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Supreme Court Rules That Dormant Commerce Clause Limits Maryland's Taxing Powers Over Its Residents.

The U.S. Supreme Court issued its long-awaited decision in Comptroller of the Treasury of Maryland v. Wynne on May 18. In a split 5-4 decision, the Court struck down as unconstitutional a feature of Maryland's income tax system because it could result in double taxation and discriminates against interstate commerce in violation of the dormant Commerce Clause.

Under Maryland's laws, residents are taxed on personal income earned both within and outside the State, and nonresidents are taxed on personal income earned only within the State. Maryland does not, however, permit its residents to take full credits for income taxes paid to other states on personal income earned outside the State. Maryland's personal income tax consists of a "state" tax component and a "county" tax component, although both components are state taxes collected by Maryland's Comptroller. Maryland allows credits to be taken for income taxes paid to other states against the Maryland "state" tax component, but not for the "county" tax component. This potentially results in double taxation of income earned by Maryland residents outside the State with respect to the "county" tax component.

The Wynnes, who are Maryland residents, earned income outside the State through their ownership interest in a Subchapter S corporation. The Wynnes paid personal income tax based on their share of the corporation's pass-through income earned in other states. On their Maryland tax return, the Wynnes claimed a credit against their Maryland personal income tax for the personal income taxes paid in those other states. The Comptroller allowed the credit as to the Maryland "state" tax component, but denied the credit as to the "county" tax component. The Wynnes challenged the denial of the credit, but lost at the administrative level. The state circuit court reversed and found the Maryland tax scheme unconstitutional under the Commerce Clause. The Court of Appeals of Maryland, the state's highest court, affirmed the lower court under the four-part test of Complete Auto Transit, Inc. v. Brady. The Maryland Comptroller sought review by the U.S. Supreme Court. Numerous amici curiae filed briefs, including the U.S. Solicitor General, the Multistate Tax Commission, and the Council On State Taxation.

In the majority opinion authored by Justice Alito—who was joined by an interesting coalition of Chief Justice Roberts and Justices Kennedy, Breyer, and Sotomayor—the Court agreed that Maryland's denial of a full credit to its residents for income taxes paid to other states is unconstitutional. In reaching that conclusion, the Court first confirmed its prior interpretation of the Commerce Clause as containing a dormant or negative command prohibiting state taxation that discriminates against or imposes excessive burdens on interstate commerce, even where Congress has not legislatively acted. "[I]t strikes at one of the chief evils that led to the adoption of the Constitution, namely, state tariffs and other laws that burdened interstate commerce." The Court found that existing dormant Commerce Clause cases "all but dictate the result," citing J.D. Adams Mfg. Co. v. Storen, Gwin, White & Prince, Inc. v. Henneford, and Central Greyhound Lines, Inc. v. Mealey. In each of those earlier cases, the Court had struck down a state gross receipts tax that could have resulted in multiple taxation of income earned outside of the state and was found to discriminate against interstate in favor of intrastate economic activity.

The Court rejected the argument that any distinction exists in the case law between gross receipts taxes and net income taxes based on gross receipts taxes being "direct and immediate" burdens on interstate commerce while net income taxes are "indirect and incidental" burdens on interstate commerce. The Court noted that current jurisprudence has replaced the "direct-indirect burdens" test with a "more practical approach" based on the economic impact of the tax. The Court also rejected Maryland's attempt to draw a distinction between corporations and individuals in applying the protection of the dormant Commerce Clause. Both corporations and individuals receive the benefit of state and local government services that are funded through the state income tax, and the Court found no reason for treating individuals less favorably than corporations.

In examining the constitutionality of Maryland's tax scheme under the dormant Commerce Clause, the Court principally relied on the "internal consistency" test adopted in Container Corp. of America v. Franchise Tax Bd. As explained by the Court, the test focuses on the structure of the tax to see whether its identical application by every state would treat interstate commerce the same as intrastate commerce. Applying the test to Maryland's tax scheme "as a whole," the Court found that it failed the test and was "inherently discriminatory and operates as a tariff" due to its unfavorable treatment of interstate commerce and the risk of double taxation of income earned outside the state.

To the surprise of some observers, the "tariff" issue was raised during oral argument by both Justices Alito and Breyer, and the majority opinion makes clear why they pursued that line of questioning. A good portion of the majority opinion was devoted to refuting arguments made in the multiple dissenting opinions.

Justices Scalia and Thomas expressed their continuing view in dissent that the dormant Commerce Clause is a "judicial fraud" because it is not part of the Constitution. Justice Ginsberg's dissent, joined by Justices Scalia and Kagan, did not dispute the majority's interpretation of the dormant Commerce Clause or its internal consistency test, but argued that the test should be inapplicable to Maryland's power to tax personal income earned by its own citizens no matter the source of the income. The majority dispensed with this argument, explaining that the dissent was confusing the requirements of the Due Process Clause, which addresses a state's jurisdiction to tax, with the dormant Commerce Clause that restricts a state from exercising its power to impose a discriminatory tax.

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The content of this article is intended to provide a general guide to the subject matter. Specialist advice should be sought about your specific circumstances.