

# Post *Wynne* Challenges: The Fate of Income Tax Credits and State and Local Tax Systems

**2018 ABA Section of Taxation May Meeting  
Washington D.C.**

Presented By:

*Moderator:* John A. Biek  
Neal, Gerber & Eisenberg LLP  
Chicago, IL  
312.269.8485  
[jbiek@nge.com](mailto:jbiek@nge.com)

*Panelists:*

Timothy P. Noonan, Esq.  
Hodgson Russ LLP  
Buffalo, NY  
716.848.1265  
[TNoonan@hodgsonruss.com](mailto:TNoonan@hodgsonruss.com)

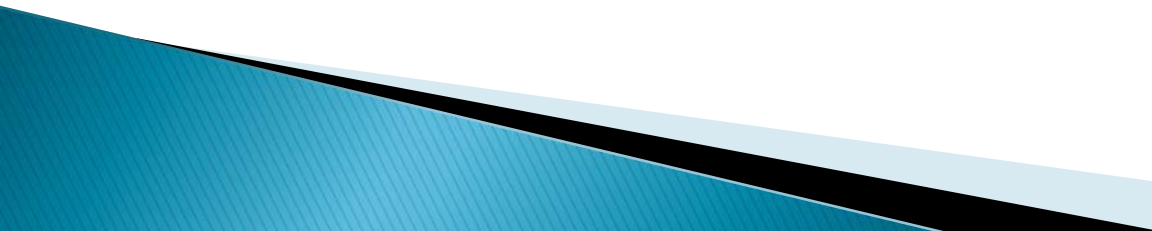
Ruth Mason  
University of Virginia  
Charlottesville, VA  
434.243.3531  
[ruth.mason@law.Virginia.edu](mailto:ruth.mason@law.Virginia.edu)

Jaye Calhoun  
Kean Miller LLP  
New Orleans, LA  
504.293.5936  
[Jaye.Calhoun@keanmiller.com](mailto:Jaye.Calhoun@keanmiller.com)


# Comptroller v. Wynne

## 135 S Ct 1787 (2015)


### Overview of the Case

- ▶ 5-4 decision by U.S. Supreme Court decided on May 18, 2015
  - ▶ MD imposed state and county-level taxes on all income of residents; allowed resident credit only against state tax
  - ▶ Held: MD's personal income tax scheme violates the dormant Commerce Clause
- 

# The Challenged Maryland Tax Scheme

- ▶ MD residents pay tax on their worldwide income
  - ▶ The tax has two components:(1) state and (2) county
  - ▶ Nonresidents only pay tax on sourced income, but they pay BOTH the state and county tax (called “special nonresident tax”)
  - ▶ Residents only allowed credit against state portion of tax
- 

# Facts in the Case

- ▶ MD residents who held stock in an S corp that operated and filed returns in 39 other states
  - ▶ Reported flow-through income from the S corp on MD income tax returns
  - ▶ Claimed resident tax credit (against both the state and county components) for taxes paid to other states
  - ▶ The MD State Comptroller disallowed credit against county component
- 

During Oral Argument before the U.S. Supreme Court, Chief Justice John Roberts observed that:

*“if each State did what we’re talking about, people who work in one State and live in another would pay higher taxes overall than people who live within one State and work in the same State.”*

# The Internal Consistency Test

- Justice Roberts was talking about the “Internal Consistency Test”
  - The Commerce Clause requires that taxes on interstate commerce be nondiscriminatory and fairly apportioned.
- This test is designed to allow us to distinguish between
  - i. a tax structure that is inherently discriminatory (bad); and
  - ii. one that might result in double taxes only as a result of two nondiscriminatory state schemes (OK)
- Past cases may have suggested that the Commerce Clause was N/A to individual income taxes; the Court laid that to waste

# Supreme Court Scorecard

- Majority: 5 Justices
  - Alito, Roberts, Kennedy, Sotomayer, Breyer
- Dissent: 4 Justices
  - Ginsberg, Scalia, Kagan
  - Thomas — separate dissent

# The Holding: MD Tax Scheme Struck Down

- ▶ MD tax scheme, which failed to provide state residents with a full credit for income tax paid to other jurisdictions, failed the internal consistency test and was therefore unconstitutional
- ▶ Explained that **the “internal consistency test” is the critical inquiry** in tax discrimination cases
- ▶ Clarified that the **protections of the dormant Commerce Clause apply to state personal income taxes:**

*“We have long held that States cannot subject corporate income to tax schemes similar to Maryland's, and we see no reason why income earned by individuals should be treated less favorably.”*



# The Internal Consistency Test




# The Internal Consistency Test

“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.”

–*Jefferson Lines, Inc.*, 514 U.S. at 185.


# Application

- ▶ Assume every state has the same rule.
  - ▶ Does interstate commerce bear a heavier burden than purely in-state commerce?
- 

# Maryland's Tax Failed the Test

	Maryland Resident	Resident of Another State
Activity in Another State	4.45%	3.2%
Activity in Maryland	3.2%	4.45%

# Virtues of the Internal Consistency Test

1. One-state inquiry
  2. Distinguishes discrimination from disparity
  3. Does not allow disaggregation of state's tax regime into separate source and residence regimes
- 

**Post-*Wynne*:**  
**The Aftermath in**  
**New York State**



# Two Post–Wynne Challenges in NYS: *Chamberlain v. NYS* and *Edelman v. NYS*

## Basic Facts :

- ▶ Taxpayers were domiciled in Connecticut
- ▶ Taxpayers were NYS statutory residents (PPA + 183 days in NY)
- ▶ Taxpayers had NY-source income
- ▶ Taxpayers had income from investments and “intangible” sources
- ▶ Connecticut taxed 100% of income
- ▶ NYS taxed 100% of income → **No credit allowed for tax paid to Connecticut on income from investments and intangibles**

# Background:

## *Tamagni v. NYS*, 91 NY2d 530 (1998)

- ▶ **Facts:** Essentially the same as *Chamberlain* and *Edelman*
- ▶ **Issue:** Does disallowance of resident credit for tax paid to home state on investment/intangible income violate the U.S. Constitution?
- ▶ **Majority Holding:** No. Constitutionality upheld because **(1)** the Commerce Clause isn't implicated by state tax on basis of residency and **(2)** even if it was implicated, the tax doesn't "facially discriminate against interstate commerce" and there's no need to apply the "internal consistency" test
- ▶ **Dissent Holding:** Yes. The tax violates the dormant Commerce Clause (and the majority is wrong) because **(1)** the Commerce Clause is implicated because the tax "substantially affects interstate commerce" and **(2)** the tax fails the internal consistency test.



# *Chamberlain v. NYS*

- ▶ Declaratory judgment action challenging the constitutionality of statutory residency provision's denial of resident credit for tax paid to other states on investment/intangible income
- ▶ Albany County Supreme Court granted motion to dismiss in favor of NYS
- ▶ The stated basis for dismissal:
  1. *Tamagni* remains controlling authority
  2. If an internal consistency analysis were necessary, New York's taxing scheme passes the test (but with no supporting analysis)
- ▶ Currently on appeal before the Appellate Division, Third Department (scheduled to be argued in September 2018)

# *Edelman v. NYS*

- ▶ Declaratory judgment action challenging the constitutionality of statutory residency provision's denial of resident credit for tax paid to other states on investment/intangible income
- ▶ NY County Supreme Court granted motion to dismiss in favor of NYS
- ▶ The court's two-pronged basis for dismissal:
  1. *Wynne* doesn't apply because the facts here are different
  2. Since *Wynne* cannot apply, *Tamagni* still controls, and therefore—on the merits—there was no violation of the Commerce Clause
- ▶ Currently on appeal before the Appellate Division, First Department (scheduled to be argued in May 2018)