroller, the Circuit Court for Howard County reversed that decision and held that the statute's failure to allow such a credit violated the dormant Commerce Clause. For the reasons that follow, we find merit in the taxpayers' contentions and affirm the judgment of the Circuit Court.

Background

State Income Taxes

A state may tax the income of its residents, regardless of where that income is earned. A state may also tax a nonresident on income earned within the state. Both of these propositions are consistent with the

---

[1] *See State v. Burning Tree Club, Inc.*, 301 Md. 9, 481 A.2d 785 (1984) (obligation of State official to defend constitutionality of statute enacted by General Assembly).

[2] *See* Chapter 3, Laws of Maryland 1975.

[3] *Comptroller v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006).

Due Process Clause of the Fourteenth Amendment. *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 U.S.450, 462-63 & n. 11 (1995); *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312-13 (1937). However, they raise the possibility of what might be termed "double taxation" when both the state of the taxpayer's residence and the state where the income was generated tax the same income. As explained below, the Commerce Clause of the federal Constitution sets certain constraints on this possibility, which the states recognize through the provision of credits for payments of out-of-state taxes.

Maryland Individual Income Tax

State law imposes an income tax on individuals. Maryland Code, Tax-General Article ("TG") §10-101 *et seq*.[4] It is composed of three parts:

> (1) a State income tax (the "State tax") at a rate set by the Legislature in statute, *see* TG §10-105;
>
> (2) a county income tax that applies only to residents of each county[5] (the "county tax") at a rate set by the county within the range allowed by statute, *see* TG §§10-103, 10-106; and

---

[4] This law also imposes an income tax on corporations – which is not involved in the present case.

[5] As is usually the case, the term "county" in this context includes Baltimore City. TG §10-101(f).

> (3) a tax on those subject to State income tax but not the county tax (the "Special Non-Resident Tax" or "SNRT") at a rate equal to the lowest county tax, *see* TG §10-106.1.

Thus, all individual taxpayers are subject to the State tax and either the county tax or the SNRT. These taxes are all collected by the Comptroller; the proceeds of the county tax are distributed to the relevant county.

Credit for Income Taxes Paid to Other States

State law allows for an individual subject to the Maryland income tax to take a credit against the State tax for similar taxes paid to other states.[6] In particular:

> a resident may claim a credit only against the State income tax for a taxable year in the amount determined under [TG §10-703(c)] for State tax on income paid to another state for the year.

TG §10-703(a). There are various exceptions to this credit, none of which are pertinent to this case.[7] In

---

[6] In this context, the term "state" includes "a state, possession, territory, or commonwealth of the United States ... or ... the District of Columbia." TG §10-101(u).

[7] The credit is not allowed to:

> (1) a Maryland resident other than a fiduciary, if the laws of the other state allow the Maryland resident a credit for state income tax paid in Maryland;

general, the credit is designed to ensure that Maryland receives, at a minimum, the Maryland income tax due on the taxpayer's income that is attributable to Maryland, regardless of the another state's method or rate of taxation.[8] *Comptroller v. Hickey*, 114 Md. App.

---

(2) a Maryland resident fiduciary, if the fiduciary claims, and the other state allows, a credit for state income tax paid to Maryland;

(3) a Maryland resident for less than the full taxable year for tax on income that is paid to another state during residency in that state;

(4) a nonresident of Maryland.

TG §10-703(b).

[8] The statute provides that the credit shall be computed as follows:

> (1) Except as provided in paragraph (2) of this subsection, the credit allowed a resident under subsection (a) of this section is the lesser of:
>
> (i) the amount of allowable tax on income that the resident paid to another state; or
>
> (ii) an amount that does not reduce the State income tax to an amount less than would be payable if the income subjected to the tax in the other state were disregarded.
>
> (2) If the credit allowed a resident under subsection (a) of this section is based on tax that an S corporation pays to another state, the credit allowable to a shareholder:
>
> (i) may not exceed that shareholder's pro rata share of the tax; and

388, 391, 689 A.2d 1316 (1997).

No credit is given against the county tax for income taxes paid in other states. TG §10-703(a); *Comptroller v. Blanton*, 390 Md. 528, 890 A. 2d 279 (2006). As this Court outlined in *Blanton*, a credit had previously applied with respect to the county tax. *See Stern v. Comptroller*, 271 Md. 310, 316 A.2d 240 (1974). However, in 1975, the Legislature amended the tax code to eliminate that credit. Chapter 3, Laws of Maryland 1975.[9]

S Corporations and Income Taxes

A Subchapter S corporation or "S corporation" is a corporation – often a relatively small business – that meets certain requirements set forth in the Internal Revenue Code and makes an election to pass through its income and losses, for federal tax purposes, to its shareholders.[10] Each shareholder reports his or her share of the S corporation's income and losses on their

---

(ii) will be allowed for another state's income taxes or taxes apsi based on income.

TG 10-703(c).

[9] The 1975 amendment was made to former Article 81, §290(b), which was later recodified as part of the Tax-General Article. Chapter 2, Laws of Maryland 1988. It has been re-enacted several times without substantive change. *See* Chapter 1, 1st Special Session, Laws of Maryland 1992; Chapter 262, Laws of Maryland 1993; Chapter 134, Laws of Maryland 1995.

[10] Douglas A. Kahn, et al., *Corporate Income Taxation* 220-21 (6th ed. 2009).

individual tax returns and is assessed federal income tax at the shareholder's individual rate. In that way, the income that the S corporation generates for its owners is taxed at one level – similar to the taxation of a partnership – rather than at two levels (corporate and shareholder) as is otherwise typically the case.[11] To accomplish this, the character of any item of income or loss of an S corporation "passes through" to its owners "as if that item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation." 26 U.S.C. §1366(b).

Some states accord similar pass-through treatment to the income of an S corporation; other states do not and require an S corporation to pay income tax directly. The Maryland income tax law incorporates, for the most part, the definitions of income under the Internal Revenue Code. *See* TG §§10-101(*l*), 10-107, 10-201 *et seq*. Accordingly, the income of an S corporation "passes through" and is attributed to its shareholders for purposes of the Maryland income tax law. *See* TG §10-104(6); *see also* TG §§10-102.1, 10-304(3).

The Wynnes and Maxim Healthcare Services

The underlying facts are undisputed. The taxpayers are Brian and Karen Wynne ("the Wynnes"), a married

---

[11] The relevant statutory provisions appear in Subchapter S of Chapter 1 of the Internal Revenue Code – hence the moniker "S corporation." *See* 26 U.S.C. §1362(1). As is generally the case, the corporation is organized under the laws of a particular state; Subchapter S merely concerns its treatment for federal, and in some cases state, tax purposes.

couple with five children residing in Howard County. During the 2006 tax year, Brian Wynne was one of seven owners of Maxim Healthcare Services, Inc. ("Maxim"), a company that does a national business providing health care services, and owned 2.4% of its stock. Maxim had made an election under the Internal Revenue Code to be treated as an S corporation. As a result of that election, Maxim's income was "passed through" to its owners for federal income tax purposes, and the Wynnes reported a portion of the corporation's income on their individual federal income tax return.

Because Maryland accords similar pass-through treatment to the income of S corporations, the Wynnes also reported pass-through income of Maxim on their 2006 Maryland tax return. A substantial portion of the pass-through income had been generated in other states and was taxed by those states for the 2006 tax year.

In particular, for the 2006 tax year, Maxim filed state income tax returns in 39 states. Maxim allocated to each shareholder a pro rata share of taxes paid to the various states. The returns did not indicate payments of income taxes to any county or local entity in other states. The Wynnes claimed their pro rata share of such income taxes paid to other states as a credit pursuant to TG §10-703(c) against their 2006 Maryland individual income tax, reflected on Maryland Form 502.

Assessment and Appeal

The Comptroller made a change in the computation of the local tax owed by the Wynnes and revised the

credit for taxes paid to other states on the Wynnes' 2006 Maryland Form 502. The net result was a deficiency in the Maryland taxes paid by the Wynnes, and the Comptroller issued an assessment, which the Wynnes appealed.

On October 6, 2008, the Hearings and Appeals Section of the Comptroller's Office affirmed the assessment, although it revised it slightly.[12] The Wynnes then appealed to the Maryland Tax Court where they argued, for the first time, that the limitation of the credit to the State tax for tax payments made to other states discriminated against interstate commerce in violation of the Commerce Clause of the United States Constitution. The Tax Court rejected that argument and affirmed the assessment on December 29, 2009.

The Wynnes then sought judicial review in the Circuit Court for Howard County. Following a hearing

---

[12] The Wynnes had originally submitted their return using the local tax rate for Carroll County and the Comptroller had later substituted the tax rate for Caroline County. The hearing officer concluded that the rate for Howard County should have been applied. There appears to be no dispute that the local tax should be computed using the rate for Howard County.

The Comptroller had determined that the Wynnes had incorrectly calculated the amount of the credit under an interpretation of TG §10-703(c) that was more favorable to themselves. The hearing officer upheld the Comptroller's revised computation, a decision that the Tax Court affirmed. The Wynnes did not further appeal that issue.

Neither of these issues is before us.

on the appeal, the Circuit Court reversed the Tax Court in a decision issued on June 29, 2011. The Circuit Court remanded the case to the Tax Court for further factual development and "an appropriate credit for out-of-state income taxes paid" on Maxim's income. An appeal was noted to the Court of Special Appeals on July 22, 2011. Prior to hearing and decision in the intermediate appellate court, this Court granted certiorari.

Discussion

Standard of Review

The Tax Court is "an adjudicatory administrative agency in the executive branch of state government."[13] A decision of the Tax Court is subject to the same standards of judicial review as contested cases of other administrative agencies under the State Administrative Procedure Act. TG §13-532(a)(1). In undertaking such review, this Court directly evaluates the decision of the agency[14] – in this case, the Tax Court.

When the Tax Court interprets Maryland tax law, we accord that agency a degree of deference as the agency that administers and interprets those statutes. *Comptroller v. Blanton*, 390 Md. at 533-35. In this case, the Tax Court's decision required the application and

---

[13] *Furnitureland S., Inc. v. Comptroller*, 364 Md. 126, 137 n.8, 771 A.2d 1061, 1068 n.8 (2001); *see also* TG §3-102.

[14] *E.g., People's Counsel for Baltimore County v. Surina*, 400 Md. 662, 681, 929 A.2d 899, 910 (2007).

analysis of cases interpreting the United States Constitution. Because our review of its analysis turns on a question of constitutional law, we do not defer to the agency's determination. *Frey v. Comptroller*, 422 Md. 111, 138, 29 A.3d 475 (2011).

The Dormant Commerce Clause

The Wynnes do not contest the State's authority to tax their income, wherever earned, under the Due Process Clause. Rather, they base their challenge to the Comptroller's assessment on what has come to be known as the "dormant Commerce Clause" of the United States Constitution. *See, e.g.*, *Quill Corp. v. North Dakota*, 504 U.S. 298, 313 n.7 (1992) ("[a] tax may be consistent with due process and yet unduly burden interstate commerce"). The dormant Commerce Clause is a restriction on State power that is not explicitly articulated in the Constitution but that has been derived as a necessary corollary of a power specifically conferred on Congress by the Constitution.

The Commerce Clause provides Congress with the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." United States Constitution, Article I, §8, cl. 3. "Though phrased as a grant of regulatory power to Congress, the [Commerce] Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." *Oregon Waste Systems, Inc v. Department of Environmental Quality*, 511 U.S. 93, 98 (1994). This negative aspect of the Commerce Clause is an "implied limitation on the power of state and local governments to enact laws

affecting foreign or interstate commerce." *Board of Trustees v. City of Baltimore*, 317 Md. 72, 131, 562 A.2d 720, 749 (1989).

We assess first whether the dormant Commerce Clause is implicated by the county tax and, if so, whether the failure to provide a credit for out-of-state taxes violates the dormant Commerce Clause.

Does the Application of the County Tax without a Credit Implicate the Dormant Commerce Clause?

Although each of the three components of the State income tax has its own label and is created by different code provisions, each is for federal constitutional purposes a state income tax. *Frey*, 422 Md. at 141-42. In any event, whether the tax is nominally a state or county tax is irrelevant for purposes of analysis under the dormant Commerce Clause because a state may not unreasonably burden interstate commerce through its subdivisions any more than it may at the state level. *Associated Industries v. Lohman*, 511 U.S. 641, 650-51 (1994).

Much recent case law concerning the dormant Commerce Clause has been "driven by concern about economic protectionism — that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *Dep't of Revenue v. Davis*, 553 U.S. 328, 337-38 (2008) (internal citation and quotation marks omitted). While many cases construing the dormant Commerce Clause concern state taxation, "[t]he dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *General Motors Corp. v. Tracy*, 519

U.S. 278, 300 (1997). Therefore, the dormant Commerce Clause will not affect the application of a tax unless there is actual or prospective competition between entities in an identifiable market and state action that either expressly discriminates against or places an undue burden on interstate commerce. *Id.* This impact must be more than incidental. *United States v. Lopez*, 514 U.S. 549, 559 (1995).

The Comptroller argues that the county income tax is not directed at interstate commerce and that the Wynnes have failed to identify any interstate commercial activity affected by a failure to allow a credit against that tax for tax payments to other states. However, application of the dormant Commerce Clause is not limited to circumstances where physical goods enter the stream of commerce. For example, a state tax exemption related to the movement of people across state borders for economic purposes has been held to implicate interstate commerce and violate the dormant Commerce Clause. *Camps Newfound/Owatonna v Town of Harrison*, 520 U.S. 564, 574 (1997); *see also Edwards v California*, 314 U.S. 160, 172 (1941) (state statute prohibiting transport of indigent persons into the state unconstitutional under Commerce Clause). Moreover, even when a state tax is imposed on an intrastate activity, if that tax substantially affects interstate commerce, the tax is subject to scrutiny under the Commerce Clause. *See, e.g.*, *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 332 (1977) (state securities transfer tax unconstitutional under dormant Commerce Clause to the extent it taxed in-state stock transfers resulting from out-of-state sales at a greater rate than in-state transfers resulting from in-state sales).

The Comptroller asserts that the Wynnes are subject to Maryland income taxes because of their status as Maryland residents and not because of their activities in intrastate or interstate commerce. But this is a false dichotomy. In fact, they are subject to the income tax because they are Maryland residents *and* because they have income derived from intrastate and interstate activities; other states may also tax some of that same income because it derives from activities in those state. This case concerns the constitutional constraint on the otherwise overlapping power to tax such income.

In making his argument based on a state's power to tax its own residents, the Comptroller relies on several cases from other states that fail to distinguish the constraints on state taxation imposed by the dormant Commerce Clause from those imposed by the Due Process Clause or that are otherwise distinguishable from the case. Those cases are not persuasive.[15]

---

[15] For example, in *Keller v. Department of Revenue*, 872 P.2d 414 (Ore. 1994), an Oregon taxpayer sought a tax credit for taxes paid to the State of Washington under Washington's business and occupations tax. The Oregon Supreme Court declined to entertain the Commerce Clause challenge. In an opinion largely devoted to a determination that the Washington tax was an excise tax rather than an income tax, the Oregon court devoted only a single paragraph to the taxpayer's contentions that the failure to allow a credit in Oregon for the Washington tax contravened various federal constitutional provisions, including the Commerce Clause, and summarily rejected those arguments on the basis of several cases construing the Due Process Clause without acknowledging the separate constraint of the dormant Commerce Clause.

The limitation of the credit for payments of out-of-state income taxes to the State portion of the Maryland income tax can result in significantly different treatment for a Maryland resident taxpayer who earns substantial income from out-of-state activities when compared with an otherwise identical taxpayer who earns income entirely from Maryland activities. In particular, the first taxpayer may pay more in total state and local income taxes than the second. This creates a disincentive for the taxpayer – or the S corporation of which the taxpayer is an owner – to conduct income-generating activities in other states with income taxes. Thus, the operation of the credit with respect to the county tax may affect the interstate

---

Tamagni v. Tax Appeals Tribunal, 695 N.E.2d 1125 (N.Y. 1998), *cert. denied,* 525 U.S. 931 (1998) concerned possible multiple taxation arising out of the fact that both New Jersey and New York classified the taxpayer as a resident, with the result that both states sought to tax investment income from intangible property, such as interest and dividends, and neither provided a credit for taxes paid to the other state with respect to that income. The New York Court of Appeals reasoned that, since the intangibles had no connection to any geographic location, there was no interstate market impacted by the tax, and thus the Commerce Clause was not implicated. *Id.* at 1130, 1134 Unlike *Tamagni*, the present controversy does not concern investment income from intangibles, but rather income attributed directly to the taxpayer and apportioned according to geographic ties.

See also Luther v. Commissioner of Revenue, 588 N.W.2d 502, 510-12 (Minn. 1999) (income tax on non-domiciliary resident did not risk multiple taxation due to credit); *Stelzner v. Commissioner of Revenue*, 621 N.W.2d 736, 741 (Minn. 2001) (income tax on non-domiciliary residents was consistent with due process and did not threaten multiple taxation as domiciliary state lacked an income tax).

market for capital and business investment and, accordingly, implicate the dormant Commerce Clause. *See, e.g,, Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (North Carolina property tax on intangibles that taxed investments in out-of-state businesses at a higher rate violated the Commerce Clause); *Boston Stock Exchange*, *supra*.

Does Application of the County Tax without a Credit Violate the Dormant Commerce Clause?

The Supreme Court has held that a state may tax interstate commerce without offending the dormant Commerce Clause so long as the tax satisfies a four-prong test. Under that test, a state tax survives a challenge under the dormant Commerce Clause if it:

> (1) applies to an activity with a substantial nexus with the taxing state;
>
> (2) is fairly apportioned;
>
> (3) is not discriminatory towards interstate or foreign commerce; and
>
> (4) is fairly related to the services provided by the State.

Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977); *see also D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30-31 (1988).

The Wynnes apparently do not dispute that the application of the county tax in this case has a substantial nexus to Maryland or that it is fairly

related to services provided by the State. Thus, for purposes of the present controversy, we focus on the remaining two prongs of the *Complete Auto* test: the requirement of fair apportionment and the prohibition against discrimination against interstate commerce.

(1) Is the county tax without a credit fairly apportioned?

The purpose of the apportionment requirement is to ensure that each state taxes only its fair share of an interstate transaction. *Goldberg v. Sweet*, 488 U.S. 252, 261 (1989). "It is a commonplace of constitutional jurisprudence that multiple taxation may well be offensive to the Commerce Clause. In order to prevent multiple taxation of interstate commerce, the Court has required that taxes be apportioned among taxing jurisdictions, so that no instrumentality of commerce is subjected to more than one tax on its full value." *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 446-47 (1979). "The rule which permits taxation by two or more states on an apportionment basis precludes taxation of all of the property by the state of the domicile.... Otherwise there would be multiple taxation of interstate operations." *Standard Oil Co. v. Peck*, 342 U.S. 382, 384-85 (1952).

The dormant Commerce Clause does not mandate the adoption of a particular income allocation formula for apportionment. *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 274 (1978) (states have "wide latitude" in the selection of an apportionment formula which will only be disturbed upon "clear and cogent evidence" that it leads to a "grossly distorted result"). In order to assess the fairness of apportionment courts look to whether a

tax is "internally consistent" as well as "externally consistent." *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 185 (1995).

(a) Is the county tax without a credit internally consistent?

"Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the 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." *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. at 185.

Internal consistency is thus measured by the answer to the following hypothetical question: If each state imposed a county tax without a credit in the context of a tax scheme identical to that of Maryland,[16] would interstate commerce be disadvantaged compared to intrastate commerce?

The answer is yes. In this scenario, TG §10-703 (or its hypothetical equivalent in other states) would grant

---

[16] A state tax "must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme," and "proper analysis must take the whole scheme of taxation into account." *Maryland v. Louisiana*, 451 U.S. 725, 756 (1981); *Halliburton Oil Well Cementing Co. v. Reilly*, 373 U.S. 64, 69 (1963).

a credit against a taxpayer's home state income tax but not against the home county income tax for income taxes paid to other states. As a result, taxpayers who earn income from activities undertaken outside of their home states would be systematically taxed at higher rates relative to taxpayers who earn income entirely within their home state. Those higher rates would be the result of multiple states taxing the same income.

This is illustrated by the following example.

- *Tax rates*. Assume each state imposes a state tax of 4.75% on all the income of its residents, a county tax of 3.2% on all the income of residents, and a SNRT of 1.25% on the income of non-residents earned within the state.

- *Credit*. Assume that each state allows a credit for income taxes paid to other states that operates in the same fashion as TG §10-703 – *i.e.*, the formula for the credit and application of the credit take only the home state "state tax" into account.

- *Taxpayer with in-state income only*. Mary lives in Maryland and earns $100,000, entirely from activities in Maryland.

  Mary owes $4,750 in Maryland state income tax (.0475 x $100,000), $3,200 in Maryland county income tax (.032 x $100,000) for a total Maryland tax of **$7,950**.

- *Taxpayer with multi-state income*. John lives in Maryland and earns $100,000, half ($50,000) from

activities in Maryland and half ($50,000) from activities in Pennsylvania.

Because John is a resident of Maryland, all of his income is subject to both the Maryland "state tax" and the "county tax"applicable to his county. Before the application of any credit, John owes $4,750 in Maryland state income tax (.0475 x $100,000), $3,200 in Maryland county income tax (.032 x $100,000) for a total Maryland tax of $7,950.

Because half of John's income was generated in Pennsylvania, John also owes $2,375 in Pennsylvania state income tax (.0475 x $50,000) and $625 with respect to the Pennsylvania SNRT (.0125 x $50,000) for a total Pennsylvania tax of $3,000.

John receives a credit in the amount of $2,375 with respect to his Maryland state income tax pursuant to credit formula set forth in TG §10-703(c).[17] This

---

[17] Under TG §10-703(c), the credit is computed as *the lesser of*:

(1) "the amount of allowable tax on income" paid to the other state – in this example, $3000, if we assume that the credit encompasses both the Pennsylvania state income tax and the Pennsylvania SNRT.

and

(2) "an amount that does not reduce the [Maryland] state income tax to an amount less than would be payable if the income subjected to tax in the other state were disregarded."

reduces his Maryland income tax to $5,575.

> Thus, John owes a combined total of **$8,575** in state income taxes.

As the above example demonstrates, a taxpayer with income sourced in more than one state will consistently owe more in combined state income taxes than a taxpayer with the same income sourced in just the taxpayer's home state. This may discourage Maryland residents from engaging in income-earning activity that touches other states. In the context of S corporations, it may encourage Maryland residents to invest in purely local businesses, and discourage businesses from seeking to operate both in Maryland and in other states. In effect, it acts as an extra tax on

---

The following calculation determines the figure for second provision of the above formula: If the income subjected to tax in Pennsylvania in this example were disregarded, the Maryland state income tax would be $2,375 (.0475 x $50,000). Thus, under this provision, the credit is capped at $2,375 – the difference between John's Maryland state tax liability ($4,750, as computed in the text) and the amount of Maryland state tax he would pay if his Pennsylvania income were ignored ($2,375).

Thus, the first method of figuring the credit yields $3,000 and the second method yields $2,375. Because the maximum allowable credit is the *lesser* of the two amounts, John would receive a credit in the amount of $2,375.

The parties disputed whether the SNRT would be included in the credit computation and whether doing so would change the result of this example. However, the same result obtains whether or not the Pennsylvania SNRT, as well as the Pennsylvania state tax, is included in the credit computation.

interstate income-earning activities. It fails the internal consistency test.[18]

While it is true that a failure to pass the internal consistency test does not always signal a constitutional defect in a state tax scheme, the circumstances under which the courts have tolerated a lack of internal consistency do not pertain here. One such case concerned a flat $100 annual fee imposed by Michigan upon trucks engaged in intrastate commercial hauling. *American Trucking Assns., Inc. v. Michigan Pub. Serv. Comm'n,* 545 U.S. 429 (2005). The petitioners in that case challenged the fee on the ground that it discriminated against interstate carriers and unconstitutionally burdened interstate trade because the fee was flat but trucks carrying both interstate and intrastate loads engaged in less intrastate business than trucks carrying only intrastate loads. 545 U.S. at 431-32. The Supreme Court held that the fee did not violate the dormant Commerce Clause. In analyzing the internal consistency of the tax, the Court concluded that, if every state imposed such a fee, an interstate trucker doing local business in multiple states would

---

[18] Some state courts have concluded that a tax that fails the internal consistency test is unconstitutional under the dormant Commerce Clause. *See Northwest Energetic Services, LLC v. California Franchise Tax Board*, 71 Cal. Rptr. 3rd 642, 658 (Cal. App. 1st Dist. 2008) (holding unconstitutional an unapportioned local tax to the extent that it applied to out-of-state business income)*; M & Assocs, Inc.. v. City of Irondale*, 723 So. 2d 592, 598-99 (Ala. 1998) (local franchise tax based on total gross receipts regardless of whether goods were sold in-state or out-of-state would result in state taking more than its fair share of taxes from interstate transaction).

have to pay hundreds or thousands of dollars in fees if it supplemented its interstate business by carrying local loads in many other states, thus an internal inconsistency. The Court nonetheless found no Commerce Clause violation because a business would have to incur such fees only because it engaged in local business in all those states. *Id.* at 438. "An interstate firm with local outlets normally expects to pay local fees that are uniformly assessed upon all those who engage in local business, interstate and domestic firms alike." *Id*. Such a fee, in effect a toll on in-state activity, is factually distinguishable from the present case involving business performed and income earned outside of Maryland. Moreover, we are not aware of an instance in which a court has upheld an unapportioned *income* tax on the authority of *American Trucking*.

The Comptroller advances an alternative argument. Because an individual can only be a resident of one county in the universe,[19] even if every taxing jurisdiction adopted Maryland's tax structure, the individual would only be required to pay a county tax once. This, argues the Comptroller, precludes the possibility of multiple taxation by operation of the county tax. However, this analysis appears to be inconsistent with the logic underlying this Court's

---

[19] The county tax applies to a resident of a county if, on the last day of the taxable year, the person was domiciled in the county or maintained a principal residence or place of abode there. TG §10-103(a). We assume, without deciding, that a person can be a resident of only one county under the statute. This may not be a safe assumption as the definition appears to allow for a principal place of abode that is different from the place of domicile, but it is fundamental to the Comptroller's argument.

holding in *Frey* that the Maryland SNRT is a state tax for constitutional purposes. 422 Md. at 142. Moreover, under dormant Commerce Clause analysis, there are generally only two levels of regulation, state and federal. *See Associated Indus. v. Lohman*, 511 U.S. 641, 650-51 (1994). The Comptroller's analysis posits a third level, the local level, such that a local tax need only be considered in the light of local taxes in other jurisdictions. But there appears to be no authority in the case law for this position.[20]

(b) Is the county tax without a credit externally consistent?

The next question is whether the current county tax scheme is externally consistent.[21] For this test, one

---

[20] As this Court discussed in *Frey,* the SNRT is justified as a "compensatory" tax on non-residents that is analogous to the county tax and that is imposed at a rate equivalent to the county tax in at least one Maryland county. 422 Md. at 149-63. Accordingly, even if one is a resident of a county of the universe other than Maryland, one may be subject to a Maryland tax analogous to the county tax – a fact that undermines the Comptroller's theory that the county tax should be considered separately from state taxation for purposes of the Commerce Clause. Even if Commerce Clause analysis recognized a third layer of income taxation, the existence of the SNRT shows how vulnerable that layer would be to multiple taxation.

[21] Although the external consistency test is only applied to confirm the proper apportionment of a tax already found to be internally consistent, *Oklahoma Tax Comm'n v. Jefferson Lines,* 514 U.S. 175, 185 (1995), it seems prudent to address this issue given the possibility that dormant Commerce Clause jurisprudence will continue to develop in the wake of *American Trucking Assns., Inc. v. Michigan Pub. Serv. Comm'n*, 545 U.S. 429 (2005).

must assess "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg v. Sweet,* 288 U.S. 252, 262 (1989). This test looks to a state's "economic justification" for its claim on the value taxed "to discover whether a state's tax reaches beyond that portion of value that is fairly attributable to economic activity within the taxing state." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). "[T]he threat of real multiple taxation (though not by literally identical statutes) may indicate a state's impermissible overreaching." *Id.*

Thus, to test for external consistency one asks: Does tax liability under the Maryland income tax code reasonably reflect how income is generated? Because no credit is given with respect to the county tax for income earned out-of-state, the Maryland tax code does not apportion income subject to that tax even when that income is derived entirely from out-of-state sources. Thus, when income sourced to out-of-state activities is subject to the county tax, there is a potential for multiple taxation of the same income. In those circumstances, the operation of the county tax appears to create external inconsistency.[22] This is

---

[22] In discussing the external consistency test, the Comptroller argues that the county tax has no effect on interstate activity on the basis that the Wynnes themselves did not directly participate in interstate commerce and the income in question is investment income. The Wynnes respond that Mr. Wynne was an officer of the company and therefore involved in its interstate activities though it is not readily apparent how that is relevant as the issue before us does not concern his salary. More to the point is that the income

further indication that the application of the tax in these circumstances without application of an appropriate credit violates the dormant Commerce Clause.[23]

---

in question is "pass-through" income of an S corporation that was generated outside of Maryland. Under the Internal Revenue Code and the Maryland tax code, such income is attributed to shareholders like the Wynnes "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); TG §10-107.

It is this treatment of pass-through income of S corporations that allows Maryland to tax non-resident individuals with no other connection to Maryland who have pass-through S corporation income from activities in Maryland. *See* TG §10-401. Thus, the same provisions that form the basis for Maryland to tax such income also govern the characterization of such income. Such income is not necessarily or simply to be characterized as investment income.

[23] Courts in other states have found local taxes that lack external consistency to be unconstitutional. *See Phila. Eagles Football Club, Inc. v. City of Philadelphia*, 823 A.2d 108, 131-35 (Pa. 2003) (levy on 100 percent of media receipts where half the team's games were broadcast from locations outside the taxing jurisdiction held to be externally inconsistent even though tax passed internal consistency test); *City of Winchester v. American Woodmark Corp*., 471 S.E.2d 495, 498 (Va. 1996) (although business license tax had been held to be internally consistent, levy on 100 percent of revenues of locally headquartered company held to be externally inconsistent where the income was derived in part from sales and manufacture located outside taxing jurisdiction and the tax bore no relationship to income generated in the jurisdiction); *Avanade, Inc. v. City of Seattle*, 211 P.3d 476, 482-83 (Wash. Ct. App. 2009) (apportionment formula that allocated all revenues to headquarters city when substantial revenues were derived in other states found to be externally inconsistent).

(2) Does the County Tax Discriminate against Interstate Commerce?

Under the third prong of the *Complete Auto* test, a tax must not discriminate against interstate commerce. Even if a tax is fairly apportioned, it "may violate the Commerce Clause if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce." *Amerada Hess Corp. v. Director, Div. of Taxation, New Jersey Dep't of Treasury*, 490 U.S. 66, 75 (1989). A state tax may not discriminate against a transaction because the transaction has an interstate element or because the transaction or incident crosses state lines. *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984). A taxing scheme that encourages interstate businesses to conduct more of their business activities within the taxing state may be found to be discriminatory. *Amerada Hess Corp.*, 490 U.S. at 77-78. Facially discriminatory state taxes are subject to the strictest scrutiny, and the "burden of justification is so heavy that 'facial discrimination by itself may be a fatal defect.'" *Oregon Waste Systems, Inc.*, 511 U.S. at 101 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 337 (1979)). There is no "*de minimis*"

A tax that risks multiple taxation but that survives external consistency scrutiny is the sales tax. *See Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 191 (1995). Similarly, taxes on services such as telephone calls have been upheld. *See Goldberg v. Sweet*, 488 U.S. 252 (1989). The Court has permitted these taxes by noting that a tax on a buyer is different from a tax on a seller. *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. at 190. In this case, however, the Wynnes are sellers because their income is generated through the sale of a good or service, whereas a tax on a buyer is a tax on consumption.

justification if a tax is found to actually discriminate against interstate commerce. *Fulton Corp. v. Faulkner*, 516 U.S. 325, 332 n.3 (1996). Discriminatory effect may lie in the tax itself, but it may also arise from interactions with other states' taxes. *See, e.g., Barringer v. Griffes*, 1 F.3d 1331, 1337-39 (2d Cir. 1993) (state use tax on automobiles that provided credit for sales tax paid in-state, but not out-of-state was discriminatory).

Particularly pertinent to the present case is the Supreme Court's analysis of a North Carolina tax in *Fulton Corp. v. Faulkner*, *supra*. North Carolina imposed an "intangibles tax" on the value of corporate stock owned by North Carolina residents. The tax was computed as a fraction of the value of the stock, with the tax rate reduced to the extent that the corporation's income was subject to tax in North Carolina. 516 U.S. at 327-28. This resulted in a North Carolina stockholder being taxed at a higher rate for holdings in companies that did not do business in North Carolina and at lower rates for holdings in companies that did business in North Carolina. The Supreme Court held that the tax violated the dormant Commerce Clause because it discriminated against interstate commerce. *Id*. at 333, 344.[24] In striking down the tax, the Court stated: "[A] regime that taxes stock only to the degree

---

[24] The Court also held that the discriminatory aspect of the tax could not be justified as a valid "compensatory" tax – *i.e.*, a tax on interstate commerce that complements a tax on intrastate commerce to the extent that it "compensates" for the burdens imposed on intrastate commerce by imposing a similar burden on interstate commerce. 516 U.S. at 331 n.2, 334-44. *See* note 25 below.

that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents...." *Id*. at 333.

This case presents a similar situation. The application of the county tax to the out-of-state pass-through income without application of a credit for out-of-state income taxes on the same income means that Maryland shareholders – the Wynnes in this case – may be taxed at a higher rate on income earned through Maxim's out-of-state activities than on income earned though its Maryland activities. This would appear to favor businesses that do business primarily in Maryland over their competitors who do business primarily out-of-state – at least in the context of ownership of a Subchapter S corporation. The only difference between *Fulton* and the present case is one of form. Whereas in *Fulton* it was North Carolina's own tax rate that varied, in the present case it is the imposition of an additional tax, the tax set by the state where the income was earned – and the failure to provide a credit for it in Maryland – that creates the discrimination. Nonetheless, the effect is the same.

While the failure to allow a credit is at the heart of the discrimination in this case, not every denial of a deduction or credit for taxes paid to another jurisdiction results in a violation of the dormant Commerce Clause. In *Amerada Hess v. New Jersey Dept. of the Treasury,* the Supreme Court evaluated the constitutionality of a New Jersey statute that denied to oil-producing companies a deduction for amounts paid under the federal windfall profits tax. Holding that the tax did not violate the Commerce Clause, the Court

noted, "a deduction denial does not unduly burden interstate commerce just because the deduction denied relates to an economic activity performed outside the taxing State." 490 U.S. at 78 n.10.

Amerada Hess is distinguishable from the present case however. At issue in *Amerada Hess* was a state deduction for a federal income tax – a tax that a business would be subject to no matter where it was located in the United States, whether within New Jersey or elsewhere. By denying a tax credit in that case, New Jersey treated all similarly-situated taxpayers equally because a business was subject to the same rate regardless of whether the windfall profits were earned within New Jersey or elsewhere. By contrast, the failure to provide a credit against the county tax in this case penalizes investment in a Maryland entity that earns income out-of-state: an investment in such a venture incurs both out-of-state taxes and the Maryland county tax on the same income; a similar venture that does all its business in Maryland incurs only the county tax.

The tax at issue in this case is also similar to the one in *Halliburton Oil Well Co. v. Reily*, 373 U.S. 64, 72 (1963). There, a Louisiana statute had the discriminatory effect of imposing a greater tax on goods manufactured outside Louisiana than on goods manufactured within that state, thereby creating an incentive to locate the manufacturing process within Louisiana. Although the mechanism is different, the application of the credit in Maryland's income tax law has a similar discriminatory effect. The more a Maryland business can locate its value-creating activities within Maryland the less it will be taxed. *See*

also Camps Newfound/Owatonna v. Town of Harrison, 520 U.S. 564 (1997) (application of tax exemption that disfavored in-state businesses with out-of-state clientele violated dormant Commerce Clause).

Thus, the application of the county tax to pass-through S corporation income sourced in other states that tax that income, without application of an appropriate credit, discriminates against interstate commerce.[25]

Conclusion

For the reasons explained above, the failure of the Maryland income tax law to allow a credit against the county tax for a Maryland resident taxpayer with respect to pass-through income of an S corporation that arises from activities in another state and that is taxed in that state violates the dormant Commerce Clause of the federal Constitution.[26]

---

[25] Such a discriminatory tax may survive constitutional scrutiny if the tax is a "compensatory" tax. *See Oregon Waste Systems,* 511 U.S. at 102-3; *see also Frey*, 422 Md. at 145-63 (analyzing whether Maryland SNRT is a compensatory tax). The Comptroller has not argued that failure to allow a credit against the county tax with respect to payments of out-of-state income taxes is part of a compensatory tax. *See Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (rejecting argument that North Carolina's discriminatory "intangibles" tax was a compensatory tax based on inability of state to collect corporate income tax from out-of-state corporations).

[26] Our colleague, Judge Greene, offers a thoughtful dissent to this conclusion. While we are not unsympathetic to the dissent as a matter of policy, we find its legal analysis unpersuasive.

The dissent first points to a hypothetical situation – not this case – in which the application of the credit for out-of-state tax payments with respect to income earned in another state with a higher tax rate than Maryland could lead to the "absurd result" that a county resident who earned all of his or her income in the other state with the higher income tax rate would pay little or no county income tax on that same income while a neighbor who earned a similar income from activity solely within Maryland and is taxed only in Maryland would pay county income tax. This rhetorical statement proves both too much and too little.

It proves too much because, in the situation posited by the dissent, the credit for the higher out-of-state tax payments would have a similar effect on the taxpayer's state income tax liability. But the dissent does not assert, and could not credibly suggest, that the state income tax would survive a challenge under the Commerce Clause without a credit for out-of-state tax payments made with respect to out-of-state income. It proves too little because the application of the credit has no effect on the taxpayer's liability for sales taxes, local property taxes, and other taxes unrelated to income that are used to provide state and county services.

The dissent also argues that key Supreme Court decisions on the application of the dormant Commerce Clause to state taxes are distinguishable on the basis that the taxes at issue in those cases were "facially discriminatory" in a way that the county tax in this case is not. But this is more a matter of semantics than substance. For example, in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), the North Carolina law in question allowed a deduction from the state intangibles tax for corporate income taxes paid in North Carolina, but no deduction for entities that were not subject to the state income tax (*i.e.*, entities that did business elsewhere) – thus effectively favoring intra-state commerce over interstate commerce. The failure to allow a credit in this case for out-of-state tax payments has the same effect as withholding a deduction in *Faulkner*. In the end, it is perhaps most telling that the dissent does not attempt to analyze the application of the county income

As for relief, the Wynnes suggest in their brief that the Maryland county income tax, the credit, or some part of the Maryland tax scheme be "struck down." In fact, the county income tax itself is not unconstitutional. Nor is the credit, which serves to ensure that the Maryland income tax scheme operates within constitutional constraints. Nor is the Maryland income tax law generally. What is unconstitutional is the application – or lack thereof – of the credit to the county income tax. As this Court explained in some detail in *Blanton,* a credit previously applied to the county income tax in these circumstances. The county income tax was only eliminated from the computation and application of the credit by a 1975 amendment of the tax code. Chapter 3, Laws of Maryland 1975. It is that amendment, when applied to the particular circumstances of taxpayers like the Wynnes, that contravenes the Constitution.[27] On remand from the Circuit Court, the Tax Court should recalculate the Wynnes' tax liability in a manner consistent with this opinion.

---

tax without a credit under the *Complete Auto* test – the analysis that the Supreme Court has directed courts to apply in assessing State taxes under the Commerce Clause.

[27] Other provisions of the 1975 amendment and the later re-enactments are severable. *See Muskin v. State Department of Assessments and Taxation*, 422 Md. 544, 554 n.5, 30 A.3d 962 (2011) ("there is a strong presumption that if a portion of an enactment is found to be invalid, the intent is that such portion be severed").

JUDGMENT OF THE CIRCUIT COURT FOR HOWARD COUNTY AFFIRMED WITH DIRECTION TO REMAND TO THE TAX COURT FOR FURTHER PROCEEDINGS CONSISTENT WITH THIS OPINION. COSTS TO BE SHARED EQUALLY BY THE PARTIES.

IN THE COURT OF APPEALS
OF MARYLAND

No. 107

September Term, 2011

[Filed January 28, 2013]

MARYLAND STATE COMPTROLLER OF THE TREASURY

v.

BRIAN WYNNE, et ux.

Bell, C.J.
Harrell
Battaglia
Greene
Adkins
Barbera
McDonald,

JJ.

Dissenting Opinion by Greene, J.,
which Battaglia, J., Joins.

I disagree with the Majority's conclusion that the federal Constitution's dormant Commerce Clause requires Maryland to reduce the Wynnes' county taxes. Since the early Nineteenth Century, the law has been:

> [T]he power of taxation is one of vital importance . . . retained by the states. . . . [T]he power of taxing the people and their property[] is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may choose to carry it. The only security against the abuse of this power, is found in the structure of the government itself. In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation.

McCulloch v. Maryland, 17 U.S. 316, 4 Wheat. 316, 425, 428, 4 L. Ed. 579, 606, 607 (1819). The Wynnes may not agree that they should pay the Howard County tax without a credit pursuant to TG § 10-703. This, however, is an issue for the elected officials of Howard County and the State, not this Court. "It is not a purpose of the Commerce Clause to protect state residents from their own state taxes." *Goldberg v. Sweet*, 488 U.S. 252, 266, 109 S. Ct. 582, 591, 102 L. Ed. 2d 607, 620 (1989) (noting additionally that the dormant Commerce Clause is not designed to protect the "insider who presumably is able to complain about and change the tax through the [state] political process"). The Maryland General Assembly's decision to apply a credit for taxes paid in other states to the Wynnes' state tax, and not their county tax, does not run afoul of the federal Constitution's dormant Commerce Clause.

The Wynnes live in Howard County where they benefit from the services provided by that county. *See*

Frey v. Comptroller, 422 Md. 111, 150, 29 A.3d 475, 497-98 (2011). To pay for these services, Howard County, like every county in Maryland, including Baltimore City, assesses a tax. As the Majority notes, TG § 10-703 does not permit the Wynnes to apply a credit for taxes paid in other states to reduce the Howard County tax. *Comptroller v. Wynne*, __ Md. __, __, __ A.3d __, __ (2013) (Maj. Slip Op. at 5). Rather, as we said in *Comptroller v. Blanton*, 390 Md. 528, 535, 543, 890 A.2d 279, 283, 288 (2006), residents of a Maryland county are required to pay for that county's services by paying the county tax without the credit. Otherwise, "if the taxpayers were allowed to pay a lesser amount of county income tax, it 'would have the possible absurd result of the [taxpayers] paying little or no local tax for services provided by the county while a neighbor with similar income, exemptions, and deductions might be paying a substantial local tax to support those services.'" *Blanton*, 390 Md. at 536 n. 9, 890 A.2d at 284 n. 9 (quoting *Coerper v. Comptroller*, 265 Md. 3, 8, 288 A.2d 187, 189 (1972)).

The Majority acknowledges that Maryland law prohibits the Wynnes from applying a credit for taxes paid to other states to reduce their county taxes. *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 5). The Majority, however, concludes that imposing a county tax without allowing for a credit pursuant to TG § 10-703 violates the dormant Commerce Clause because Maryland's taxing scheme fails two prongs of the *Complete Auto* four-part test, namely that it is not fairly apportioned, and it discriminates against interstate commerce. *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 17, 20, 23-24, 28-29). As we have said before, however:

> Declaring a statute enacted by the General Assembly to be unconstitutional and therefore unenforceable is an extraordinary act. Statutes are generally presumed to be Constitutional and are not to be held otherwise unless the Constitutional impediment is clear. We have said many times that since every presumption favors the validity of a statute, it cannot be stricken down as void, unless it plainly contravenes a provision of the Constitution.

Maryland State Bd. of Ed. v. Bradford, 387 Md. 353, 387, 875 A.2d 703, 723 (2005) (quotation and citations omitted). *See also San Antonio Independent Sch. Dist. v. Rodriguez*, 411 U.S. 1, 44, 93 S Ct. 1278, 1302, 36 L. Ed. 2d 16, 49 (1973) (noting that state laws are traditionally accorded a "presumption of constitutionality"). Because of this presumption, a heavy burden is on the Wynnes to prove that this Court should not enforce Maryland law as it is written.

The Majority states that before this Court can decide whether the dormant Commerce Clause has been violated, we must "assess first whether the dormant Commerce Clause is implicated by the county tax . . . ." *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 11). Contrary to the Majority's conclusion, however, it appears that the Wynnes have failed to meet their burden of showing that the dormant Commerce Clause is implicated.[1]

---

[1] In *General Motors v. Tracy*, 519 U.S. 278, 300, 117 S. Ct. 811, 825, 136 L. Ed. 2d 761, 781 (1997), the Supreme Court noted that "in the absence of actual or prospective competition" within "a

States have the power to impose taxes that may result in some overlap in taxation of income. *See Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 278-79, 98 S. Ct. 2340, 2346-47, 57 L. Ed. 2d. 197, 207-08 (1978) (concluding that it does not necessarily constitute a violation of the dormant Commerce Clause when two states' taxing schemes tax income differently, and this results in some overlap in taxation). As the Majority notes, "[T]he dormant Commerce Clause will not affect the application of a tax unless there is actual or perspective competition between entities in an identifiable market and state action that either expressly discriminates against or places an undue burden on interstate commerce. [*General Motors Corp. v. Tracy*, 519 U.S. 278, 300, 117 S. Ct. 811, 825, 136 L. Ed. 2d 761, 781 (1997)]. This impact must be more than incidental. *United States v. Lopez*, 514 U.S. 549, 559

---

single market" between those engaged in interstate commerce and those engaged in intrastate commerce, there can be no dormant Commerce Clause violation. Because of this, the New York Court of Appeals has determined that before a tax can be subjected to the *Complete Auto* test, the party challenging the tax must "identify the interstate market that is being subjected to discriminatory or unduly burdensome taxation." *In re Tamagni*, 695 N.E.2d 1125,1131 (NY 1998). "This requires, at the outset, identification of the similarly situated in-State and out-of-State interests which the tax treats differently." *Id.* The Wynnes argue that "Maryland taxpayers and companies that do business out of state, on the one hand, and those that restrict their trade to Maryland, on the other" constitute similarly situated parties in one market. These two groups are not similarly situated, however. Those who engage in out-of-state business enjoy the protections and markets provided by the states where they do business. Taxpayers and companies that restrict their business to Maryland only receive the protections and services provided by Maryland.

[115 S. Ct. 1624, 1630, 131 L. Ed. 2d 626, 637] (1995)." *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 12). In the present case, the Wynnes have failed to prove that requiring them to pay a county tax without a credit either expressly discriminates against interstate commerce or places more than an incidental burden upon interstate commerce. Therefore, the Wynnes have failed to prove that the dormant Commerce Clause is implicated.

The Howard County tax, assessed without a credit, does not expressly discriminate against interstate commerce. As the Comptroller argues, the Howard County tax is directed at income earned by residents of Howard County, not interstate commerce.[2] And while, as the Majority notes, the dormant Commerce Clause

---

[2] In most of the cases where the Supreme Court has subjected a tax to the *Complete Auto* test, the tax was directly on interstate commerce itself or items in interstate commerce. *See Okla. Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 177, 183, 115 S. Ct. 1331, 1334, 1337, 131 L. Ed. 2d 261, 267, 271 (1995) (analyzing an Oklahoma tax on a bus ticket for interstate travel); *Goldberg*, 488 U.S. at 255-56, 259-60, 109 S. Ct. at 585-86, 587-88, 102 L. Ed. 2d at 613, 615-16 (analyzing an Illinois state tax on interstate calls); *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 26, 31-33, 108 S. Ct. 1619, 1620-21, 1623-24, 100 L. Ed. 2d 21, 24, 28-29 (1988) (analyzing a Louisiana use tax on catalogs printed outside the state and shipped to persons in the state); *Wardair Canada v. Fla. Dept. of Revenue*, 477 U.S. 1, 3-4, 8, 106 S. Ct. 2369, 2370-71, 2373, 91 L. Ed. 2d 1, 7, 10 (1986) (analyzing a tax on fuel sold in Florida and used in interstate commerce). The challenged Howard County tax without a credit is assessed upon the income of residents of the County. While a portion of that income may derive from interstate commerce, the challenged tax is not directed to interstate commerce or items in interstate commerce. Rather, the connection to interstate commerce is more attenuated.

"is not limited to circumstances where physical goods enter the stream of commerce[,]" *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 12), the other cases the Majority relies on all involve situations where, unlike the present case, the law was facially discriminatory. The Majority looks to *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564, 117 S. Ct. 1590, 137 L. Ed. 2d 852 (1997), *Edwards v. California*, 314 U.S. 160, 62 S. Ct. 164, 86 L. Ed. 119 (1941), *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 97 S. Ct. 599, 50 L. Ed. 2d 514 (1977), and *Fulton Corp. v. Faulkner*, 516 U.S. 325, 116 S. Ct. 848, 133 L. Ed. 2d 796 (1996) to conclude that the dormant Commerce Clause is implicated. In all four of those cases, the challenged tax law facially discriminated against interstate commerce by either first distinguishing between organizations and businesses that were involved in interstate business and those organizations and businesses that were only involved with intrastate business, and then imposing a disadvantage upon those involved in interstate transactions, or, in the case of *Edwards*, placing a restriction upon people moving in interstate commerce itself.

In *Camps Newfound/Owatonna*, the challenged Maine tax law granted a general exemption from real estate and personal property taxes for charities incorporated in Maine, but limited that exemption for organizations that mostly served non-Maine residents. 520 U.S. at 568, 117 S. Ct. at 1594, 137 L. Ed. 2d at 859. The law, thereby, distinguished between groups that served people traveling in interstate commerce and those that only served Maine residents and explicitly benefitted the latter. 520 U.S. at 575-76, 117 S. Ct. at 1598, 137 L. Ed. 2d at 864. In *Edwards*, the

challenged law directly implicated interstate commerce and travel by prohibiting the transportation of indigent persons across state lines. 314 U.S. at 174, 62 S. Ct. at 167, 86 L. Ed. at 125-26. In *Boston Stock Exchange*, the challenged New York tax law distinguished between sales of securities made within New York and those made outside New York, and then imposed a lower tax rate and a cap on taxes for in-state sales and a higher tax rate and no cap on taxes for out-of-state sales. 429 U.S. at 319, 324-25, 97 S. Ct. at 602, 604, 50 L. Ed. 2d at 518, 521. Finally, in *Fulton Corp*., North Carolina imposed a tax on investments in corporations but allowed stockholders to reduce their tax liability based on the business the corporation did in North Carolina. 516 U.S. at 327-328, 116 S. Ct. at 852, 133 L. Ed. 2d at 802-03. In *Fulton Corp.*, the United States Supreme Court noted that the tax facially discriminated against interstate commerce, and North Carolina "practically concede[d] as much." 516 U.S. at 333, 116 S. Ct. at 855, 133 L. Ed. 2d at 806.

In the present case, nothing on the face of the Maryland tax laws imposing a county tax, TG § 10-103, or the Maryland tax law limiting credits for taxes paid in other states to state taxes, TG § 10-703, discriminates against interstate commerce. TG § 10-103 imposes a county tax on all residents with no distinction drawn based upon the source of the income. And, TG § 10-703, on its face, provides a benefit to interstate commerce by applying a credit to reduce the amount of Maryland state taxes paid by residents who earned income in interstate commerce. The only distinction drawn between income earned in intrastate commerce and income earned in interstate commerce pursuant to these two laws is that a benefit

is bestowed upon interstate commerce through the credit that is applied to state taxes. This can hardly be interpreted as discriminating against interstate commerce on the face of the law.

The fact that Maryland's tax scheme is not facially discriminatory is critical to the dormant Commerce Clause analysis. As the Majority notes, "[f]acially discriminatory state taxes are subject to the strictest scrutiny, and the 'burden of justification is so heavy that 'facial discrimination by itself may be a fatal defect.''" *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 25) (quoting *Oregon Waste Systems, Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 101, 114 S. Ct. 1345, 1351, 128 L. Ed. 2d 13, 22 (1994) (in turn quoting *Hughes v. Oklahoma*, 441 U.S. 322, 337, 99 S. Ct. 1727, 1737, 60 L. Ed. 2d 250, 262 (1979)); *see also Frey*, 422 Md. at 144, 29 A.3d at 494 ("[F]acially discriminatory state taxes raise a presumption of per se invalidity."). In other words, when a court is examining a law that, on its face, draws a distinction between interstate and intrastate commerce and imposes a disadvantage to the former, the burden of proving that the law expressly discriminates against interstate commerce and that the dormant Commerce Clause is implicated is met. *See United Haulers Ass'n. v. Oneida-Herkimer Solid Waste Mgmt. Auth.*, 550 U.S. 330, 338-39, 127 S. Ct. 1786, 1793, 167 L. Ed. 2d 655, 664-65 (2007). In this case, there is no facial discrimination against interstate commerce, and thus, the burden of proving that the dormant Commerce Clause is implicated requires a higher level of proof.

As noted above, the Wynnes have the burden of proving that interstate commerce is implicated. The

Wynnes, however, fail to meet this burden with the arguments they present. In arguing that the dormant Commerce Clause is implicated, the Wynnes primarily rely on two lines of arguments, both of which are inapplicable to the present case.

First, the Wynnes rely on our decision in *Frey* where we concluded that the "Special Nonresident Tax," or SNRT, implicated the dormant Commerce Clause.[3] The SNRT is applied to nonresidents doing business in Maryland. On its face, the SNRT singles out income from interstate commerce and applies a tax on that income. It is thus a "facially discriminatory state tax[]," and subject to "the strictest scrutiny[.]" *Frey*, 422 Md. at 144, 29 A.3d at 494. The county tax, on the other hand, draws no distinction between income earned in interstate and intrastate commerce and is not facially discriminatory. Therefore, unlike the SNRT, the county tax does not expressly discriminate against interstate commerce and our conclusion in *Frey* that the SNRT implicated the dormant Commerce Clause is inapplicable to the present case.

Second, the Wynnes rely on *Camps Newfound/Owatonna*, *Fulton Corp.*, and a case from the Minnesota Supreme Court, *Chapman v. Comm'r of*

---

[3] Similarly, at oral argument before this Court, counsel for the Wynnes argued that, in footnote 14 of the *Frey* decision, this Court indicated that the county tax implicates the dormant Commerce Clause. A close reading of footnote 14 indicates that what we concluded was that "[t]he SNRT may thereby substantially affect interstate commerce and is consequently susceptible to Commerce Clause scrutiny." 422 Md. at 143 n. 14, 29 A.3d at 493 n. 14. We said nothing in the footnote about county taxes.

Revenue, 651 N.W. 2d 825 (Minn. 2002). As noted above, *Camps Newfound/Owatonna* and *Fulton Corp.* address facially discriminatory laws. Likewise, *Chapman* addresses a facially discriminatory law. The law in question allowed Minnesota taxpayers to take a tax deduction for contributions to charities "located in and carrying on substantially all of its activities within [Minnesota]," but did not allow a tax deduction for contributions to non-Minnesota charities. 651 N.W. 2d at 834. The Minnesota Supreme Court stated that "[o]n its face, the statute treats contributions to in-state charitable organizations differently from contributions to out-of-state charitable organizations," and concluded that it was "facially discriminatory." 651 N.W. 2d at 834. As noted above, a law that facially discriminates against interstate commerce necessarily implicates the dormant Commerce Clause. Maryland's tax scheme, which is not facially discriminatory, however, does not necessarily implicate the dormant Commerce Clause. Therefore, like *Camps Newfound/Owatonna* and *Fulton Corp.*, the conclusion that the law in *Chapman* implicated the dormant Commerce Clause is inapplicable to the present case.

In the absence of facial or express discrimination, an undue burden on interstate commerce must be shown.[4] *See Tracy*, 519 U.S. at 287, 117 S. Ct. at 818,

[4] The Supreme Court in *Dept. of Revenue v. Davis*, 553 U.S. 328, 128 S. Ct. 1801, 170 L. Ed. 2d 685 (2008), articulated the standard for when a nondiscriminatory law can violate the dormant Commerce Clause. It stated that "[a]bsent discrimination for the forbidden purpose [of economic protectionism], however, the law 'will be upheld unless the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local

136 L. Ed. 2d at 773 (internal quotation and citations omitted) ("The negative or dormant implication of the Commerce Clause prohibits state taxation . . . or regulation . . . that discriminates against or unduly burdens interstate commerce and thereby impedes free private trade in the national marketplace[.]"). In *Amerada Hess Corp. v. Dir., Div. of Taxation, New Jersey*, 490 U.S. 66, 78-79 n. 10, 109 S.Ct. 1617, 1624-25 n.10, 104 L.E.2d 58, 70 n.10 (1989), the Supreme Court, in considering New Jersey's denial of a state tax deduction for federal windfall profit tax payments, observed that "in the absence of discriminatory intent or a statute directed specifically at economic activity that occurs only in a particular location . . . a deduction denial does not unduly burden interstate commerce just because the deduction denied relates to an

---

benefits.'" 553 U.S. at 338-339, 128 S. Ct. at 1808, 170 L. Ed. 2d at 695 (quoting *Pike v. Bruce Church*, 397 U.S. 137, 142, 90 S. Ct. 844, 847, 25 L. Ed. 2d 174, 178 (1970)); *see also Oregon Waste Sys., Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 99, 114 S. Ct. 1345, 1350, 128 L. Ed. 2d 13, 21 (1994) (quotations omitted) ("If a restriction on commerce is discriminatory, it is virtually *per se* invalid. . . . By contrast, nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."); *Bd. of Trustees v. Mayor and City Council of Baltimore City*, 317 Md. 72, 134-35, 562 A.2d 720, 750 (1989) (citations omitted) ("With regard to state regulatory legislation, the Supreme Court has long recognized that, while discrimination in favor of local economic interests is usually invalid under the Commerce Clause, nondiscriminatory legislation will be upheld unless the burden on interstate commerce outweighs the local interests effectuated by the legislation."). In the present case, the Wynnes have failed to prove that any alleged burden upon interstate commerce is "clearly excessive" in relation to the local services paid for by the Howard County tax.

economic activity performed outside the taxing State." The Wynnes, in failing to prove discriminatory intent or unacceptable statutory geographical specificity, have demonstrated neither an undue burden on interstate commerce nor an implication of the dormant Commerce Clause.[5]

---

[5] In another section of their brief to this Court, the Wynnes argue that the dormant Commerce Clause requires taxes to be apportioned, which can be read as an assertion that an un-apportioned tax might implicate and violate the dormant Commerce Clause. Some un-apportioned taxes could have a significant effect on interstate commerce such that they "unduly" burden interstate commerce, thereby implicating and violating the dormant Commerce Clause. *Amerada Hess*, 490 U.S. at 75, 109 S. Ct. at 1623, 104 L. Ed. 2d at 68. The dormant Commerce Clause, however, does not protect against taxes and laws that have only an incidental effect on interstate commerce. *Fulton Corp.*, 516 U.S. at 331, 116 S. Ct. at 854, 133 L. Ed. 2d at 805. TG § 10-703 provides a credit for state taxes, significantly diminishing any effect Maryland income taxes have on interstate commerce. As noted above there is a strong presumption that an act of the Maryland General Assembly is constitutional. Additionally, the Supreme Court has concluded that "[t]he dormant Commerce Clause protects markets and participants in markets, not taxpayers as such." *Tracy*, 519 U.S. at 300, 117 S. Ct. at 825, 136 L. Ed. 2d at 781. The Wynnes have not provided evidence that any markets or market participants, as opposed to taxpayers, have been disadvantaged by some taxpayers being required to pay slightly more in taxes. Additionally, there is no evidence that, as the Majority fears, interstate commerce will be harmed because taxpayers will have a "disincentive . . . to conduct income-generating activities in other states with income taxes." *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 14). In fact, as the Majority notes, Maryland residents have paid a county tax without a credit pursuant to TG § 10-703 since the tax code was amended in 1975. *Wynne*, __ Md. at __, __ A.3d at __ (Maj. Slip Op. at 5-6). There has been no evidence presented to this Court that Maryland

The *Blanton* decision conclusively established that Maryland law applies TG § 10-703' s tax credit only to state taxes, not county taxes. 390 Md. at 543, 890 A.2d at 288. The Wynnes asked this Court to conclude that settled Maryland law is unconstitutional under the dormant Commerce Clause. The presumption has always been that Maryland law is constitutional, and the Wynnes, as challengers of the Maryland tax law, have failed to overcome that presumption by proving that Maryland's tax scheme expressly discriminates against or unduly burdens interstate commerce such that the dormant Commerce Clause is implicated. The Wynnes may believe that it is bad policy to require them to pay the Howard County tax without a tax credit; however, they have failed to prove that it is in violation of the dormant Commerce Clause. Accordingly, I respectfully dissent.

Judge Battaglia joins in the views expressed herein.

---

companies or taxpayers have been deterred from engaging in interstate commerce over nearly four decades since 1975. In fact, at issue in the present case is the income generated by the Maxim Corporation, a company founded in 1988, from business in 39 other states where the income was taxed. Thus, even if we were to accept the argument that the federal Constitution requires the apportionment of taxes as a contention by the Wynnes that the dormant Commerce Clause is implemented, the Wynnes have failed to prove this.

APPENDIX B

IN THE COURT OF APPEALS OF MARYLAND

No. 107

September Term, 2011

[Filed May 17, 2013]

MARYLAND STATE COMPTROLLER OF THE TREASURY	)
	)
v.	)
	)
BRIAN WYNNE, ET UX.	)

Bell, C.J.
Harrell
Battaglia
Greene
Adkins
Barbera
McDonald,

JJ.

Opinion on Motion for Reconsideration by McDonald, J.

The Comptroller has filed a Motion for Reconsideration and, Alternatively, a Motion for Stay of Enforcement of the Judgment. The Wynnes opposed that motion. The parties filed memoranda of law and other materials in support of their respective positions.

It appears appropriate to clarify two points raised in the papers submitted by the parties:

(1) The Comptroller raised the question of whether he could deny application of a credit to the Wynnes for income taxes paid by an S corporation, such as Maxim, in another state that does not accord pass-through treatment to S corporation income, but rather taxes the income of such a corporation in the same way that it taxes the income of a C corporation. The parties did not brief, and we did not consider, the ways in which other states may treat S corporation income other than as pass-through personal income of the corporation's shareholders. Our opinion does not foreclose different treatment in Maryland of income taxes paid in other states that are not based on pass-through personal income.

(2) A state may avoid discrimination against interstate commerce by providing a tax credit, or some other method of apportionment, to avoid discriminating against interstate commerce in violation of the dormant Commerce Clause. The Comptroller interprets a footnote in our earlier opinion to hold that a state must provide a tax credit. Slip Op. at pp. 28-29 n.26. While the footnote might have been worded more elegantly, it referred primarily to the method used by the Legislature in the Maryland income tax; we did not

mean to preclude other methods that might be utilized in other contexts.

The Motion for Reconsideration is DENIED; however, we shall STAY the effective date of the mandate pending the disposition of a timely petition for certiorari filed by the Comptroller with the United States Supreme Court.

APPENDIX C

IN THE CIRCUIT COURT
FOR HOWARD COUNTY

CASE #: 13-C-10-80987

MARYLAND TAX COURT

Appeal #: 08-IN-00-0791

[Filed June 29, 2011]

BRIAN WYNNE, *et al.*)
)
Petitioners)
)
FOR JUDICIAL REVIEW OF A)
DECISION OF THE)
MARYLAND TAX COURT)
)
And)
)
MARYLAND STATE COMPTROLLER)
OF THE TREASURY)
)
Respondents)
)

MEMORANDUM

This is an appeal from the December 29, 2009 Order of the Maryland Tax Court (J. Silberg), affirming the determination of the Comptroller of Maryland that disallowed credit for out-of-state income taxes paid against the "county" portion of State income taxes due to Maryland pursuant to Md. Code Ann., Tax - General Art., § 10-101 *et seq.*, particularly § TG § 10-703(a).

In this case, this Court must determine whether Maryland's current tax credit procedure under the applicable sections of that Tax Article, when income taxes paid to other states on income earned by Maryland residents are not permitted to be offset by the "county portion of the State income tax," runs afoul of constitutional protections of the Commerce Clause of the U.S. Constitution.

This Court holds that, since the present Maryland's income tax scheme does not permit a constitutional allowable credit for that "county portion" against such income earned and taxed out-of-state, Maryland substantially burdens its residents conducting business in interstate commerce, as compared to those conducting purely intrastate commerce. In finding this statutory scheme unconstitutional pursuant to the Commerce Clause of the U.S. Constitution, this Court reverses the findings of the Maryland Tax Court and remands this case for findings consistent with the following interpretation of the law.

I. PROCEDURAL BACKGROUND

Brian and Karen Wynne ("the Wynnes") contested the determination of their 2006 Maryland income tax liability by filing a complaint with the Maryland Comptroller of the Treasury (the "Comptroller"). A hearing officer from the Comptroller's Office determined that the tax credit permitted for out-of-state taxes paid only applied to the portion owing to "state income taxes" under TG § 10-102, and not to any portion of "county income taxes" under TG § 10-103. The Wynnes appealed to the Maryland Tax Court with the parties going forward on an Agreed Statement of Facts and Stipulation of Exhibits # 14 in Transcript of Record from Maryland Tax Court (Tr.) and Amended Agreed Statement of Facts and Stipulation of Exhibits (Tr # 15). The evidence stipulated to by the parties is summarized at pp. 3-5 of Comptroller's Pre-Trial Memorandum of Law (Tr # 15). After considering oral argument on June 18, 2009 and Memoranda, that administrative body affirmed the Comptroller's determination at a Continued Hearing before it on December 10, 2009. This appeal comes before this Court on judicial review of the Tax Court's decision, as permitted under Tax - General, § 13-532, Md. Code Ann. and Maryland Rule 7-207.

II. FACTUAL BACKGROUND

The Wynnes, longtime Maryland residents, are married with five children. Brian Wynne is one of seven owners of Maxim Healthcare Services, Inc. ("Maxim"), company founded in Howard County in 1988 and since having grown into a nationwide healthcare services provider.

The Wynnes posit that Maxim is an S or "tax pass through" corporation for purposes of both Maryland and federal tax laws. In 2006, the Wynnes earned $2,667,133 in taxable net income; much of it from their 2.4% ownership interest in Maxim. Without tax credits, the Maryland tax on that income would have amounted to $207,984. However, the Wynnes, due to the multi-state nature of Maxim, already paid $84,550 in taxes on some of that income to 39 other states. In some states, a S-corporation, such as Maxim can pay taxes on its shareholders' behalf by deducting those payments from the shareholders' distributions by filing a "composite return", while in other states the corporation pay taxes on its own behalf, and those tax payments become liabilities of the corporation by filing a "corporate return". The Wynnes paid the taxes they owed to other states through a combination of composite and corporate returns. The distinction was relevant to the statutory issues raised before the Maryland Tax Court but not those now on review before this Court. The basis of that out-of-state liability was income generated within the border of those other states. Due to the fact that Maxim is an S-corporation, the Wynnes, as owners, were liable for their share of Maxim's tax liability to other states directly. The Comptroller denied the Wynnes' claim for a credit in the full amount of $84,550 (state taxes paid to other states for income generated within their borders).

Relying on TG § 10-703(a), Md. Code, the Comptroller allowed taxes paid to other states to offset only those taxes owed to Maryland representing "state income tax," and not "county income tax." The Tax Court, in affirming the determination of the Comptroller, found no constitutional basis to overturn

that determination and affirmed, based on prior Maryland judicial and administrative agency interpretations of this statute, stating in its ruling set out in the transcript of the December 10, 2009 Continued Hearing (Tr #22, 6, lines 11 - 20) as to the constitutionality of TG § 10-703's credit procedure with a short reference to the Court of Appeals' decisions in "a number of different cases" including "*Blanton* ... for credits for taxes paid to North Carolina." Referring to *Comptroller v. Blanton* 390 Md. 528, 890 A.2d at 279 (2006) it finally concluded by stating:

> Mr. Blanton wanted to get credit towards both the state tax and the county tax and they said 'it doesn't work.' You don't get the credit, and it's not unconstitutional to do this.

On appeal this Court judicially reviews that decision, promulgated by written order on December 29, 2009, focusing on the issues of constitutional law raised.

III. STANDARD OF REVIEW

Counsel for the Plaintiffs in opening argument before this Court on July 7, 2010 indicated that the issue to be resolved herein involves a very narrow question of constitutional law; thus, this Court should review the case, *de novo*, without deference to what the Tax Court did below. *Frey v. Comptroller*, 184 Md.App. 315, 330 (2009). As Rochvarg, *Maryland Administrative Law*, Md. 2nd Ed., §§ 4.59, 181, points out in the quotation below that term "*de novo*", is somewhat of a misnomer, "... since the Court does not rely on previously created record or a previous decision,

when it hears a case "*de novo*". Further, he states there:

> A "*de novo*" hearing involves testimony of witnesses, introduction of documents and other evidence, opening and closing arguments, and a decision based on the record created at that *de novo* hearing. The phrase "*de novo* review" is an oxymoron because if the hearing is "*de novo,*" there is nothing reviewed; the prior proceeding is a nullity. The only instance in Maryland where there is a *de novo* hearing, following an administrative hearing is in a workers' compensation case. In fact, in Maryland, it appears that *de novo* review would be unconstitutional for agencies other than the Workers' Compensation Commission. State Gov't. §10-2 - 201 with §10-222, entitled Judicial Review.

Rochvarg, *supra*, further indicates at §4-35, 161, Review of Legal Issues that,

> Agency decisions also can be challenged as contrary to law. These legal challenges come in different packages. . . . .First, the agency decision can be challenged as unconstitutional.

At § 4.36, 161, Challenges to the Constitutionality of the Agency Decision, that author further notes:

> If the agency decision violates the Maryland Constitution or those portions of the United States Constitution that apply to the states, the agency decision must be invalidated. Even if there is substantial evidence in the record that supports each factual finding upon which the agency decision is based, if the decision is unconstitutional, it cannot stand.

See *Md. Aggregates Ass'n v. Maryland,* 337 Md. 658, 655 A.2d 886, *cert. denied sub nom. Genstar Stone Prod.* Co. *v. Maryland*, 514 U.S. 1111 (1995).

As noted by the Court of Appeals of Maryland in *Public Safety v. Demby*, 390 Md. 580, 614, 890 A.2d 310 (2006), a case denying prison inmates confinement credits under certain circumstances, confirmed the following standard for circuit courts reviewing administrative agency decisions:

> In our review of the decision of an administrative agency, we consider the agency's decision pursuant to the "same statutory standards as would the circuit court, and we do not employ those standards to reevaluate the decision of the circuit or intermediate appellate court." *Charles County Dep't of Soc. Servs. v. Vann,* 382 Md. 285, 294, 855 1.2d 313, 318 (2004). Our role is limited to ascertaining whether there exists substantial evidence in the record as a whole that supports the findings and

> conclusions of the agency; we must also determine "if the administrative decision is premised upon an erroneous conclusion of law." *United Parcel Serv., Inc. v. People's Counsel for Baltimore County*, 336 MD. 569, 577, 650 A.2d 226, 230 (1994).

As to the instant case, it is noted that the Maryland Tax Court is an "independent administrative unit of the State government." Md. Code. Ann., Tax - General, § 3-102. *See also Abington Ctr. Assoc. Ltd. Partnership v. Baltimore County*, 115 Md. App. 580, 694 A.2d 165 (1997) (stating that, notwithstanding its name, the court is an administrative agency of the State government but functions in many respects as a court); *Frey v. Comptroller*, 184 Md.App. 315, 330 (2009). The Maryland Court of Appeals has examined, in detail, a court's role in reviewing an administrative agency's adjudicatory decision, and held that a court's task on review is *not* to "substitute its judgment for the expertise of those persons who constitute the administrative agency," *United Parcel v. People's Counsel,* 336 Md. 569, 576-577, 650 A.2d 226, 230 (1990), quoting *Bulluck v. Pelham Wood Apts*., 283 Md. 505, 513, 390 A.2d 1119, 1124 (1978).

Even with regard to some legal issues, a degree of deference should often be accorded the position of the administrative agency below. Thus, an administrative agency's interpretation and application of the statute which the agency administers should ordinarily be given considerable weight by reviewing courts. *Lussier v. Md. Racing Commission*, 343 Md. 681, 696-697, 684 A.2d 804, 811-812 (1996), and cases there cited;

McCullough v. Wittner, 314 Md. 602, 612, 552 A.2d 881, 886 (1989) ("The interpretation of a statute by those officials charged with administering the statute is . . . entitled to weight."). Furthermore, the expertise of the agency in its own field should be respected. *Bd. of Ed. for Dorchester* Co. *v. Hubbard*, 305 Md. 774, 792, 506 A.2d 625, 634 (1986) ("application of the State Board of Education's expertise would clearly be desirable before a court attempts to resolve the" legal issues); *Maryland Aviation Administration v. Noland*, 386 Md. 556, 571-72, 873 A.2d 1145, 1154-55 (2005), quoting *Board of Physician Quality Assurance v. Banks*, 354 Md. 59, 68-69, 729 A.2d 376, 381 (1999) (alternation in original) (alterations added) (footnote omitted).

It has been held that recognizing the agency's decision is "prima facie correct and presumed valid," "we must review the agency's decision in the light most favorable to it." *Comptroller of the Treasury v. Citicorp Int'l. Commc'ns*, 389 Md. 156, 163, 884 A.2d 112, 116 (2005) (quoting *Ramsay, Scarlett & Co. v. Comptroller*, 302 Md. 825, 834-35, 490 A.2d 1296, 1301 (1985)); Md. Code § 13-411 of the Tax-General Article ("[a]n assessment of tax . . . is prima facie correct").

As noted by Rochvarg above, a *de novo"* review of matters of law in an administrative judicial review, as the instant case raising mainly legal issues of constitutionality still involves an examination of the record created below of testimony of witnesses, of documents and other evidence, opening and closing arguments, and with appropriate deference being giving to the decision of the agency but also the weighing, *de novo*, of the arguments in the memoranda filed and orally at the judicial review hearing. Unless

the Tax Court's decision herein was erroneous as a matter of law, or its conclusion was not supported by substantial evidence, this Court must affirm that decision. *See Citicorp*, 389 Md. at 164, 884 A.2d at 117; *CBS v. Comptroller*, 319 Md. 687, 697-98, 575 A.2d 324, 329 (1990) (internal quotations and citations omitted).

This Court is well aware of the following standards to be applied when it judicially reviews a statute or statutory scheme for constitutionality:

> In deciding the constitutionality of a statute, we begin with the presumption that the statute is valid. *Galloway v. State*, 365 Md. 599, 610, 781 A.2d 851 (2001), *cert. denied*, 535 U.S. 990, 122 S.Ct. 1547, 152 L.Ed.2d 472 (2002). We will not find a statute unconstitutional if, " 'by any construction, it can be sustained.' " Id. At 611, 781 A.2d 851 (quoting *Beauchamp v. Somerset county* 256 Md. 541, 547, 261 A.2d 461 (1970). When the challenge to a statute is based on vagueness, the burden of establishing unconstitutionality is on the party attacking the statute.
>
> *Livingston v. Maryland*, 192 Md. App. 553, 568 (2010).

See also *Fell v. Maryland*, 42 Md. 71, 77 (1875) which held:

> Courts will not pronounce a statute unconstitutional, unless it is plainly and undoubtedly a violation of the Constitution. All presumptions are in favor of the law, and to

doubt at all, is to resolve the case in favor of the statute.

Thus, applying those legal standards, this Court will focus on reviewing the legal underpinning and conclusions of the Tax Court's ruling.

IV. ANALYSIS

The specific issue in this case is whether the Tax Court's interpretation of § 10-703(a) of the Tax-General Article, Md. Code, allowing for a credit solely against the "state" portion but not the "county" portion tax of the Maryland State income tax, is constitutionally proper under the Commerce Clause of the U.S. Constitution, Article 1, Section 8, Clause 3, (U.S.C.A., §8, cl.3) known as "the dormant commerce clause". For the following reasons, this Court finds it is violative of that clause and is, thus, unconstitutional.

A. Overview of Maryland's Tax Credit Procedure

1. FULFILLMENT OF CONSTITUTIONAL REQUIREMENTS

Maryland, like most other states, taxes income earned by its residents. *See generally* Md. Code Ann., Tax-General Art., § 10-101 *et seq*. (setting forth mechanism for assessing and collecting taxes income tax from individuals and other entities). The General Assembly has promulgated a system under the Tax-General Article, whereby state income tax consisting of two different components is imposed on all Maryland residents and out-of-state individuals conducting

business in Maryland: (1) a "State income tax" and (2) a "county income tax or local income tax."[1] TG §§ 10-105 & 10-106. Depending on the county of residence of the taxpayer, the rate of local income tax paid by the individual will vary. *See* § TG 10-106 (explaining that each Maryland county, subject to State law promulgating certain minimum and maximum rates, sets out its applicable county income tax rate).

It is clear that sovereign jurisdictions such as Maryland have the authority to levy taxes on residents and any other individuals conducting activity within their borders, whether they are intended to generate revenue for the state or for their constituent localities. Such taxes are necessary to provide for the common welfare of a state's residents. Furthermore, constitutional jurisprudence affirms the states' rights to tax their residents on all income earned from whatever source, at least subject to the limitations imposed under the Due Process Clause of the Constitution. *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937). However, the state taxation at issue implicates another constitutional limitation on it separate from the Due Process Clause: namely, the Commerce Clause.

---

[1] Out-of-state individuals conducting business in Maryland, who are not subject to a "local income tax" because they are not domiciled in the state, are subject to a special non-resident tax imposed on income earned in Maryland. TG § 10-106.1. The rate of tax mirrors the lowest prevailing county tax rate for the year and is collected and applied towards the Maryland General Fund. *See Frey v. Comptroller*, 184 Md.App. 315, 965 A.2d 923, (2009) *cert. granted*, Md. , 972 A2.d 861 (2009). Currently, this rate is 1.25% (reflecting the county tax rate of Worcester County).

While the Due Process Clause of the Constitution permits states to tax their residents on all income earned regardless of the source, i.e., they can levy taxes on all of their residents' out-of-state earnings, the Commerce Clause provides a second, much more stringent restriction on the states' ability to tax. *See Quill Corp v. North Dakota*, 504 U.S. 298 (1992) (explaining that, while there is some overlap in these constitutional requirements, they are "analytically distinct"). The Due Process Clause is primarily concerned with the ability to tax based on sufficient nexus; in the case of state residents, there is such nexus establishing the ability to tax because the inhabitants of a state by virtue of their residency have subjected themselves to the rights and privileges of the state, such as access to public services and the protection of state law. The Commerce Clause is not concerned with the ability of a state to tax its residents purely based upon that nexus; instead, it was promulgated to ensure that a state is not using taxation in such a way as to impermissibly enter into the federal realm by negatively affecting interstate commerce to a significant degree. If a state's taxing procedures, as a whole or in part, significantly burden interstate commerce, that activity is analytical dissected as such and then labeled as violating the "dormant Commerce Clause".

Although discussed more fully *infra,* such violation of the dormant Commerce Clause will necessitate striking down a state statute or taxation scheme if found to effectively result in double or multiple taxation. *See Hellerstein*, State Taxation: 3rd Edition, ¶ 20.10[2][b], an authoritative text referenced for decades by the U.S. Supreme Court, in taxation cases

(explaining that multiple taxation is an unconstitutional risk and, explaining how the taxing by states based purely on residency, needs to provide credit mechanisms to prevent multiple taxation). That is, if a statute either expressly or effectively imposes any tax on a taxable event or other basis when a tax(s) has already been imposed by another jurisdiction having primary authority to tax (*i.e.*, where the income being taxed is "sourced", explained *infra*), the statute will likely be unconstitutional. In income taxes matters, to not run afoul of the dormant Commerce Clause, a state must either confine its taxation to those events occurring within its borders or, alternatively, must provide remedial or balancing measures, i.e., appropriate and reasonably proportionate tax credits for taxes paid to another state for income sourced there, when exercising its jurisdiction to tax on all income of its residents, wherever earned.

2. HISTORY OF MARYLAND OUT-OF-STATE INCOME TAX CREDITS

Maryland, like many other states, has attempted to meet its constitutional burdens under the Commerce Clause by instituting a comprehensive income tax credit scheme under TG § 10-701 *et seq.* See also *Hellerstein* at 20.10[2][b] (stating that "At a minimum, we believe that the Commerce Clause would bar a state's absolute denial of a credit to residents who engage in commercial activity across state lines regardless of the source of their income."). This remedial or balancing measure provides generally that, when a Maryland resident has been taxed on income earned in another state, Maryland will offer a credit corresponding to the amount of tax liability in order to

negate any double taxation.[2] The first iteration of this mechanism was put in place in 1939 and remained constant until *Stern v. Comptroller,* 271 Md. 310, 316 A.2d 240 (1974). When that latter case came before the Court of Appeals in 1974, the tax credit for out-of-state taxes paid was determined at *Stern*, 271 Md. at 311 as follows:

> The relevant statutory material is found in Maryland Code (1957, 1969 Repl. Vol.) Art. 81. The credit allowed Maryland residents for income taxes paid another state was provided by Chapter 277, § 12 of the Laws of 1939, which became section 224 of Article 81, and survives unchanged as section 290" ":
>
> > "Whenever a resident individual of this State has become liable for income tax to another state upon such part of his net income for the taxable year as is properly subject to taxation in such state, *the amount of income tax payable by him under this subtitle* shall be reduced by the amount of the income tax so paid by him

[2] For example, if Taxpayer, a State X resident earned $100,000 in State X (tax rate of 10%) he would have a tax liability of $10,000 (owed to State X). If, however, Taxpayer earned the $100,000 in State Y (tax rate of 10%) and State X taxed its residents on all income wherever earned but incorporated tax credits to avoid double taxation, taxpayer would still have a $10,000 tax liability. Taxpayer would owe $10,000 to State Y (where income generated), and the State X pre-credit tax liability would be $10,000; however, the credit of $10,000 in State Y would exactly offset this and result in no tax liability.

> to such other state upon his producing to the Comptroller satisfactory evidence of the fact of such payment; but application of such credit shall not operate to reduce the tax payable under this subtitle to an amount less than would have been payable if the income subjected to tax in such other state were ignored. . . ."

Furthermore, in *Stern*, 271 Md. at 311 relying on the plain reading of this statute and not constitutional analysis, the Court of Appeals determined that the Sterns could credit out-of-state income taxes paid against the state tax liability and "that portion of their Maryland income tax which would be collected by the Comptroller and paid to the county where the Sterns reside."[3] **Significantly the appellate court in *Stern* held the county or local income portion of the tax to be a tax imposed by the State of Maryland.** Apparently in response to that court's decision, the General Assembly enacted emergency legislation in an attempt to reduce revenue lost (from local or county income taxes) by the interpretation of the statute in *Stern*.

Later in 2006 the Court of Appeals, in *Comptroller v. Blanton,* 390 Md. 528, 541, 890 A.2d at 287 gave a

---

[3] It should be noted that *Stern* was decided by the Court of Appeals in 1974 while *Coerper v. Comptroller,* 265 *Md. 3. 288 A.2d 187* was decided by the Court of Appeals in 1972. Under the same logic as applied by that court (in *Stern*), which did not change even in light of the statutory amendment, *Coerper* is neither authoritative nor binding or even guiding on the principles of local income tax credits in this scenario as well.

synopsis of the legislative and case law history including the *Stern* decision and the Maryland General Assembly's reaction to the appellate court in *Stern*:

> In February 1975, the Legislature enacted emergency legislation, amended § 290 by adding § 290(b), which provided that only the income tax portion of the State tax could be reduced and no reduction from the local tax portion would be permitted. *See* Ch. 3 of the Acts of 1974 (stating that the § 290(b) was amended as an emergency repeal and re-enactment for the "immediate preservation of the public health and safety . . ."). Section 290(b) provided, in relevant part:
>
> § 290. Credit allowed residents.
>
> (b) . . . [W]ith respect to the taxable year 1974 and each taxable year thereafter, the credit provided for by this section operates to reduce **only** the State income tax payable under this subtitle and does not operate to reduce any local income tax imposed. . . .

Md. Code (1957, 1975 Repl Vol., 1976 Cum. Supp.), Article 81 § 290(b)."

That version of the Code was replaced in 1988, when the Legislature passed Senate Bill 1. In doing so, previous Sections 290(a) and (b) became Maryland Code (1988), § 10-703(a) of the Tax-General Article. While the new statute had minor modifications in its wording, the effect remained the same. In *Blanton*, the Court of Appeals stated that, although no legislative history was submitted with the revisions and the new statute omitted "only" in referring to "State income

taxes," the substance remained the same. *Comptroller v. Blanton* 390 Md. 528, 543, 890 A.2d at 288. Therefore, in that limited context the plain construction of the statute precluded crediting against any local or county income tax. *Id.* However, it is extremely significant that neither the *Stern* nor *Blanton* courts ever relied upon constitutional bases for deciding this issue; in each, it was always purely a matter of statutory construction.

3. EXPLANATION OF *BLANTON*, *COERPER*, *HICKEY* AND *FREY* CASES

While no Maryland case has ever explicitly dealt with the constitutionality of the current procedures for out-of-state income tax credits, whether it be under the Due Process Clause or Commerce Clause, this Court, nevertheless, finds the Tax Court was mistaken in its decision in that regard. The Tax Court Judge opined in his ruling set out in the transcript of December 10, 2009 Continued Hearing (Tr #22) on the constitutionality of TG § 10-703's credit procedure:

> ...it's been heard before, and the Court of Appeals has affirmed this section in a number of different cases...The same statute came up in *Blanton* for credits for taxes paid to North Carolina. Mr. Blanton wanted to get credit towards both the state tax and the county tax and they said 'it doesn't work.' You don't get the credit, and it's not unconstitutional to do this.

Although *Blanton*, *Coerper*, *Frey* and *Comptroller v. Hickey*, citing at 114 Md.App. 388 (1997) all deal with the application of the taxes or tax credits for non-state

level income taxes (i.e. "local tax or county income tax or county portion of the state income tax"), only *Blanton* dealt specifically with TG § 10-703(a); but even that case did not focus on nor was it decided on constitutional grounds.

While *Blanton*, 390 Md. 528, did refer to TG § 10-703(a) and the credit procedure, and the appellate court found that taxes paid to other states were not creditable against "local taxes," it did so on the basis of statutory interpretation and not on constitutionality. Therefore, *Blanton* provides really no or very little guidance on the constitutionality of this section. Furthermore, as explained *infra*, while the two Maryland appellate court have each ruled on TG § 10-703 on two separate occasions, only *Blanton* has specifically dealt with TG § 10-703(a) regarding the credit procedure.

The other cases dealing with or related to TG § 10-703 were as follows and specifically involved the statutes so indicated: in *Hickey*, TG § 10-703(c)(1) (on maximum allowable credit against state tax liability); in *Coerper*, as to the predecessor to TG § 10-201 (on the proper taxable base for determining local income taxes due), and in *Frey,* TG § 10-106.1 (on the constitutionality of the special non-resident tax "SNRT"). While the Comptroller argues that the issues raised by the Wynnes are foreclosed by precedent set in *Comptroller of the Treasury v. Blanton*, 390 Md. 528, 890 A.2d 279 (2006), this Court finds, as discussed below in detail, the issues of constitutionality raised herein, being ones of first impression, are not foreclosed by any previous ruling of either the Maryland Courts of Appeals or Special Appeals.

As noted the *Blanton* court dealt with the application of the tax credit procedures in TG § 10-703 but focused on the statutory interpretation of this statute and not the constitutional limitations on Maryland's ability to tax its residents.

In *Blanton*, Maryland residents challenged the Comptroller's determination of their state tax liability. Specifically, the taxpayers in that case attempted to have taxes paid to other states credited against their Maryland tax liability: both the "state" and "local" portions. While the factual situation was analogous to that in the present case, the *Blanton* petitioners argued, and the court ruled, only on the ability of the taxpayers to credit these out-of-state taxes against "local" taxes under the statute as it was and is presently written. The appellate court, in reversing the reviewing circuit court held, purely as a matter of statutory interpretation of legislative intent, that under TG § 10-703, the taxpayers were only allowed to apply credit against "the State income tax." Since the statute provided for two levels of tax, "State" and "local," a plain reading of the statute brought about the conclusion that credits were inapplicable to the "local" portion. The *Blanton* opinion never specifically addressed the issue of constitutionality.

The Comptroller urges in the instant case, however, that *dicta* found in a footnote in *Blanton,* leads to a sufficient conclusion that Maryland has previously addressed any "double taxation" issue and that the Court of Appeals has found no impermissible taxation under the Commerce Clause. Footnote 9 at 390 Md. 536-537 reads as follows:

The Blantons argue that a violation of this State's policy against double taxation occurred when the Blantons were not allowed a credit for the full amount they paid toward North Carolina income taxes.

We find that the Blantons' double taxation argument is unpersuasive. The Legislature resolved the double taxation issue by providing a credit toward State income tax under § 10-703 of the Tax-General Article. Although § 10-703 was enacted to allow taxpayers to avoid double taxation to some extent, it also required that Maryland receive, at the least, the income tax on the income attributable to Maryland, regardless of the amount paid to another state. *See Comptroller v. Hickey*, 114 Md.App. 388, 401, 689 A.2d 1316, 1322 (1997); § 10-703 (c) (1) (i) and (ii) of the Tax-General Article.

Further, the Blantons argue that they should pay local tax on the amount earned in Maryland and not on the adjusted gross income for federal income tax purposes, which included income from both states. In response to the Blantons' contention, we turn to *Coerper v. Comptroller*, 265 Md. 3, 6, 288 A.2d 187, 188 (1972), where the taxpayer maintained that the amount paid to New York in income tax should be deducted from his state and county income taxes. The Court held that if the taxpayers were allowed to pay a lesser amount of county income tax, it "would have the possible absurd result of the Coerpers paying little or no local tax for the services provided by the county while a neighbor

> with similar income, exemptions, and deductions might be paying a substantial local tax to support those services." *Id.* at 8, 288 A.2d at 189.
>
> The court continued, writing that [t]he key word here is "credit." The General Assembly granted a credit against the tax liability of a taxpayer. When it referred to state income tax liability it meant the amount of tax computed as due from a taxpayer on his income after allowance of the usual deductions and exemptions. The fact that there might be credited against that tax liability losses arising from . . . sums paid other states for income taxes was not intended to reduce one whit the liability of the taxpayer or the sum payable by the taxpayer to the local subdivision. *Id.* In light of our holding in *Coerper*, we reject the Blantons' contention.

A full reading of this footnote, which again is *dicta* and not binding, shows that the holding of the Court of Appeals is neither on point with the issue raised in the instant case nor respectfully is it technically totally accurate. First, it is necessarily true that legislation in this state must comply with the federal Constitution and that, in order to do so, Maryland must endeavor to have a tax structure which fully, or at least significantly, avoids double taxation, and not just "to some extent." This principle will be discussed more fully *infra.* Second, while the Comptroller points out that Maryland is to receive "at the least, the income tax on the income attributable to Maryland, regardless of the amount paid to another state," this point does not directly relate to the issue here (whether tax credits may be taken against the "local tax" liability), but it

instead stands for the proposition that credits related to income earned in other states cannot reduce the tax liability owed to Maryland for income earned by the Maryland resident in Maryland. A quick example illustrates the limiting effect of TG § 10-703(c)(1), as explained in *Hickey*, 114 Md.App. 388, 395, 689 A.2d 1319:

> *Example 3*-TP earned $100,000; of this, $60,000 was earned in Maryland, and $40,000 was earned in State X. State X taxes income earned in that state at 15%. Maryland taxes income at 10%. Under section 10-703(c) (1) (i), TP would pay $6,000 ($40, 000 * .15) in taxes to State X. Under section 10-703(c) (1) (ii), TP's credit would be equal to $4,000 (($100,000 * .10) – (($100,000–$40,000) .10)). Therefore, TP's credit would be limited to $4,000. TP would have to pay $6,000 (($100,000 *.10) – $4,000) in taxes to Maryland.

Basically, this part of the statute, TG § 10-703(c) (1), is aimed at preventing Maryland's relinquishment of tax revenue via another state's imposition of tax at a higher rate. It should be noted, however, that this statute is aimed at retaining tax revenue sourced to Maryland, *i.e.*, getting all taxes otherwise due by Maryland residents for income generated in Maryland. In the sense that *Hickey* uses the phrase "income attributable to Maryland" (to which tax liability may not be reduced), this Court finds the statute means income earned within the state of Maryland and not income taxed based purely on Maryland residency.

Furthermore, although the opinion in *Coerper v. Comptroller*, 265 Md. 3 288 A.2d 187, (1972) (addressed in the footnote) is not dispositive as it addressed the predecessor statute to TG § 10-703, the holding of that case does not bear on our current analysis. In that case, the Court of Appeals determined whether the local income tax authorized by former Art. 81, § 283(a) of the Code is to be "a percentage of the liability of such resident for State income tax" *before* or *after* application of the credit provided in § 290 of Art. 81. The Court held that the local tax is a percentage of the liability before application of the credit and provided the following example, illustrative of its holding:

> An example of a practical application of the *Coerper* argument can be seen in this hypothetical situation. If a taxpayer's income tax liability to the State of Maryland for 1968 were $1,185.89, but he received a credit for taxes paid to another state in the amount of $1,158.74, the balance then remaining due the State of Maryland would be $27.15. If that taxpayer resided in a county imposing a local tax of 35% of the state income tax liability, as some counties did, the amount of local tax due the county would be $9.50. A next door neighbor with similar income, exemptions, and deductions, but with no credit for income tax paid to another state, would pay his county $415.06 income tax. Under the *Coerper* argument the language of § 292, § 288 (g), and Art. 23, § 427, to which we have alluded, would also call for the deduction of those items in the computation of "state income tax liability" and

> place the "piggy back" tax on the remaining result. 265 Md. at 8

Thus, the holding in *Coerper* is limited to the determination that the base for Maryland local income taxes is made prior to any offset for a credit based on taxes paid to another state. Again, *Coerper* deals with identification of the tax base, i.e. whether the taxable amount is pre- or post-credit, and not whether a tax credit may be taken against the county or local portion of the State income tax liability. Here, the issue is not the appropriate base for imposing the "local income tax," but instead is whether taxes paid to other jurisdictions must be credited against the amount owed to Maryland as "the local or county tax or the county portion of the state income tax" (on a pre-credit basis).

Lastly, in *Frey v. Comptroller*, 184 Md.App. 315 (2009), *cert. granted*, the Court of Special Appeals dealt with the constitutionality of the Special Non-Resident Tax ("SNRT") imposed under TG § 10-106.1. In holding that that latter tax did not violate the Equal Protection Clause, Commerce Clause, or Privileges and Immunities Clauses of the U.S. Constitution, the appellate court explained that *Blanton* did not determine whether the local tax imposed under TG § 10-106 was a state tax for constitutional purposes, but only that the local income tax did not fall within the meaning of "only against the State income tax" under TG § 10-703(a). Most significantly as relates to this Court's analysis and ruling herein, the appellate court went on to state, in likening "SNRT" to the "local income tax:"

> In appellants' case, the Circuit Court for Anne Arundel County correctly noted: "The Court of Appeals' observation in *Blanton* that the State tax and the local tax are two distinct taxes does not mean that they are imposed by different authorities." **The State and county taxes are different, but that does not mean that they are not both State taxes. They are imposed by the same authority. The local tax is not imposed by the county, it is imposed by the State. We thus conclude that the local income tax imposed under T. G. § 10-106 is a State tax. (Emphasis supplied.)**

Id. at 352.

Thus, while no court has determined whether forbidding a credit for "county income tax" for out-of-state taxes paid violates the Commerce Clause, at least the appellate court in *Frey* determined that "county income tax" is a state tax. This Court determines that that holding is clearly binding for purposes of its *de novo* constitutional analysis herein.

Since no prior case has dealt with the merits of whether TG § 10-703(a) passes constitutional muster, this Court now addresses the Petitioner's arguments as to why the application of this Md. Code section by the Tax Court violates the Commerce Clause of the U.S. Constitution.

B. "Interstate Commerce" Is Impermissibly Involved

In order for a statutory scheme to meet constitutional requirements under the Commerce Clause, a law must not discriminate or burden interstate commerce. That is, at a threshold level, a statute must at least implicate "interstate commerce" before a Commerce Clause analysis is merited. The Comptroller contends that TG § 10-703 does not succumb to a constitutional attack on the basis of the dormant Commerce Clause because nothing within the "local income tax" mechanism implicates "interstate commerce," at least as applied to the Wynnes and/or their income earned, as S-corporation shareholders, through Maxim. Specifically, the Comptroller urges that this is so because (1) the Wynnes' "passive investment" in a Maryland S-corporation cannot implicate interstate commerce, (2) no interstate economic activity or market is identified, (3) Maryland's local tax scheme effectuates a legitimate local interest and does not differentially burden in-state or out-of-state economic interests, and (4) that "local" income taxes and the corresponding credits do not affect interstate commerce.

It should be noted from the outset that in *Frey,* the Court of Special Appeals has previously held that the imposition of the Special Non-Resident Tax ("SNRT") under TG § 10-106.1 implicates the Commerce Clause. That court rather succinctly stated: "In the present case, since the law firm is doing business in Maryland and appellants, Pennsylvania residents, are partners in the law firm and thus earn income in Maryland, which is taxed under the SNRT, the Commerce Clause

applies." 184 Md. App. at 335, 965 A.2d at 935. While that case involved the imposition of tax on a partnership, not an S-corporation, it is notable that the appellate court held that a tax imposed by Maryland on out-of-state residents for business performed in Maryland was enough to implicate the Commerce Clause. Since the operation of the SNRT is applied similarly in effect to all non-resident owners in pass-through entities, *i.e.*, partnerships and S-corporations, the Commerce Clause is implicated by the mere operation of an income tax on in-state income against out-of-state residents. This logic requires that the exact opposite effect, *i.e.*, the assessment of income tax on out-of-state income against in-state residents, implicates the Commerce Clause as well.

While the logical conclusion of *Frey* is that interstate commerce is affected by TG § 10-703, this Court will further analyze and explain why it will not adopt those Comptroller's contentions, which it finds are erroneous in this case.

1. PASS-THROUGH INVESTMENTS IN S-CORPORATIONS ARE NOT "PASSIVE."

The Comptroller argues strongly that the situation at issue does not implicate "interstate commerce" because the taxpayer's income is "passive" in character. This Court finds the income is not passive in character, as the taxpayer's income is "pass-through" due to the nature of the entity involved (an S-corporation). Furthermore, even assuming *arguendo* that the taxpayer's income was passive, it finds the statute still impermissibly burdens interstate commerce.

A plain reading of the statute leads to the conclusion that Maryland law dictates that the income, generated by the S-corporation and passed through to its shareholders, is sourced and characterized at the entity level (*i.e.*, the S-corporation level). Under TG § 10-101, an S-corporation is defined as "a corporation that elects to be taxed as a small business S-corporation under Subchapter S of the Internal Revenue Code." Furthermore, as to the necessity to apply federal income tax law when interpreting Maryland's income tax statutes, TG § 10-107, dictates that: "To the extent practicable, the Comptroller shall apply the administrative and judicial interpretations of the federal income tax law to the administration of the income tax laws of this State." Thus, while nothing in the Maryland income tax statutes explicitly determines the character or source of income received by S-corporation shareholders through distributions, 26 U.S.C. § 1366(b) does as follows:

> **Character passed thru.** The character of any item included in a shareholder's pro rata share under paragraph (1) of subsection (a) shall be determined as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation.

Read together, those statutes compel this Court to find that any income earned by S-corporation shareholders, for purposes of Maryland's income tax laws, is characterized "in the same manner as incurred by the corporation." Also, nothing in the facts in the record in this case permits a finding that Maxim earned its income through passive means (and thus

passed through that character of income to the Wynnes).

"Passive investment income" pursuant to the Internal Revenue Code is rather narrowly defined for S-corporation purposes in § 1362(d)(3)(C): "Except as otherwise provided in this subparagraph, the term 'passive investment income' means gross receipts derived from royalties, rents, dividends, interest, and annuities." It should be noted, however, that this definition is only applied in determining a penalty tax for S-corporations with accumulated earnings and profits and for terminations of S-corporation elections. Under a wholly different Internal Revenue Code provision, "passive activities" are defined as "trade or business activities in which you do not materially participate" or certain "rental activities." 26 U.S.C. § 469. This section is aimed at limiting a taxpayer's ability to offset income from earned or ordinary sources with "passive" investments. Neither of these two sections of the Internal Revenue Code has any bearing on the Petitioner taxpayers' situation in the instant case, as the Comptroller argues it does.

Other states have confirmed this view of the characterization of income rules for distributions under similar statutes; that is, the pass-through of items by an S-corporation to its constituent shareholders does not change the character of the item. In *Camacho v. Iowa Dept. of Rev. and Finance,* 666 N.W.2d 537, 540 (Iowa 2003), the Supreme Court of Iowa made a determination on whether certain interest earned in a bank account titled in the name of a non-resident S-corporation, was taxable by Iowa. *Id.* at 539. The question of whether the income was classified as

business income or non-business income required an interpretation of the federal Internal Revenue Code. *Id.* at 540. (The Iowa tax code provided that interpretations of the Iowa Code, when dealing with S-corporations and where no specific authority was given by statute, were to be made in accordance with the Internal Revenue Code.) Emphasizing the flow-through nature of the S-corporation (and its similarity to a partnership), and finding that the interest was not "business income," the Iowa court stated:

> The fact that an item is passed through does not. . .change the character of the item. In other words, any item passed through to shareholders will be treated "as if such item were realized directly from the source from which realized by the corporation, or incurred in the same manner as incurred by the corporation. *Id.*

Similarly the Ohio Supreme Court in *Agley v. Tracey,* 719 N.E.2d 951, 954 (1999) held that the "business income generated by an S-corporation retains its status as business income as it passes through to the shareholders." There in a fact pattern analogous to *Camacho* (*i.e.*, the issue involved whether income was business or non-business), the Ohio appellate court also relied upon the characterization rules as used under the Internal Revenue Code. Citing to § 1366(b), the Court stated that:

> ...the character of the item distributed to a shareholder is to be determined as if the item were realized from the source from which the corporation realized the item. **Thus, business income generated by an S-corporation**

> **retains its status as business income as it passes through to the shareholders."** ***Id.*** **at 268.**

This same result is explained again, in great detail, in *Valentino v. Franchise Tax Bd.*, 105 Cal.Rptr.2d 304 (4th Dist. 2001). In explaining how California responded to the creation of Subchapter S of the Internal Revenue Code, the Court stated:

> California imposes a tax on the entire taxable income of every nonresident to the extent it is derived from sources in this state. (§ 17041, subd. (b).) As summarized above, California has essentially adopted federal tax law regarding the treatment of subchapter S-corporations. (§ 23800, subd. (a).) Thus, following federal tax law, the character of a shareholder's pro rata share of S-corporation income is determined as if the income were realized directly from the source from which realized by the corporation. (26 U.S.C. § 1366(b).). This principle is known as the "conduit rule" and was intended by Congress to be the same as the partnership rule. (Sen.Rep. No. 97-640, 2d. Sess. (1982), reprinted in 1982-2 C.B. 718, 725; Eustice & Kuntz, Federal Income Taxation of S-corporations (3rd ed.1993) ¶ 7.07[5], p. 7-97; Rev. Rul. 87-121, 1987-2 C.B. 217; Christian & Grant, Subchapter S Taxation (4th ed.2000) H 16.10, p. 16-27.) **"As in the case of nonresident partners, nonresident S-corporation shareholders may be taxed by a state only to the extent the income claimed to be subject to tax is fairly attributable to activities of the S-**

> **corporation in the taxing state." (Willson & Windfeld, Tax Management Multistate Tax Portfolios-State Taxation of Pass-Through Entities: General Principles, No. 1500 (BNA 1998), p. 43.)** ***Id.* at 308.**

Thus, the overwhelming consensus rule, in applying income tax statutes of various state which defer to the Internal Revenue Code's sourcing and characterization of income rules for S-corporations, is to treat the income as if it were realized by shareholders from the source brought to fruition by the S-corporation. This principle is further supported by Maryland's own policy of taxing the pro-rata distributive shares of non-resident shareholders via the generation of that income by a S-corporation doing business in Maryland. See TG § 10-102.1 (setting forth the procedure for withholding taxes due from non-resident S-corporation shareholders at the S-corporation level). As the Petitioners correctly point out, this is the only way that Maryland can legitimately tax such individuals (*i.e.*, if such income was not characterized in relation to the S-corporation, the income would be "passive" and no nexus would exist for Maryland to tax such shareholders); furthermore, a uniform application of this rule would result in the Wynnes and other Maryland residents receiving distributions from S-corporations doing business in other states to be classified based upon the characterization of income at the corporate level (and passed through). Here, the uniform application of this principle applied in concert with Internal Revenue Code § 1366(b) and the prevailing interpretations of this statute, requires that the income received by the Wynnes not be deemed "passive" just by virtue of their being shareholders. Its

character is necessarily determined by reference to how Maxim earned such income, *i.e.*, whether it was from services rendered (active) or from investments in other entities (possibly passive). No such information is given on the record in the instant case adequately supporting a finding that such income is passive.

Petitioners are found, on three of the following bases, to have refuted the Comptroller's arguments that that the Wynnes play no "active role in the administration or management of the Maxim corporation and/or the Wynnes merely earn money from "passive investments", in the same way that the holder of a traditional C Corporation stock receives an annual dividend:

First, the record reflects Brian Wynne as president of Maxim Corporation, was intimately involved in the management of the business in 2006 from which he drew an annual salary on which he paid federal and state income tax.

Secondly, the argument made by the Comptroller that income generated by S-corporations and distributed to shareholders is passive, levied on the shoulders of the Wynnes as individual Maryland residents and not part of interstate commerce as such, flies in the face of Maryland's tax scheme as applied to out-of-state S-corporations and out-of-state shareholders generating income in Maryland. If the Comptroller's interpretation of S-corporation taxation rules were accurate, Maryland would be unable to tax out-of-state S-corporations unless they had made distributions to in-state resident shareholders. That is so because, if S-corporation income was always sourced

in relation to shareholder residency rather than the income's source of generation (because it is always passive), Maryland could only tax Maryland resident shareholders; illustrated differently, out-of-state shareholders would not be taxable by Maryland on any income earned by an S-corporation (and distributed to them) regardless of the type of income.[4] This position is simply incorrect and, on analysis, is not found to be carried through in related regulations implementing income taxes on non-resident S-corporations and shareholders.

While it is clear that the income earned by the Wynnes via distributions from Maxim is not "passive" by default (but that reference must be made to how Maxim earned such income), it is also apparent that a mere classification or labeling of income as "passive" or "active" is far from the last word on whether or not an activity affects "interstate commerce" as a matter of substantive law.

---

[4] This is because, if S-corporation income is sourced based on the residency of a shareholder, out-of-state resident shareholders would have all income sourced out-of-state. If income, even though generated through an S-corporation in Maryland, is "sourced" out-of-state (because of residency) and the shareholder does not reside in Maryland, Maryland will have no taxable nexus to that income (i.e. no domicile or residency and no "sourcing" of income there). Unless Maryland were to impose a tax at the S-corporation level, which is in direct opposition to TG 10-102.1 (which only imposes tax on an S-corporation in order to collect from non-resident shareholders for their taxes due, unlike a corporate level tax), no taxes would be collected from out-of-state shareholders in S-corporations, many of the existing income tax provisions would not make any sense, and the statute would be "internally inconsistent," as discussed *infra.*

Again this second theory of the Comptroller is that the S-corporation's owner's income should be treated as if is passive, be levied on the shoulders of the Wynnes as individual Maryland residents, not realized as directly coming from the corporation as its source. However to adopt it, this Court finds would conflict with several Maryland laws as explained below.

The third position of the Petitioners, which the Court adapts, in not accepting the Comptroller's argument that the Wynnes' S-corporation income was passive when it came as stock dividends, and thus, does not affect interstate commerce, is that, even if it were deemed passive, the Commerce Clause would still apply, as Maryland's tax procedure would discourage domestic corporations from plying their trade in interstate commerce. Thus, even if income were deemed passive, under the standards set out in the *Fulton* case and other discussed later below the dormant Commerce Clause would still apply.

Although the Comptroller attempts to show that such a qualification matters in this instance, case law as well as sound public policy mandate a finding that both passive and actively generated income can affect interstate commerce, and, thus, implicate the Commerce Clause. The Comptroller cites to a variety of cases that arguably support the proposition that a taxpayer's receipt of passive income was too "remote and speculative to constitute a dormant commerce clause violation" including *In re Mallinckrodt*, No. 807553, N.Y.Tax.App.Trib., Nov. 12, 1992, 1992 WL 346998. First the Court notes that the Tax Appeals Tribunal in *Mallinckrodt* not once, even in passing, mentioned the term "passive" income in rendering its

opinion nor did it refer to the "dormant Commerce Clause." Furthermore, while it dealt with a resident tax credit being allowable with respect to intangible property held by a resident trust, that opinion only determined that the failure to allow a tax credit for payment of out of state taxes on income payable to beneficiaries earned by New York trusts did not violate the double taxation prohibition on New York residents under the Commerce Clause of the United States constitution. That Tribunal, being only another state's administrative agency, is of little persuasive authority even if such statements were made or inferences arguably drawn from *Mallinckrodt* as the Comptroller opined.

This Court finds the Comptroller seems to be primarily referring to *Chase Manhattan Bank v. Gavin,* 249 Conn. 172, 733 A.2d 733, 172 (1999), *cert. denied*, 528 U.S. 965 (1999). In that case, the Supreme Court of Connecticut held that the statutory denial of a credit for taxes paid to another state by a state resident with an interest in a trust domiciled there, but where the trustee is from another state, did not violate the dormant Commerce Clause. The case was limited to the circumstances where income was generated through a trust, and not to all passive income, and was premised on the notion that the "incentives and risks have not been sufficiently established so as to result in a dormant commerce clause violation." It should be noted, however, that even though the statute was not found unconstitutional, the court still "reject[ed] the defendant's argument that the commerce clause does not apply because the trusts are not engaged in interstate commerce." *Id.* at 208; *also citing General Motors Corp v. Tracy*, 519 U.S. 278, 300 (1997) (holding

presence of actual or prospective competition between supposedly favored and disfavored entities in a single market determines applicability of the Commerce Clause).

Furthermore, two judges expressed in *Chase Manhattan Bank v. Gavin*, 733 A.2d at 808 a strong dissent noting that the taxing scheme violated the Constitution on both Due Process and Commerce Clause grounds. Specifically, as to the Commerce Clause, that dissent stated that mere risk of multiple taxation, and not necessarily the actuality, is enough to establish the violation of the Commerce Clause, citing *Goldberg v. Sweet*, 488 U.S. 252, 261-62, 109 S.Ct. 582, 102 L. Ed. 2d 607 (1989). The dissenters also reiterated that a state's taxing power must at least bear "fiscal relation to protection, opportunities and benefits given by the state." *Citing Wisconsin v. J. C. Penney Co.*, 311 U.S. 435, 444, 61 S. Ct. 246, 85 L. Ed. 267 (1940).

The Comptroller seems to argue additionally that cases such as *In Re Barton-Dobenin*, 269 Kan. 851, 9 P.3d 9 (2000) and *Stelzner v. Commission of Revenue*, 621 N.W.2d 736 (2001), support the proposition that either "passive" investment cannot trigger the Commerce Clause or, alternatively, that state taxes and credits do not affect interstate commerce generally. That argument misses the mark.

In *Re-Barton-Dobenin*, which dealt with the Foreign Commerce Clause, not the interstate commerce clause, the Kansas Supreme Court upheld the denial of a tax credit for taxes paid to a foreign country on income received as a partner in a partnership owning income-producing commercial property abroad. While both

stemming from the same Article of the Constitution, these bodies of law are significantly different and the rationale behind the Foreign Commerce Clause is not always consistent with that underpinning of the "interstate" Commerce Clause. See, *e.g.*, *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979) (stating that different policies underlie fair apportionment as between foreign states and the several states and suggesting that the need for uniformity is more paramount in the context of the Foreign Commerce Clause).

Furthermore, *Stelzner* also has absolutely no bearing on the issue currently presented. In *Stelzner*, the taxpayers challenged the validity of a state tax on non-domiciliary residents' entire income under the Commerce Clause. 621 N.W.2d at 737. This case involved the ability of a state to tax, based on "non-residency domiciliary" status, not based upon where the income was actually generated. *Id.* Therefore, it held taxation based upon residency status (i.e., the classification) would not, by itself, implicate the Commerce Clause. *Id.* at 741. Furthermore, unlike in the present case, there was a ruling that the Minnesota statute provided full protection from "multiple taxation" and so this issue was not discussed in the context of Commerce Clause jurisprudence. *See Id.* at 740, n. 1 (stating that, since Nevada, another state involved therein had no individual state income tax, there was no issue of multiple taxation; furthermore, a specific statute protects non-domiciliary residents from multiple taxation in Minnesota by allowing credits).

As indicated, since the income at issue here is neither "passive," nor does the classification of the

character of the income as "passive" versus active", definitively determine whether the Commerce Clause is implicated, the Court will not dispose of this matter on these grounds.

2. IDENTIFICATION OF INTERSTATE MARKET OR ACTIVITY AFFECTED BY TG § 10-703

The Comptroller also argues that the Wynnes have not identified any similarly situated persons with whom they "compete" and have not shown that any "identifiable interstate economic activity or market" is affected by Maryland's tax credit scheme at issue herein. In the Comptroller's opinion, "arguably, the similarly situated persons are other Maryland residents with income from passive investments." As previously ruled, since the Wynnes did not "passively" invest in Maxim, it would be illogical to compare them with other Marylanders with income from passive investments. The more appropriate analogy would be between the Wynnes and other Maryland residents who own shares in S-corporations doing business entirely within the confines of Maryland. The groups to be so compared could also be as broadly defined as Marylanders generating income solely in Maryland and Marylanders with any out-of-state sourced income. Under this analysis, the "economic activity or market" could be broadly viewed as anything generating income. Applying the statute at issue, TG § 10-703, to these two groups of similarly situated persons, it is easy to tell that those generating out-of-state income are systematically denied "local income tax" credits and end up with the higher tax bill (when aggregating in-state and out-of-state taxes). While the Wynnes have

not put forth evidence to show that Maxim's business operations are affected by its Maryland resident shareholders' marginally higher taxes, it is clear that, in the aggregate, the monetary effect on interstate commerce is immense. Indeed, the Comptroller states as much in their argument:

> ...the imposition of the local tax and the denial of a credit against the tax do not impermissibly give Maxim an incentive to transfer all of its operations into Maryland. Rather, if anything, it may provide an incentive to the Wynnes to move out of Maryland...this may be an unwelcome outcome.

Here, it is easy to see that businesses, whether run as sole proprietorships or as S-corporations, have an incentive to move their operations out-of-state if they conduct business interstate (as opposed to purely intrastate). Thus, as each group clearly constitutes an interstate market, this denial of a tax credit affects most interstate businesses operating in or involved with investors in Maryland.

3. TAX SCHEME EFFECTS MORE THAN LOCAL INTERESTS AND DOES TREAT KEY ECONOMIC INTERESTS DIFFERENTIALLY

The Comptroller further argues that the "county income tax" imposed by the state on residents' out-of-state income and the corresponding lack of a tax credit impacts mainly local interest and does not treat economic interests differently, and therefore should be upheld. The Comptroller stresses throughout his briefs

that the local income tax is necessary to provide for "the fire, police, public works, and other services funded through, among other streams of revenue, the local income tax," a legitimate local interest. If this was the only part of the analysis, *i.e.*, a tax only needed to affect a legitimate local interest, it is likely that no statute would ever be struck down as violating the Commerce Clause. While the "county income tax" clearly does provide for a legitimate interest, it still must not treat economic interests differentially depending upon an interstate element. Here, effectively this credit procedure does treat interstate economic interests differently. By not offsetting out-of-state income taxes paid, residents or economic interests generating a significant portion of their income out-of-state will be subjected to higher effective taxes. That is, the denial of the credit, which layers "county income tax" on top of a Virginia or Pennsylvania income tax if earned in those states, will necessarily result in a higher (and differential) effective tax rate for these taxpayers.

4. THE INCOME TAXES AND CREDITS AT ISSUE HEREIN ARE NOT PURELY LOCAL SO THEY AFFECT INTERSTATE COMMERCE:

While many cases have previously held that "local" or non-state levied taxes can and do affect interstate commerce, this Court need not even determine here whether such a "local" tax can implicate interstate commerce. *See, e.g.*, *Philadelphia Eagles Football Club v. City of Phila.*, 823 A.2d 108 (Pa. 2003) (where a city gross receipts tax was found unconstitutional under the Commerce Clause); *Avanade, Inc. v. City of Seattle*, 211

P.3d 476 (Wash. Ct. App. 2009) (city business and occupations tax deemed unconstitutional). This is because, in *Frey*, the Court of Appeals already explained that for purposes of constitutional analysis the "county income tax" is a state tax, i.e., a component thereof and not a "local" tax. *Frey*, 965 A.2d at 945 (distinguishing constitutional question in that case from statutory construction issue in *Blanton* and concluding also that, were the "county income tax" under TG 10-106 not a state tax, the SNRT would be facially discriminatory). This is because the tax is collected and imposed by the state, is commingled with other taxes collected by the state, and goes to a government in the state (at one level or another). *Id.* at 945, 956.

It is clear that a state-imposed tax and credit scheme can implicate interstate commerce, as have been decided by the many Supreme Court cases cited. See, *e.g.*, *Amerada Hess Corp. v. New Jersey Dept. of Treas.*, 490 U.S. 66 (1989) (evaluating constitutionality of state deduction procedures related to federal windfall profits tax); *Complete Auto Transit v. Brady*, 430 U.S. 274 (1977) *discussed infra*; *Oklahoma Tax Commission v. Jefferson Lines*, *Inc.*, 514 U.S. 175 (1995) *discussed infra*; *Armco Inc. v. Hardesty*, 467 U.S. 638 (1984) (finding West Virginia wholesale gross receipts tax unconstitutional); *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) ("intangibles tax" imposed by North Carolina based on value of corporate stock and corporate exposure to income tax unconstitutional).

A. **<u>TG § 10-703 is Unconstitutional under the *Complete Auto* Analysis</u>**

Since the income tax statute here does, at least, affect interstate commerce, the Court must analyze the statute under the analysis set forth in *Complete Auto Transit*, *Inc. v. Brady*, 430 U.S. 274 (1977).

In this seminal case, the Supreme Court dealt with " 'the perennial problem of the validity of a state tax for the privilege of carrying on, within a state, certain activities' related to a corporation's operation of an interstate business." *Id.*; *citing Colonial Pipeline Co. v. Traigle*, 421 U.S. 100, 101 (1975) (quoting *Memphis Gas Co. v. Stone*, 335 U.S. 80, 85 (1948)). Specifically, the Court addressed whether "Mississippi runs afoul of the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3, when it applies the tax it imposes on 'the privilege of . . . doing business' within the State to appellant's activity in interstate commerce." *Id.* In sustaining the Mississippi tax, the Court explained what is necessary to "sustain[] a tax against Commerce Clause challenge." *Id.* at 279. Specifically, the Supreme Court in *Complete Auto* examined "not the formal language of the tax statute but rather its practical effect" to ensure that it was "[1] applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, [4] and is fairly related to the services provided by the State. *Id.* Precedent following *Complete Auto* indicates that each and every element of the test must be satisfied in order not to violate the Commerce Clause. *D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 30 (1988), *citing Wardair Canada Inc. v. Florida Dept. of Revenue*, 477 U.S. 1 (1986).

While the nexus requirements of the Due Process Clause and the Commerce Clause are not exactly the same, this Court does not address the issue of whether Maryland has and the income taxed has "substantial nexus." *See Quill Corp. v. North Dakota*, 504 U.S. 298, 313 (1992) (stating that "the 'substantial nexus' requirement is not, like due process' 'minimum contacts' requirement, a proxy for notice, but rather a means for limiting state burdens on interstate commerce. Accordingly, contrary to the State's suggestion, a corporation may have the 'minimum contacts' with a taxing State as required by the Due Process Clause, and yet lack the 'substantial nexus' with that State as required by the Commerce Clause"); *also see Tyler Pipe Indus., Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 250-51 (1987) (finding "crucial factor governing nexus is whether the activities performed in this state on behalf of the taxpayer are significantly associated with the taxpayer's ability to establish and maintain a market in this state for the sales").

Furthermore, it not necessary for this Court to determine whether or not the tax it issue is "fairly related" to services provided, although it likely is. This Court instead relies on the second and third prongs of the *Complete Auto* analysis in making its decision in this case. This Court holds the income tax statute, as applied to individuals and businesses engaging in multi-state business, is not "fairly apportioned" and discriminates against interstate commerce and thus fails to satisfy the Commerce Clause.

1. "FAIR APPORTIONMENT" PRONG OF *COMPLETE AUTO*

The second prong of the *Complete Auto* analysis requires that a state tax be "fairly apportioned." 430 U.S. at 279. As interpreted in *Container Corp. of America v. Franchise Tax Bd.*, 463 U.S. 159, 169, fair apportionment requires "internal consistency — that is, the formula must be such that, if applied by every jurisdiction, it would result in no more than all of the unitary business' income being taxed" and also "external consistency — the factor or factors used in the apportionment formula must actually reflect a reasonable sense of how income is generated." In order to strike down a statute based upon lack of "fair apportionment," the taxpayer must prove "by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted in that State.' "[5] *Id.* at 170 (citations omitted) These two required consistencies for fair apportionment under *Complete Auto*, both internal and external, are lacking in the context of Maryland's income tax statute for reasons explained below.

---

[5] For purposes of this opinion, the court will not indulge in a thorough analysis of whether "clear and cogent" evidence has been presented on the unfair apportionment of Maryland's income tax structure (we believe it to be clear). This higher burden of proof is typically necessary in scenarios where value of a non-resident is taxed by a State where the business is conducted. *See, e.g.*, COMAR 03.04.03.08 (dealing with apportionment of income for multistate businesses based on sales, payroll, and property). Here, Maryland's "county income tax" provisions are wholly unapportioned, *i.e.* no attempt to gauge the value of items taxed is made.

2. INTERNAL CONSISTENCY

In order for a state tax to pass muster under the Commerce Clause, the tax must also be "internally consistent." *Id.* That test generally requires a court to determine that if an identical tax statute was in force in every state, interstate commerce would not be at a disadvantage when compared with purely instate commerce. A recent analysis from the Supreme Court in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 185, 115 S.Ct. 1331 (1995), is illustrative:

> Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear. This test asks nothing about the economic reality reflected by the tax, but simply looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with intrastate commerce. A 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, since allowing such a tax in one State would place interstate commerce at the mercy of those remaining States that might impose an identical tax.

Therefore, the application of the "internal consistency" doctrine requires examining the following hypothetical in this case: If the Tax - General Article, § 10-101 et seq. (*i.e.*, the entirety of Maryland's income

tax statute), viewed as a whole, was applied across all 50 states, would individuals conducting business in multiple states be put at a disadvantage as compared to those conducting business only in one state? The answer is yes.

In order to demonstrate why this is so, many different parts of the income tax statute must be viewed together. *See Frey v. Comptroller of Treasury*, 965 A.2d 923, 939 (Md. Ct. Spec. App.), *cert. granted*, 972 A.2d 861 (2009) (stating that "a state tax must be assessed in light of its actual effect considered in conjunction with other provisions of the State's tax scheme" and "proper analysis must take the whole scheme of taxation into account") (quoting *Maryland v. Louisiana*, 451 U.S. 751, 756 (1981), and *Halliburton Oil Well Cementing Co. v. Reilly*, 373 U.S. 64, 69 (1963). To start, TG § 10-103 provides that:

> Each county shall have a county income tax on the Maryland taxable income of: (1) each resident, other than a fiduciary, who on the last day of the taxable year: (i) is domiciled in the county; or (ii) maintains a principal residence or place of abode in the county.

In ending his analysis here, the Comptroller states that the county tax must stand because a taxpayer can only be domiciled in one place on the last day of the year, and thus only one state will impose a local tax and therefore no double taxation occurs. This analysis, however, does not incorporate other important provisions of this Article, including TG §§ 10-102 and 10-102.1 (regarding imposition of tax for individuals and certain pass-through entities respectively and

which generally impose state income tax on Maryland residents wherever such income is earned), TG §§ 10-106 and 10-106.1 (regarding imposition of county income taxes and special non-resident taxes), and TG § 10-703, the focal point of this entire case. The latter statute provides that:

> *(a)* *In general* - Except as provided in subsection (b) of this section, a resident may claim a credit only against the State income tax for a taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year.

A previous interpretation of this statute in *Comptroller v. Blanton*, 390 Md. 528 (2006), clearly indicates that TG § 10-703(a) affords a credit against only State income tax, and not against any local income tax liability. Viewed together, and as exemplified by the Petitioner, the income tax scheme in Maryland will usually work a more onerous tax on individuals that generate any income out-of-state, when compared to those generating all of their income in Maryland (and never a less onerous tax). An example shows the practical effect of the income tax statute and its disparate effect[6]:

---

[6] The rates reflected in the following hypothetical are gathered from 2009 and assume that the local/county tax rate is that of Howard County for 2009.

Maryland Resident with Only In-State Income Assuming State Has Same Tax Rate as MD

1000 Widgets @ $1 = $1000 revenue

MD State tax
(6.25% of $1000) = $62.50

MD County tax
(3.2% of $1000) = $32.00

MD tax liability = $94.50

=====

State **X** State tax
(6.25% of $1000) = $62.50

State **X** County tax
(1.25% of $1000) = $12.50

Maryland Resident Only Out-of-State Income (State X)

1000 Widgets @ $1 =
1000 revenue

MD State tax
(6.25% of $1000) = $62.50

MD County tax
(3.20% of $1000) = $32.00

MD tax liability
(pre-credit) = $94.50

State **X** tax
liability = + 75.00

Taxpayer's
total tax liability
(pre-credit) = $169.50

Tax credits
(limited to MD
state tax) = - 62.50

Final Combined
tax liability
Only Out-of-State
Income (State **X**)= $107.00

=====

In essence, since Maryland systematically excludes credits against the local income tax portion of the taxpayer's liability, Maryland residents will necessarily pay more in total tax liability (i.e., the tax liability owed Maryland and other states) if a large enough percentage of their income is derived out-of-state, assuming all states have an identical tax framework to Maryland (see example above illustrating this). This will happen regardless of whether the taxpayer earns their income personally, or whether such income is derived from distributions made by an S-corporation. Since Maryland's tax structure, when applied hypothetically to all states, results in differing tax liability depending on whether or not the income is earned in-state or out-of-state, it fails the "internal consistency" test as set forth in *Jefferson Lines.*

While case law mainly depicts statutes failing for lack of internal consistency because of a lack of *any* credit for cross-jurisdictional taxation, the same analysis carried out in those cases holds for Maryland's partial credit scheme as well.[7] As pointed out by the Alabama Supreme Court in *M & A Assocs., Inc. v. City of Irondale*, 723 So. 2d 592 (Ala. 1998), a gross receipts tax that taxed all money earned by locally domiciled businesses, no matter where earned and without providing credits for taxes paid to other jurisdictions

---

[7] By partial credit scheme, it should be noted that this refers to Maryland's crediting against state taxes and not local taxes, even though both are state taxes for constitutional purposes. *See Frey.* This is not meant to imply that Maryland gives a credit towards local taxes owing to out-of-state generated income, as the Code does not provide for this.

and also taxed money earned by businesses domiciled elsewhere was unconstitutional. *Id.* at 593. Applying the "internal consistency" analysis, the court reasoned that, if every state where a business operated sought to impose the same tax on gross receipts, one sale would be subjected to multiple layers of tax (one from each jurisdiction) purely based upon the fact that business was performed there, regardless of amount. *Id.* at 598. The court went on to say that a law "that creates the possibility of such multiple taxation does not satisfy the 'fair apportionment' part of the *Complete Auto Transit* test." *Id*; *accord, e.g. Tyler Pipe Indus., Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232 (1987) (applying internal consistency analysis to Washington state taxes); *Northwest Energetic Servs., LLC v. Franchise Tax Bd.*, 159 Cal. App. 4th 841, 862 (2008) (striking down LLC tax as internally inconsistent because "LLC engaging in business in multiple states" would face multiple taxation while "LLC operating only in one state would pay the [tax] only once"). As the example shows, some amount of total tax due under Maryland's income tax scheme will be duplicated without providing any credit against "county income tax." For this reason, TG 10-703(a), as currently interpreted by the Tax Court below, cannot stand for lack of "internal consistency."

3. EXTERNAL CONSISTENCY

Another requirement to pass constitutional muster under the dormant Commerce Clause is "external consistency." *Container Corp.*, 463 U.S. at 169. Generally speaking, external consistency asks "whether the State has taxed only that portion of the revenues from the interstate activity which reasonably

reflects the in-state component of the activity being taxed." *Id.* at 169-170. Thus, the Court looks to the activity which triggers the taxable event and the practical or economic effect of the tax on that interstate activity. A brief overview of judicial precedent setting out this test is useful in explaining this Court's finding that the local tax procedure with its lack of an appropriate credit mechanism is not externally consistent as interpreted by the Comptroller.

The doctrine was explored rather comprehensively in *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995), a case that dealt with the constitutionality of state sales tax that taxed the entire value of a fare for bus travel from Oklahoma to another state. The Supreme Court stated that while "internal consistency" deals with the threat of multiple taxation from literally identical statutes, external consistency instead focuses upon the "economic justification for the State's claim upon the value taxed" to discover whether the tax "reaches beyond the portion of value that is fairly attributable to economic activity within the taxing State" and could lead to "impermissible overreaching" under the Commerce Clause. *Id.* at 185.

While *Jefferson Lines* spoke primarily about the external consistency of sales taxes and credits, this Court examined and cited a host of cases involving disputes on state income taxes, such as *Moorman Mfg. Co. v. Bair*, 437 U.S. 267 (1978), *Container Corp.*, 463 U.S. at 170, and *Central Greyhound*, 334 U.S. at 663. These cases dealt with fair "apportionment" of corporate income by attributing to the taxing state income from the corporation "in the proportion which the gross sales made within the state bear to the total

gross sales," *Moorman* at 270, on a formula "based, in equal parts, on the proportion of [such] business' total payroll, property, and sales which are located in the taxing State," *Container Corp.* at 170, and for a bus line, the "gross receipts...limited to that portion reflecting miles traveled within the taxing jurisdiction." *Central Greyhound* at 663. In each of these instances, the Supreme Court upheld the statute because it was at least intended to reasonably allocate taxes based upon income attributable to the taxing state. Maryland is, in fact, no different in this respect. As to non-resident multi-state income-generating individuals and corporations, Maryland law attempts to tax only the fair share of income by limiting the tax base to items of income generated in Maryland, according to an apportionment formula. *COMAR*, 03.04.03.08. However, while Maryland is required to address risks of external consistency in the context of non-residents generating income within state lines, it must also address risks of multiple taxation in the reverse situation: Maryland residents earning income outside of Maryland's borders.

In this respect, the Maryland statute fails. The Supreme Court dictated, that as an alternative to apportionment and allocation schemes, a state may meet its burden under external consistency by permitting a credit to taxes for residents against out-of-state sourced income. *Goldberg v. Sweet*, 488 U.S. 252, 264 (1989) (*citing D.H. Holmes Co. v. McNamara*, 486 U.S. 24, 32 (1988)). However, under this alternative method to satisfy external consistency, the state still must try to adequately avoid the problems of multiple taxation. This is not satisfied by merely providing a credit against a portion of taxes paid to other states; it

must at least attempt to give a credit against all taxes on income sourced to other states.

This principle is illustrated in cases such as *Philadelphia Eagles Football Club v. City of Philadelphia*, 823 A.2d 108 (2003) and *Avanade, Inc. v. City of Seattle*, 211 P.3d 476 (Wash. Ct. App. 2009). In that first case the city of Philadelphia imposed a gross receipts tax on all income earned by the football team, even though only half the games were played within the city limits. *Philadelphia Eagles* at 115-16. The Supreme Court of Pennsylvania, in overturning the decision of the lower court, held that, while proceeds from the media contracts were correctly included in calculating the gross receipts tax due from the organization, external consistency under the Commerce Clause did not permit the city to include "receipts attributable to the one out of every two football games that were played by the Eagles Team in, and telecast from, other taxing jurisdictions." *Id.* at 135. Such unapportioned taxation would lead to the unconstitutional "risk of being subjected to multiple taxation." *Id.* at 132-33. The Court also explained that under precedent set in *Central Greyhound*, 334 U.S. 653 (1948), gross receipts taxes, as a form of income tax and not a retail sales tax, were subject to apportionment measures (unlike retail sales which could be on an apportioned basis due to their "local" subject matter). The recognition of a requirement to apportion income has been reiterated in numerous cases. *See, e.g. Polychrome Int'l Corp. v. Krigger*, 5 F. 3d 1522, 1540 (3d Cir. 1993) ("any tax – including one imposed on, or measured by, gross receipts from interstate and foreign commerce–must be apportioned to reflect only that business activity attributable to

intrastate commerce"); *City of Winchester v. American Woodmark Corp.*, 252 Va. 98, 471 S.E.2d 495, 495, 498 (1996) (recognizing taxpayers' right to apportionment of a gross receipts tax); *Southern Pacific Transp.* Co. *v. Arizona, Dep't of Revenue*, 202 Ariz. 326, 44 P.3d 1006, 1014 (2002) ("In our view, *Jefferson Lines* compels the view that gross receipts taxes . . . must be apportioned to comply with the . . . Commerce Clause."); *see generally*, Hellerstein & Hellerstein, *State Taxation*, ¶ 18.08[5].

Applying this analysis to the case at bar, since Maryland levies tax on all income of its residents and attempts to limit such tax to its "fair share" by providing a credit against out-of-state income taxes paid, Maryland must at least have a credit procedure which gives a credit against income allocable to other states. While the statute need not be perfectly symmetrical with other states' formulas (and some minimal double taxation may result), Maryland may not constitutionally deny a reasonably apportioned credit against local tax, and thus double tax, income clearly emanating from out-of-state sources.

In *Avanade*, the Court of Appeals of Washington dealt with the constitutionality of Seattle's business and occupation tax (B&O tax). 211 P.3d at 476. The court there held the statute unconstitutional under the Commerce Clause because the "manner in which it utilized cost apportionment improperly attributed revenue to Seattle that should have been attributed elsewhere." *Id*. at 477. While the city did attempt to meet its constitutional burden regarding "fair apportionment" by applying a formula to determine a taxable base attributable to the city, the court held that

it unacceptable because it "failed to allocate any revenue for on-site work in states without physical Avanade offices to those states, notwithstanding that the Avanade consultants at issue were based in those states, and notwithstanding that the work was performed in those states, exclusively for businesses also based in those states." *Id.* at 482. In so holding, the court relied upon precedent from *Gen. Motors Corp. v. Wash.*, 377 U.S. 436, 440, 84 S.Ct. 1564, 12 L.Ed.2d 430 (1964), and *Tyler Pipe Indus., Inc. v. Wash. State Dep't of Revenue*, 483 U.S. 232, 107 S.Ct. 2810, 97 L.Ed.2d 199 (1987).

As these cases indicate, merely because the tax at issue is a "local income tax" does not permit Maryland to deny taxpayer a credit against this tax for income taxes paid to other states. Taxation of a "fair share" of value, at least for income-based taxes, by a state or municipality for external consistency purposes does not look to whether the tax is levied for a particular purpose or governing body. It merely asks whether a taxing jurisdiction has overstepped its bounds and is reaching more than its share (resulting in multiple taxation), by not conceding primary authority to tax to the state where the activity was performed. It was clear in *Philadelphia Eagles* that a city based income did not exempt its tax scheme from meeting the external consistency analytical standard; the same line of reasoning used in that case requires finding a lack of external consistency as to Maryland due to neither an appropriate apportionment scheme or credit procedure. Thus, based on the foregoing analysis, this Court reaches the same conclusion as those in the aforementioned case just cited, which will require the same result.

4. DISCRIMINATION AGAINST INTERSTATE COMMERCE

The third prong of the *Complete Auto* test requires that in order for a tax statute to be constitutional under the dormant Commerce Clause it must not "discriminate against interstate commerce." 430 U.S. at 279. Various cases decided by the Supreme Court have held that a state tax may not "unjustifiably... discriminate against or burden the interstate flow of articles of commerce," *Oregon Waste Sys., Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 98 (1994), nor may it "discriminate between transactions on the basis of some interstate element." *Armco*, 467 U.S. at 642 (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 332 n. 12 (1977).

While a tax that imposes differential treatment on its face is "virtually per se invalid" (*Frey*, 965 A.2d at 936 (quoting *Oregon Waste*, 511 U.S. at 99), "[u]nder the anti-discrimination component of the *Complete Auto* test, a tax [also] discriminates against interstate commerce if it is 'facially discriminatory, has a discriminatory intent, *or* has the effect of unduly burdening interstate commerce.'" *Sprint Commc'ns Co. v. Kelly*, 642 A.2d 106, 114 (D.D. 1994) (quoting *Amerada Hess Corp. v. Division of Taxation*, 490 U.S. 66, 75 (1989)).

As the Petitioner correctly states, discriminatory effect may stem not only from the tax standing alone, but may arise from its interaction with other states' taxes based on the same value. *See Barringer v. Griffes*, 1 F.3d 1331 (2d Cir. 1993) (finding a "use tax" on cars unconstitutional because when taken together with

sales taxes imposed by other states, the statute had the "secondary effect[]" of foisting a larger tax burden on vehicles brought in from outside Vermont and thus "creat[ing] a bias towards in-state purchases). Many other cases have struck down taxes on the basis of discrimination if they either placed multiple tax burdens on activities or if they tended to discourage participation in multi-state business. *See Fulton Corp. v. Faulker*, 516 U.S. 325 (1996) (finding a North Carolina tax on stock holdings discriminatory because it penalized stock owners for owning stock in companies that operated in more than one state) The *Fulton Corp.* case is analogous to the case at bar. In striking down the statute at issue, the Supreme Court stated: "a regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents." 516 U.S. at 333. Here, the credit provisions of TG § 10-703 work to tax individuals or pass-through entities more extensively when they actually participate in interstate commerce as well (by generating income out-of-state). The resulting effect of these incrementally higher net taxes on multi-state business operations puts multistate domestic entities at a disadvantage compared to purely intrastate domestic entities and thus "tend[s] to discourage domestic corporations [and individuals] from plying their trades in interstate commerce." *Id*; *accord Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 576 (1997) (striking down as discriminatory a Maine tax that "encourage[d] affected entities to limit their out-of-state clientele"), *AT&T Corp. v. Mississippi State Tax Comm'n*, 2006 WL 2506366, at *3 (Miss. Ch. Ct. June 12, 2006) (where a tax exempting from a

company's gross income only those dividends received from in-state affiliates was found discriminatory because it "discourages S-corporations from choosing to locate their operations outside Mississippi"), and *Chapman v. Comm' r of Revenue*, 651 N.W.2d 825, 834 (Minn. Sup. Ct. 2002) (striking down statute allowing individuals to deduct contributions to local charities but not out-of-state charities).

As the Supreme Court has signified before, merely because taxes akin to the "county income tax" and corresponding credit provisions appear nondiscriminatory "does not save it from invalidation." *Tyler Pipe*, 483 U.S. at 238. Since Maryland's income tax statute "ha[s] the effect" of treating businesses differently depending upon the percentage of income generated in Maryland, the statute and its lack of giving any credit for "county income tax" when such income is generated and taxed out-of-state is unconstitutional, *quoting Westinghouse Elec. Corp v. Tully*, 466 U.S. 388, 400 (1984).

5. OTHER POLICY REASONS

By way of illustration to demonstrate the faulty logic of the ruling of the Tax Court below in upholding Maryland's lack of full credit tax scheme, if the county income tax was not subject to the same "double taxation" considerations of the Commerce Clause (*i.e.*, no tax credit was required), there would be nothing to prohibit Maryland from collecting all State income taxes as "county income taxes" to avoid the necessary credit mechanism. This perverted result, which takes the current scheme to its extreme, would clearly burden interstate commerce.

The county income tax, although, *arguendo*, generally generating revenue to support services provided to Maryland and/or Howard County residents, does not aid income-generating activities of those residents occurring out-of-state. As the sourcing rules indicate (*i.e.*, primary taxable source of income is the place where generated), this income is more clearly related to the services provided by the states where the income is generated. In order not to violate the dormant Commerce Clause strictures discussed herein, Maryland, or Howard County, if either seeks to impose taxes in order to provide for local services, needs to rely on the local tax base in Howard County, *i.e.*, income taxes on income earned, sales tax based upon sales occurring, property taxes on property located there, etc. By way of further illustration, Maryland and its counties (and the services they provide) have little more, if any, connection to a Howard County resident's services actually performed in Virginia than they do to a sale of Delaware beach property the resident owns, or of his business sold in Ohio. However, by virtue of residence in Maryland, the Comptroller asserts that all of these transactions could be fully subject to "county income tax" without regard for any credit against the tax imposed by the other states.

If Maryland was not required to provide credits against "local income tax," the end result, as the Comptroller suggests, would likely be that many Marylanders with business across state lines would quickly become ex-Marylanders. Projecting this lack of credit mechanism further, there is no reason to believe that individuals, who conduct business primarily out-of-state, would live in Maryland would willingly continue to be subjected to a 3.2% "county income tax"

merely for the sake of living there (when the county has nothing to do with the generation of this income and they are likely already paying a similar tax to some other out-of-state county). Many of these high income earners would clearly prefer to live out of state where they are only taxed once. Alternatively, multi-state business entities would either reorganize their operations, and solely operate within state lines or turn away from Maryland altogether. Either path would lead them away from Maryland's double tax system and would also cause a drop in Maryland's tax revenue from other channels.

This Court finds the Comptroller wrong in his assertion that individuals like the Wynnes, as only minor shareholders, cannot affect the operations of a multi-billion dollar organization. In the aggregate, seemingly minor changes in income tax rates and other policies affecting businesses can have a great impact on the location of their businesses. Constitutional jurisprudence holds that there is no "de minimis" defense to the charge of discriminatory taxation under dormant commerce clause.

Furthermore, while revenue generated from "county income taxes" imposed on individuals like the Wynnes may be substantial, it likely pales in comparison to the lost revenue from the tax imposed on the income of hundreds and thousands of those employed by Maxim in Maryland (which might be lost if Maxim moves its operations under the direction of the Wynnes).

Building off this last point, if this situation was allowed to stand, investment by Marylanders in S-corporations would likely be stifled. Since Maryland

investors in S-corporations are essentially doubled taxed via "county income taxes," they face a higher cost of investment as compared to individuals in other states investing in multi-state S-corporations are individuals in Maryland investing in S-corporations doing business purely in-state. This effect could curb much investment in such corporations and could steer corporate operations (and jobs) away from Maryland.

The correct way to achieve the level of taxation to provide for county and state services to meet constitutional standards is to adjust and/or apply the tax code and tax rates, which imposes two levels of tax, by providing complete or fair and reasonable credits for "the county tax" component on certain activities.

It should also be noted that while an S-corporation is required to compensate its shareholder/managers adequately with salary (so they do not avoid paying employment taxes like FICA/Social Security which are not taxes imposed on distributions), it is often hard to distinguish between the income from S-corporations due to salary and distributions. To set forth a categorical rule that S-corporation distributions were passive would almost definitely influence shareholder/managers to arbitrarily alter these two types of income so as to not be taxed at all by Maryland or have all income classified as salary (and entitled to a credit). This is another reason why the Comptroller's attempt to classify S-corporation distributions as "passive" makes no practical sense.

Thus, based on the forgoing analysis, the tax scheme in question herein is found to have an adverse

effect on interstate commerce, so as to implicate the "dormant" Commerce Clause.

IV. **CONCLUSIONARY DISCUSSION & RULINGS**

By way of summarizing the highlights, this Court notes the Comptroller essentially argues that the income in question, despite being Subchapter S income, is passive in nature, that its actual source for valuation purposes is really the residency of the recipient Petitioners and not the out-of-state sources of Maxim S-corporate income, as the Petitioners argue. He particularly notes that, being Howard County residents on the last day of the taxable year, the Petitioners are subject to "the local tax." Thus, because of the income's alleged "passive" rather than "pass-through" nature, the Comptroller posits that Petitioners should not be given a credit for out-of-state taxes paid against the county portion of the Maryland tax, *i.e.*, that portion being arguably related more to the residency of the Petitioners to compensate the state government for police and fire protection services, *etc*., they receive at their residence in Howard County. He bases that argument on the case law cited below that allows for a state to retain or arguably allocate a reasonable portion of its tax towards the support of such services as just mentioned.

Specifically he further argues all of those taxes on income of Maxim corporation that Petitioners argue is sourced out-of-state and upon which out-of-state state taxes were paid to those jurisdictions, should not be credited against the county portion of the Maryland tax as that percentage represents a reasonably

proportionate amount to cover those services rendered particularly by the state and/or the county of the Petitioners' residency. The Petitioners do not necessarily contest that latter point as to proportionality of services. That Office also argues that, since the mechanism we are dealing with here is a credit and not a tax itself and, thus, is more indirect in nature, it should not be seen as having a significant negative impact on interstate commerce.

This Court has considered all those arguments; while most have some merit at first blush, they do not withstand further constitutional analysis. Having found that the income at issue here is "pass-through" sub S-corporation income on which tax was paid to other states and understanding that the Petitioners and the Comptroller both concede that the tax rates set by Howard County is not directly based on any formula for revenue generation/reimbursement of Howard County or the state for police, fire services, *etc*., rendered by either to either government entity or on behalf of each other there, this Court simply comments that latter reimbursement/attribution aspect has only a neutral effect in weighing any consideration that the State is free not to credit the "county portion' of the tax to payment of out of state taxes.

Nevertheless, based on the record before it, this Court finds that "county tax" herein and its rate are significant and the county tax at its 3.2% rate has not been actually shown to be reasonably close to proportionate the costs to support any government services received by the Petitioners in their resident Maryland county of Howard.

This Court certainly understands that a credit is more indirect in nature than a direct taxes paid on some economic activity or value. It, nevertheless, finds that, because "the county portion" cannot be directly or proportionately related, by formula or otherwise, to support legitimate services that the county or state had rendered to the Petitioners, the State is not justified in withholding most of the credit for it. It particularly notes that these Petitioners have paid a significant amount of tax to the State of Maryland based on income sourced in-state, *etc*., for which they obviously would not have received any credit. Also, it finds they have paid at least an adequate or proportionate share of their state income taxes which would be generally attributable to support or compensate for to those related government services. In addition, understanding as Hellerstein points out that the credit mechanism is one which is used extensively by various states to balance the effect of their state tax schemes so as not to impact negatively on interstate commerce, this Court finds that Maryland has failed to do so. That failure to grant a fairly apportioned credit for the county portion of the state taxes paid for out-of-state taxes on income sourced out-of-state is not so insignificant nor is it generically so indirect as to not have a negative impact on interstate commerce.

The Comptroller argues, based on the record herein, that the Wynnes have not shown by any clear and cogent evidence that the credit scheme in question sufficiently affects or is connected to Interstate Commerce as arguably required by the three cases they cite: *Fulton Corporation v. Faulkner*, 516 U.S. 325 (1996); *Camps Newfound/Owatonna, Inc. v. Town of*

Harrison, 520 U.S. 564 (1997) and *Chapman v. Commissioner*, 651 N.W.2d 825 (Minn. 2002).

In analyzing that argument, this Court notes, first however, that *Chapman* holds that, although it is true that the Commerce Clause protects markets and participants in markets rather than taxpayers as such, a state regulation, imposed on individual taxpayers that does not directly tax a commercial activity or organization, can implicate the Commerce Clause. U.S.C.A. Const. Art. 1, §8, cl.3; M.S.A. §290.21, subd. 3(b) (2000). To withstand Commerce Clause scrutiny, a state tax scheme as a whole must (1) be applied to an activity with a substantial nexus with the taxing state, (2) be fairly apportioned, (3) not discriminate against interstate commerce, and (4) be fairly related to the services provided by the state. U.S.C.A. Const. Art. 1, §8, cl.3. Under the "dormant" Commerce Clause, a state may not tax a transaction or incident more heavily when it crosses state lines than when it occurs entirely within state. Maryland's scheme does. Constitutional jurisprudence holds that there is no "de minimis" defense to the charge of discriminatory taxation under dormant commerce clause.

Next, contrary to the Comptroller's position, this Court finds the logic and precedential authority set out by the U. S. Supreme Court in *Fulton* applies to the situation herein. The *Fulton* decision involved the petitioner corporation, which owned stock in other out-of-state corporations, disputing the constitutionality of an intangibles tax levied on corporate stock owned by residents of the state by the respondent state authority. The corporation contended that the scheme based on the taxable percentage deduction violated the

Commerce Clause by discriminating against interstate commerce. It claimed entitlement to a refund of the tax it had paid and attorney fees. The *Fulton* holding is summarized as follows:

> The Supreme Court determined that the scheme was facially discriminatory against shareholders in out-of-state corporations by forcing them to pay tax on a higher percentage of share value than shareholders of corporations operating solely in the state. It rejected the state's contention that the tax amounted to a valid compensating tax for availing themselves of the state's capital market. It held that there was no proof of any in-state activity or benefit to justify the compensatory levy and that the state could not treat general revenue measures, such as the capital market, as relevant interstate burdens for purposes of the compensatory tax doctrine.
>
> It further held there are three conditions necessary for a valid compensatory tax which this Court finds to be analogously applicable to the tax credit scheme involved herein. First, a state must, as a threshold matter, identify the interstate tax burden for which the State is attempting to compensate. Second, the tax on interstate commerce must be shown roughly to approximate the amount of the tax on intrastate commerce. Finally, the events on which the interstate and intrastate taxes are imposed must be substantially equivalent; that is, they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other.

Further relying on Oregon *Waste Systems*, *Inc. v. Department of Environmental Quality of Ore.*, 511 U.S. 99, the Supreme Court in *Fulton* held at 332 - 333:

> We have also recognized, however, that a facially discriminatory tax may still survive Commerce Clause scrutiny if it is a truly " 'compensatory tax' designed simply to make interstate commerce bear a burden already borne by intrastate commerce."

and ...

> First, "a State must, as a threshold matter, 'identify... the [intrastate tax] burden for which the State is attempting to compensate.' " *Oregon Waste*, *supra*, at 103 (quoting *Maryland v. Louisiana*, 451 U.S. 725, 758, 68 L.Ed. 2d 576, 101 S. Ct. 2114 (1981)). Second, the tax on interstate commerce must be shown roughly to approximate – but not exceed – the amount of the tax on intrastate commerce." *Oregon Waste*, 511 U.S. at 103. "Finally, the events on which the interstate and intrastate taxes are imposed must be 'substantially equivalent'; that is, they must be sufficiently similar in substance to serve as mutually exclusive 'proxies' for each other." *Ibid.* (quoting *Armco Inc. v. Hardesty*, *supra*, at 643).

Thus, this Court, having ruled the Maryland tax scheme in question to be discriminatory against Maryland resident shareholders of S-corporations by disproportionally taxing income streams sourced out-of-state and, thus, adversely effecting interstate commerce, rules Maryland has failed to meet its burden of proof and persuasion required by *Fulton* and *Oregon Waste Systems*, *Inc.*, *inter alia.* Those burdens include a showing its tax credit scheme meets the three conditions mentioned above. Thus, it is Maryland, and not the Wynnes as argued by the Comptroller, which has the burden of proof as to meeting those three conditions. It has failed to meet them as well as failed to show that interstate commerce is not affected by its tax credit scheme.

In addition, this Court rules, under the required internal consistency test under *Oklahoma Tax Commission v. Jefferson Lines, Inc.* & the *Complete Auto* cases, that the Wynnes do not have to identify or show either that similarly situated persons with whom they compete. Though somewhat more indirect in nature than a compensatory or an intangibles tax because of the inherent character of any tax credit scheme, there are identifiable interstate activities and markets being affected here. First of all, the Wynnes' income stream in question here was sourced out-of-state and subject to out-of-state taxes. Thus, there is by play between an out-of-state corporation and income streams generated by it and taxed out-of-state and a Maryland tax credit scheme related to that income stream received by Maryland residents.

Also, interstate economic activity is involved because the income streams ultimately involved and

affected by lack of a effect of allowing double-taxation in those states and, as such, by definition, would adversely affect Interstate Commerce.

Also, while the Comptroller argues that a Maryland resident has to pick up the pro-rated share of distribution from investments and S-corporations by virtue of having to report their federal adjusted gross state income when reporting income for state income tax purposes, this Court does not find that to have significance to the resolution of the instant case, *e.g.*, the out-of-state tax would obviously not have been accounted for or credited in that calculation. In fact, that is exactly what is at issue herein. Note you do not get credit on federal return for the payment of state income taxes. Also, again, this Court has ruled that the income stream in question here is not passive as the Comptroller argues, but is pass-through, as defined under Federal tax law which interpretation Maryland, by its own statute, is required to follow.

This Court finds that the record is sufficient to indicate that the failure of Maryland to allow a fair and reasonably apportioned credit for "the county tax" adversely affects Interstate Commerce. While it may not directly affect a product or market, it would have the effect of discouraging other Maryland residents from investing in corporations that generate income out-of-state.

V. CONCLUSION

For all the reasons stated herein and just summarized, the Court finds in conclusion that the failure to provide a credit for the county portion of the

state taxes paid on out-of-state income violates the negative Commerce Clause of the United States Constitution. The Court makes this finding of unconstitutionality noting particularly that this county portion of the Maryland state income tax is not a county or city tax levied by those lower tiers of government but then collected for them for the sake of convenience by the State, when a resident files his or her Maryland state income tax return. It is a component of a Maryland State imposed tax. Based on clear statements in Maryland case law cited above in *Blanton*, etc., "the county portion" is simply a portion of the State income tax that has a different mechanism for arriving at its rate to form one of two components of one ultimate Maryland State income tax.

This finding of unconstitutionality of Md. Code, TG § 10-703(a) credit procedure as interpreted by the Tax Court below is made based on clear and logical evidence on the record herein and on application of the stringent standards for making such a ruling pursuant to *Livingston v. Maryland*, *192* Md. App. 553, 568 (2010) and *Fell v. Maryland*, 42 Md. 71, 77 (1875) as well as *Aggregates Ass'n v. Maryland*, 337 Md. 658, 655 A.2d 886, *cert. denied sub nom. Genstar Stone Prod.* Co. *v. Maryland*, 514 U.S. 1111 (1995) & *Department of Public Safety & Correctional Services v. Demby*, 390 Md. 580, 890 A.2d 310 (2006). It is also made, after given the appropriate degree of deference and weight accorded to the position of the administrative agency below and the Tax Court and their legal interpretation and application of the statutory tax scheme in question herein, which the Comptroller Office administers and which the Tax Court ruled on below. This Court makes this ruling understand it may have a detrimental effect

on the ability of the State to collect tax revenue during times of economic downturn and diminished tax collection. But nevertheless, after such consideration, this Court has ruled the Tax Court was erroneous as a matter of law. As the U.S. Supreme Court recently ruled on June 16 in *Bond v. United States*, 564 U.S. __ (2011) (Slip Opinion):

> An individual has a direct interest in objecting to laws that upset the constitutional balance between the National Government and the States when the enforcement of those laws causes injury that is concrete, particular and redressable.

Each of those last three descriptors has application to this case.

V. <u>FINAL RULING</u>

For all the reasons stated herein, the Tax Court's interpretation of TG Art. §10-703 (a) that "... a resident may claim a credit only for the State income tax for the taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year "as only applying to "the state component thereof and not the "county tax" component is in error, as a matter of constitutional law. That is so because the failure of the Maryland Comptroller and Tax Court applying Maryland statutory law, specifically TG Art. §10-703(a), Md. Code to allow for a credit of the entire portion of the applicable subject State income tax calculated to be paid by the Petitioners including the "county tax" calculated at the Howard County rate or a fair and

reasonable apportionment of the latter against the out-of-state income taxes paid by the Petitioners, on income as identified in the record herein is found to be unconstitutional as it violates the "dormant" Commerce Clause of the U. S. Constitution, Article 1, Section 8, Clause 3, (U.S.C.A. §8, cl.3).

Thus, the judgment of the Tax Court is reversed and this case is remanded to it for further factual considerations and final ruling allowing for the proper redress, an appropriate credit for out-of State income taxes paid on the income earned out-of-state including the "pass thru" income received by the Petitioners from Maxim S-corporation consistent with the legal rulings set forth herein, with the right of the Tax Court to remand to the Comptroller's Office for further proceedings, if deemed necessary and appropriate.

June 28, 2011	/s/ Louis A. Becker, Judge
Date	Louis A. Becker

CC: Christopher T. Handman, Esquire
Brian L. Oliner, Asst. Atty General

IN THE CIRCUIT COURT
FOR HOWARD COUNTY

CASE #: 13-C-10-80987

MARYLAND TAX COURT

Appeal #: 08-IN-00-0791

[Filed June 29, 2011]

BRIAN WYNNE, *et al.*

Petitioners

FOR JUDICIAL REVIEW OF A DECISION OF THE MARYLAND TAX COURT

And

MARYLAND STATE COMPTROLLER OF THE TREASURY

Respondents

ORDER

Upon consideration of the record below before the Tax Court being the Agreed upon Statement of Facts, testimony, evidence including documentary exhibits, and arguments of counsel;

Upon appropriate deference, having been given to the decision of the Comptroller and Tax Court along with the weighing, *de novo*, of the arguments of the parties in the Memoranda filed and presented orally on judicial review;

For all the reasons stated in the attached Memorandum, causing this Court to conclude that the Tax Court's interpretation of TG Art. §10-703(a) Md. Code, that "...a resident may claim a credit only for the State income tax for the taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year "as only allowing a credit for "the state component thereof and not the "county tax" component, was erroneous as a matter of law;

And, further causing this Court to conclude that the failure of the Maryland Comptroller and Tax Court applying the law, specifically TG Art. §10-703(a), Md. Code to allow for a credit of the entire portion of the applicable subject State income tax calculated to be paid by the Petitioners including the "county tax" calculated at the Howard County rate or a fair and reasonable apportionment of the latter against the out-of-state income taxes paid to other states by the Petitioners, on income as identified in the record herein including the attached Memorandum;

And further causing this Court to rule said section of the Tax — General Article, Md. Code as applied by the Maryland Tax Court as violative of the "dormant" Commerce Clause of the U. S. Constitution, Article 1, Section 8, Clause 3, (U.S.C.A. §8, cl.3), and, thus, unconstitutional,

Therefore, it is this 28th day of June, 2011 in the Circuit Court of Howard County,

ORDERED that the judgment of the Tax Court be and is hereby reversed and this case is remanded to it for further factual considerations and final ruling allowing for an appropriate credit for out-of State income taxes paid on the income earned out-of-state including the "pass thru" income received by the Petitioners from Maxim S corporation consistent with the legal rulings set forth herein, with the right of the Tax Court to remand to the Comptroller's Office for further proceedings, if it is deemed necessary and appropriate.

/s/ Louis A Becker, Judge
Louis A. Becker

CC: Christopher T. Handman, Esquire
Brian L. Oliner, Atty. General's Office

APPENDIX D

MARYLAND TAX COURT
301 West Preston Street, Suite 1513
Baltimore, Maryland 21201

MTC No. 08-IN-OO-0791

[Dated December 10, 2009]

BRIAN and KAREN WYNNE)
)
- vs -)
)
COMPTROLLER OF THE TREASURY)
)

Baltimore, Maryland

(Continued Hearing)

BEFORE: HONORABLE STEVEN E. SILBERG

APPEARANCES:

ON BEHALF OF THE PETITIONERS:

ROBERT A. SNYDER, JR., ESQUIRE
MATTHEW F. PENATER, ESQUIRE

ON BEHALF OF THE RESPONDENT:

BRIAN L. OLINER, ESQUIRE

Transcribed by:
Diane E. Smith

[p.2]

CONTINUED HEARING

THE CLERK: Your Honor, the next case is that of Brian and Karen Wynne versus Comptroller of the Treasury. The Tax Court Appeal No. is 08-IN-OO-0791. The Petitioners are represented by Mr. Robert A. Snyder, Jr. and Mr. Matthew F. Penater, while the Comptroller is represented by Brian Oliner. This matter is before the Court on a continued hearing.

JUDGE SILBERG: Good!

MR. OLINER: Good afternoon, Your Honor. Preliminarily, I've given a copy of this to Mr. Snyder, which was your answers -- or the answers, hypothetical, that you requested. Just to explain what we have there: Initially, the first page, which is the one that doesn't have boxes on it, we did that in using the actual tax rates, the 2008 tax rates, which are graduated tax rates. So what we did is, after we saw what the Petitioners had provided the Court using a flat rate, we went and the second page shows our responses using the flat rates that they used, which in fact are the same what they had done in column one, I believe . . .

JUDGE SILBERG: The Maryland tax rates really weren't relevant to what was going on.

MR. OLINER: Which is why I thought, for

[p.3]

comparison sake, you'd want to see that we came up with, at least for the Comptroller's position in this case, the same thing, and that we didn't have any dispute with the numbers that they came up with.

JUDGE SILBERG: You actually agree with their column one?

MR. OLINER: Their column one.

JUDGE SILBERG: Okay.

I guess my first question is, you have columns two and three, which is the point of view that you think should prevail?

MR. SNYDER: We believe it's column two that should prevail.

JUDGE SILBERG: Okay. So . . .

MR. SNYDER: But we did columns two and three because we had in the Petition, as well as in the Pre-Hearing Memo and the Post Hearing Memo both the constitutional argument and the statutory position that we have taken. So and there's a difference in the . . .

JUDGE SILBERG: Okay. If you think column two should prevail, I'm not going to argue with you about it. I'm perfectly happy to forget about column three at least to some extent. And if I'm not incorrect, example two, the only difference is a Sixty-four Thousand Dollar credit towards the end of the column. On example two.

[p.4]

MR. SNYDER: Actually, Your Honor, example two and example . . .

JUDGE SILBERG: Well, let's start with two.

MR. SNYDER: Okay. Example two, that is correct. The only difference between our position and the Comptroller's position would be the Sixty-four Thousand Dollar credit in column two.

JUDGE SILBERG: And example one, if I'm not -- again, the only difference is the Sixty-four Thousand Dollar credit.

MR. SNYDER: Yes, Your Honor.

JUDGE SILBERG: And example three, they're both the same. There is no difference.

MR. SNYDER: That is correct because there is no, under the hypothetical, there is no corporate income tax payable and no income tax payable to Green State, so there's no credit available.

JUDGE SILBERG: Okay. So, I guess, the only real concern then is whether or not a credit should be allowed for the County portion of the taxes paid in Maryland, the Sixty-four Thousand Dollars?

MR. SNYDER: Yes, Your Honor.

JUDGE SILBERG: That was just . . .

MR. OLINER: Did you set that up on purpose, Your Honor?

[p.5]

JUDGE SILBERG: No, I wasn't that clever.

MR. OLINER: Okay.

JUDGE SILBERG: This is not quite like a law school exam when you have clever names, but, okay. I just wanted -- Part of the reason for doing this was just to pin down for sure where you agreed and where you didn't and the ramifications. Okay. I appreciate your extra effort.

And somebody lied about the attendance figures for today.

MR. PENATER: I did, Your Honor. I'm sorry.

JUDGE SILBERG: Yeah. I asked, How many people will likely be here? And he said, Well, I don't know, two or three. Greatly exceeded our expectations.

All right. Any other comments anybody wants to make?

MR. SNYDER: We have none, Your Honor, other than . . .

JUDGE SILBERG: You're ready to hear what I have to say, I think.

MR. SNYDER: Probably.

JUDGE SILBERG: But anything else that you want to say?

MR. OLINER: No, Your Honor.

JUDGE SILBERG: All right. Let me start by, I

[p.6]

want to thank you all for making my life a lot more interesting than it would have been otherwise. People ask me, what kind of cases I like to try? And I said, when I have good attorneys on both sides. Invariably the subject matter becomes a lot more interesting. When you have pro se taxpayers who don't understand the law, the cases are very uninteresting. So much for my point of view.

We'll start with the constitutional argument: I'm not buying it. This case, as to whether or not this statute is unconstitutional for commerce grounds or any other reason, it's been heard before, and the Court of Appeals has affirmed this section in a number of different cases. So I'm not going to overturn the statute

that appears to be there. I really don't see much impact, if any, on Interstate Commerce by the statute itself. The same statute came up in Blanton for credits for taxes paid in North Carolina. Mr. Blanton wanted to get credit towards both the state tax and the county tax and they said, it doesn't work. You don't get the credit, and it's not unconstitutional to do this.

To some extent, I think I probably already answered the other question in front of us as to how this whole statute's going to work. That you will get credit the way the Comptroller asked for it. The way you suggested, the Comptroller was asking that you get credit

[p.7]

for taxes paid to the extent of the Maryland income tax, nothing towards the County surcharge.

All that being behind us, the Order that I need to sign will be to affirm the decision of the Comptroller, and to deny the Petitioners' request for -- I don't know. Procedurally, where are we? What do I need to -- What's the Order going to say to get us there?

MR. OLINER: Upon a review of the stipulated facts and evidence presented and argument of counsel, the Court is affirming the assessment as made by the Comptroller's Office, I believe.

JUDGE SILBERG: Okay. I know -- Well, they filed a petition . . .

MR. OLINER: Right.

JUDGE SILBERG: . . . for an accounting, and I don't know if any of their -- Am I correct? I'm not sure.

It's what you actually filed to get us started.

MR. SNYDER: We filed a petition to, I guess, contest the assessment.

MR. OLINER: Right.

JUDGE SILBERG: Okay. There were some adjustments made to the initial assessment?

MR. OLINER: I believe that that was -- I think it's reflected in the Notice of Final Determination.

[p.8]

MR. SNYDER: I believe that's correct.

MR. OLINER: So it's the assessment that is . . .

JUDGE SILBERG: Okay. I wasn't -- I know there were some changes made, . . .

MR. OLINER: Right.

JUDGE SILBERG: . . . and the Petitioner changed the County of residence at least once.

MR. OLINER: That, and then I think also -- yeah, but the bottom line is whatever changes were made . . .

JUDGE SILBERG: They all have occurred prior or before.

MR. OLINER: . . . are reflected in the Notice of Final Assessment, which is what was appealed to this Court.

JUDGE SILBERG: Okay. All right. Then I will just be signing an Order affirming the Notice of Final Determination that occurred before.

MR. SNYDER: Excuse me, Your Honor.

JUDGE SILBERG: Am I missing something?

MR. SNYDER: We had filed a Motion for a written statement of the grounds for the decision.

JUDGE SILBERG: Well, I just gave you an oral one. If that's not sufficient, then I guess it can be

[p.9]

transcribed. I did remember that.

MR. SNYDER: Thank you.

****

I, DIANE E. SMITH, a Notary Public in and for the State of Maryland, City of Baltimore, do hereby certify that the aforegoing was transcribed by me in a true and accurate manner.

/s/ Diane E. Smith
DIANE E. SMITH
Court Transcriber

APPENDIX E

IN THE MARYLAND TAX COURT

APPEAL NO. 08-IN-OO-0791

[Filed December 29, 2009]

BRIAN & KAREN WYNNE,	)
	)
Petitioners	)
	)
v.	)
	)
COMPTROLLER OF THE TREASURY,	)
	)
Respondent	)
	)

ORDER

This matter having come before the Court for a hearing, and the matter having been heard and considered by the Court, it is this 29th day of Dec., 2009, by the Maryland Tax Court for the reasons stated by the Court, on the record, at the conclusion of the hearing held on December 10, 2009,

ORDERED that the assessment entered by the Comptroller against the Petitioners, as affirmed in the Comptroller's Notice of Final Determination dated October 6, 2008, be and the same hereby is

AFFIRMED.

CERTIFIED TRUE COPY
TEST: John T. Hearn, Clerk

NOTICE: You have the right of appeal from the above Order to the Circuit Court of any County or Baltimore City, wherein the property or subject of the assessment may be situated. The Petition for Judicial Review MUST be filed in the proper Court within thirty (30) days from the date of the above Order of the Maryland Tax Court. Please refer to Rule 7-200 et seq. of the Maryland Rules of Court, which can be found in most public libraries.

CC: ROBERT A. SNYDER, JR., ESQ.
MATTHEW F. PENATER, ESQ.
BRIAN L. OLINER, ESQ.

APPENDIX F

Annotated Code of Maryland, Tax-General Article

§ 10-102. Imposition of tax – In general

Except as provided in § 10-104 of this subtitle, a tax is imposed on the Maryland taxable income of each individual and of each corporation.

§ 10-103. County Income Tax.

(a) *Required*. – Each county shall have a county income tax on the Maryland taxable income of:

(1) each resident, other than a fiduciary, who on the last day of the taxable year:

(i) is domiciled in the county; or

(ii) maintains a principal residence or a place of abode in the county;

(2) each personal representative of an estate if the decedent was domiciled in the county on the date of the decedent's death;

(3) each resident fiduciary of:

(i) a trust that is principally administered in the county; or

(ii) a trust that is otherwise principally connected to the county and is not principally administered in the State; and

(4) except as provided in § 10-806(c) of this title, a nonresident who derives income from salary, wages, or other compensation for personal services for employment in the county.

(b) *Limitation*. – Except for the county income tax, a county, municipal corporation, special taxing district, or other political subdivision may not impose a general local income, earnings, or payroll tax, a general occupational license tax, or a general license or permit tax based on income, earnings, or gross receipts.

§ 10-703. For Tax Paid by Resident to Another State.

(a) *In general*. – Except as provided in subsection (b) of this section, a resident may claim a credit only against the State income tax for a taxable year in the amount determined under subsection (c) of this section for State tax on income paid to another state for the year.

(b) *Exceptions*. – A credit under subsection (a) of this section is not allowed to:

(1) a resident other than a fiduciary, if the laws of the other state allow the resident a credit for State income tax paid to this State;

(2) a resident fiduciary, if the fiduciary claims, and the other state allows, a credit for State income tax paid to this State;

(3) a resident for less than the full taxable year for tax on income that is paid to another state during residency in that state; or

(4) a nonresident.

(c) *Amount of credit for resident*. – (1) Except as provided in paragraph (2) of this subsection, the credit allowed a resident under subsection (a) of this section is the lesser of:

(i) the amount of allowable tax on income that the resident paid to another state; or

(ii) an amount that does not reduce the State income tax to an amount less than would be payable if the income subjected to tax in the other state were disregarded.

(2) If the credit allowed a resident under subsection (a) of this section is based on tax that an S corporation pays to another state, the credit allowable to a shareholder:

(i) may not exceed that shareholder's pro rata share of the tax; and

(ii) will be allowed for another state's income taxes or taxes based on income.