Comptroller v. Wynne and the Futile Search for Non-Discriminatory State Taxation

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I. INTRODUCTION

In *Comptroller v. Wynne*,[1] the U.S. Supreme Court has been asked to determine whether Maryland's unapportioned income tax on resident taxpayers violates the dormant Commerce Clause because it does not offer a fully offsetting credit for income taxes that its residents pay to other jurisdictions. The case arises in the context of a unique Maryland income-tax system that bifurcates the state income-tax assessment into two components—a "state" income tax and a "county" income tax. Notably, the tax credit that the state grants its residents for income taxes that they pay to other states applies only against the state portion of that tax. Residents must always pay the county portion in full. The taxpayers in *Wynne* challenged that partial-credit system as a violation of the dormant Commerce Clause, and the Maryland Court of Appeals upheld that challenge. The court ruled that the Maryland credit mechanism resulted in a duplicative tax burden on

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1. 64 A.3d 453, 470 (Md. 2013), *cert. granted*, 134 S. Ct. 2660 (2014).

resident taxpayers who had income from sources outside of the state and that it consequently gave an unconstitutional tax preference to in-state income generation.[2]

Wynne is a particularly interesting case because it addresses the growing conflict between the federal government's historic deference for state taxing authority, especially within the realm of residency-based taxation, and the Court's more recent dormant Commerce Clause jurisprudence and the challenges presented by labor and capital dispersion in the modern economy. Though many aspects of the case are worth discussing, this Essay focuses on the Maryland court's conception of the meaning of tax discrimination and how that basic formulation is unsuitable for adoption by the Court.

Scholars have long questioned the meaning and scope of the Court's dormant Commerce Clause jurisprudence, generally, and the efficacy and advisability of the Court's unique *Complete Auto* test that applies only to challenges to state tax statutes.[3] That work identifies and analyzes the immense difficulties presented when the Court acts in this area. The Court readily admits the resulting doctrinal confusion. Indeed, the Court has referred to its decisions in this area as "tangled underbrush" and a "quagmire."[4] This Essay suggests that *Wynne* simply invites the Court back into the thicket. The standard that the Maryland court applied for evaluating tax discrimination is one that economists label "locational neutrality." Well-accepted economic theory, however, establishes that locational neutrality is not achievable under states' current taxing systems. If the Court were to adopt that standard, then, it would call into question the constitutionality of state practices that go well beyond Maryland's partial-credit system. Those practices include historically sacrosanct areas of state authority like a state's ability to set its own tax rates. This Essay consequently concludes that

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2. *Id.*

3. *See, e.g.*, Edward L. Barrett, Jr., *"Substance" vs. "Form" in the Application of the Commerce Clause to State Taxation*, 101 U. PA. L. REV. 740 (1953); Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentive for Business*, 110 HARV. L. REV. 377 (1996); Walter Hellerstein, *Is 'Internal Consistency' Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation*, 87 MICH. L. REV. 138 (1988); Walter Hellerstein et al., *Commerce Clause Restraints on State Taxation after* Jefferson Lines, 51 TAX L. REV. 47 (1995); Bradley Joondeph, *The Meaning of Fair Apportionment and the Prohibition on Extraterritoral State Taxation*, 71 FORDHAM L. REV. 149 (2002); Donald H. Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986); Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895 (1992); Edward A. Zelinsky & Brannon P. Denning, *Debate—The Future of the Dormant Commerce Clause: Abolishing the Prohibition on Discriminatory Taxation,* 155 U. PA. L. REV. PENNUMBRA 196 (2007).

4. Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 456 (1959), *cited with approval in* Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 315 (1992).

the Court must reject the Maryland court's analysis unless it is prepared to deal with protracted uncertainty and litigation in this area or to fundamentally alter the traditional taxing autonomy of the states and the relationship between the federal and state governments. Fortunately, there are ways for the Court to avoid this fate. This Essay discusses two of those options—the Court could adopt an explicitly pragmatic, legislative approach or it could avoid the anti-discrimination question all together.

This Essay proceeds in four additional parts. Part II summarizes the Maryland Court of Appeals' dormant Commerce Clause analysis and identifies and discusses its application of the principle of locational neutrality. Part III explains how the Court will be unable to achieve that neutrality absent a willingness to fundamentally restrict the historic power of states. Part IV then outlines two of the approaches that the Court could take to avoid those issues. Part V concludes.

II. TAX DISCRIMINATION UNDER *WYNNE*

As discussed above, *Wynne* presents the basic question of whether an unapportioned state income tax violates the dormant Commerce Clause if the state's residents receive only a partial credit against that tax for income taxes that they pay to other jurisdictions. Dormant Commerce Clause challenges to state taxes are generally evaluated under the test established by the Court in *Complete Auto Transit, Inc. v. Brady*.[5] In that case, the Court determined that state taxes are prohibited by the dormant Commerce Clause if they (1) apply to taxpayers who do not have a substantial nexus with the state; (2) are not fairly apportioned; (3) are discriminatory; or (4) do not fairly relate to the services provided by the state.[6]

The taxpayers in *Wynne* challenged Maryland's partial income-tax credit under the second and third prongs of the *Complete Auto* test. The Maryland Court of Appeals independently analyzed the state's tax under both of those prongs in kind,[7] but the court's analysis under each prong naturally had the exact same focus—whether a Maryland resident is taxed more heavily if she earns income from outside of the

5. 430 U.S. 274, 279 (1977). Whether the *Complete Auto* test even applies to state residency-based income taxes has been questioned by the State of Maryland. Brief for the Petitioner at *33, Md. State Comptroller of the Treasury v. Wynne, No. 13-485 (July 29, 2014) 2014 WL 3749508. This Essay will proceed on the assumption that *Complete Auto* does apply.

6. *Complete Auto*, 430 U.S. at 279.

7. Md. State Comptroller of the Treasury v. Wynne, 64 A.3d 453, 463–470 (Md. 2013), *cert. granted*, 134 S. Ct. 2660 (2014).

state than if she earns income from inside the state.[8] The court ultimately found that both prongs were violated because a Maryland resident would indeed suffer a higher tax burden if she received income from out-of-state activities than if she received that income from in-state activities.

To illustrate how this would occur, assume that Maryland imposes a 5% state tax and a 2% county tax on a particular taxpayer's income. If that taxpayer earns $1000 of wages in the state, she would owe $50 of state tax and $20 of county tax. Her total Maryland income tax liability would thus be $70. Assume, in the alternative, that she earned her $1000 of wages while working in a state with a 7% tax rate. That state would impose a $70 tax on that income on a source basis. Maryland would also impose its tax on that income on the basis of her residency in the state. Her tentative Maryland tax liability would thus still be $70, but she would get a credit against the state portion of that tax, which would amount to a $50 credit. Her aggregate tax liability in this situation would thus be $90—the $70 paid to the state where she worked and the $20 of Maryland county tax. That aggregate liability is, of course, greater than the liability that she would have faced if she had provided her services within Maryland. That increased tax burden is precisely what caused the Maryland Court of Appeals to reject the Maryland credit limitation as unconstitutional.

The Maryland court's focus is not unusual or unexpected. In fact, it is consistent with a concept that economists have long discussed as locational or capital export neutrality.[9] A neutral or non-discriminatory

8. *See id.* at 464 (finding a violation of the internal consistency test by holding that "taxpayers who earn income from activities outside of their home states would be systematically taxed at higher rates relative to taxpayers who earn income entirely within their home state"); *see also id.* at 470 (finding the state system discriminatory because it results in higher taxes for those who invest in entities that earn income out-of-state). The similarity of focus is not surprising given the unusual posture of testing whether an unapportioned tax is fairly apportioned. This is not unique to the Maryland court, though. The Supreme Court has similarly purported to apply a fair-apportionment analysis to an unapportioned tax. *See* Am. Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 284–87 (1987) (applying the internal-consistency test to Pennsylvania's flat tax imposed on trucks operating on the state's highways). In that case, the purported discrimination was against out-of-state producers rather than out-of-state production, but the Court's analysis similarly focused on the greater tax burden imposed on interstate commerce than on intrastate commerce. *See id.* (noting that the flat tax imposed a burden on out-of-state companies "that is approximately five times as heavy as the cost per mile borne by local trucks").

9. *See, e.g.*, Rueven S. Avi-Yonah, *All of a Piece Throughout: The Four Ages of U.S. International Taxation*, 25 VA. TAX. REV. 313, 325–26 (2005); Michael J. Graetz, *The David Tillinghast Lecture Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 TAX L. REV. 261, 270 (2001); Ruth Mason & Michael S. Knoll, *What is Tax Discrimination?*, 121 YALE L.J. 1014, 1041 (2012). For purposes of simplicity, the remainder of this Essay will refer to the concepts of locational neutrality and capital export neutrality simply as locational neutrality. It is also worth noting that locational neutrality is not the only neutrality

tax under the concept of locational neutrality applies such that a person will face the same tax burden whether she provides capital or services in foreign jurisdictions or in her jurisdiction of residence.[10] On our hypothetical numbers provided above, locational neutrality would require that a resident be subject to tax at her home state's rate of 7% regardless of where she earns that income. Importantly, achieving that result would require that her home state provide her with a *full* credit for taxes that she pays to other states. A partial credit would not suffice because she would necessarily face increased taxation by engaging in interstate commerce. Home state activity would thus be tax-advantaged in violation of locational neutrality.

Looking at the Maryland court's opinion in *Wynne*, it is clear that the court did not *explicitly* adopt locational neutrality as its non-discrimination standard. It did, however, implicitly test the state's partial-credit system against a locational-neutrality ideal. The court's discrimination analysis first noted that the Wynnes "may be taxed at a higher rate on income earned [out of state] than on income earned though [sic] [their] Maryland activities."[11] The court was also concerned that the state's "failure to provide a credit against the county tax . . . penalizes investment in a Maryland entity that earns income out-of-state"[12] and that, as a consequence, "[t]he more a Maryland business can locate its value-creating activities within Maryland the less it will be taxed."[13] The court then held that the Maryland partial credit was unconstitutionally discriminatory based only on those observations.[14] The court's decision thus rested on the existence of an increased tax burden on Maryland taxpayers who have out-of-state economic activity—the focus of locational neutrality.

The import of recognizing the Maryland court's focus on locational neutrality in its non-discrimination analysis is that we can benefit from scholars' analyses of locational neutrality more broadly. That work shows that, although the Maryland court's approach seems

concept. In addition to locational neutrality, economists have identified other neutrality frameworks, including capital import neutrality and capital ownership neutrality. *See* Jane G. Gravelle, *Does the Concept of Competitiveness Have Meaning in Formulating Corporate Tax Policy?*, 65 TAX L. REV. 323, 326–37 (2012) (discussing the various neutrality conceptions); Mason & Knoll, *supra* at 1041–42 (briefly describing these three neutrality frameworks). A full discussion of these neutrality conceptions is well beyond the scope of this Essay, but suffice it to say that achieving neutrality under any of them would require significant modifications to states' taxing systems.

10. Graetz, *supra* note 9, at 270; Mason & Knoll, *supra* note 9, at 1043.

11. *Wynne*, 64 A.3d at 469.

12. *Id.* at 470.

13. *Id.*

14. *Id.*

perfectly logical on its face,[15] locational neutrality is actually not a workable constitutional standard under the current structure of our federal system. Needless to say, that is problematic if it is to be applied as the standard for tax discrimination under the dormant Commerce Clause.

III. THE INCOMPATIBILITY OF LOCATIONAL NEUTRALITY AND STATE TAXING AUTONOMY

The concept of locational neutrality is well developed and has been applied in a significant body of scholarship addressing the question of tax neutrality and the role of tax discrimination in international taxation. That scholarship establishes that locational neutrality is virtually impossible to achieve in a system where national or subnational taxing authorities act autonomously. Indeed, locational neutrality requires either (1) complete tax harmonization (i.e., all states adopt the same tax rates and tax bases); (2) residence-only taxation (i.e., source states give up the right to tax income earned within their boundaries); or (3) worldwide taxation with fully refundable credits for source-state taxes.[16] Achieving the first would require a historic level of cooperation among states, which will not occur without a federal mandate.[17] The second is similarly unrealistic and inconsistent with state taxing autonomy. The third is much closer to our current system, but with one major caveat.

To achieve complete locational neutrality in a system with worldwide (nationwide) taxation, resident states must *fully* equalize their residents' tax burdens when they work or invest in and out of the state. Obtaining that result can require more than one might think. To fully equalize tax burdens, for example, a resident state that imposes a tax rate that is lower than that of a foreign[18] jurisdiction must not only

15. The pursuit of capital export neutrality over capital import neutrality is in accord with the predominant preference of economists. *See* Graetz, *supra* note 9, at 272; Mason & Knoll, *supra* note 9, at 1041 (noting that capital import neutrality "does not have many advocates among policymakers or economists"). It also accords with at least one positive account of the Court's dormant Commerce Clause jurisprudence with respect to state taxes. *See* 1 JEROME R. HELLERSTEIN, WALTER HELLERSTEIN & JOHN A. SWAIN, STATE TAXATION ¶ 8.01[1][a], at n.39 (3d ed. 1998) (stating that "[p]ut in terms of international income tax parlance, the Commerce Clause requires capital export neutrality . . . not capital import neutrality").

16. Mason & Knoll, *supra* note 9, at 1046.

17. Theoretically, that mandate could come from the Court or from Congress. Given the current state of affairs, however, it seems unreasonable to suggest that Congress would interject itself in that way.

18. Of course, in the U.S. state-taxation context, a "foreign" jurisdiction is simply another state.

reduce its tax on income from that foreign source to zero, it must also provide taxpayers with refunds to reduce their overall tax burdens to the state's lower rate.[19] Assume, for example, that a taxpayer's home state has a tax rate of 5% and that the source jurisdiction has a tax rate of 7%. If a taxpayer paid that 7% tax, locational neutrality would require that the home state *refund* her the extra 2% and bring her total tax burden down to 5%. Absent that payment, the state would still be discriminating against interstate commerce within the locational-neutrality framework. Home-state production would be given a tax preference.

Of course, no states offer such refundable credits. To do so would be to simply provide subsidies to their higher-tax brethren. This practice, however, could come into question if the Court were to blindly adopt locational neutrality as the constitutional standard for non-discrimination under the dormant Commerce Clause. Absent a fully equalizing credit, residents of lower-tax states would necessarily face increased taxation by engaging in interstate commerce with higher-tax states.[20] In the alternative, assuming that the Court were not inclined to require states to subsidize their higher-tax neighbors with fully offsetting credits, the lower tax rates themselves would be unconstitutionally discriminatory under a pure locational-neutrality standard.[21]

Lest one think that the practical difficulties with achieving locational neutrality could be avoided by simply not requiring that states provide refundable credits, it is important to note that other credit limitations similarly prevent states from achieving that goal. For example, many states allow their residents tax credits for taxes paid to another state only if the *resident state's own rules* would have

19. Hugh J. Ault & Jacques Sasseville, *Taxation and Non-Discrimination: A Reconsideration*, 22 WORLD TAX J. 101, 102 n.2 (2010); Mason & Knoll, *supra* note 9, at 1047 n.123.

20. One need look no further than the briefing in *Wynne* to see this very argument being accepted and made in support of the Wynnes. *See* Brief of the Maryland Chamber of Commerce as Amicus Curiae in Support of Respondents at *23–24, Md. State Comptroller of the Treasury v. Wynne, No. 13-485, (Sep. 26, 2014), 2014 WL 4895274 (arguing that Maryland's "taxing scheme is also facially discriminatory" because it "discriminates against shareholders and their corporations seeking to compete in high-tax markets" and because it "plac[es] economic pressure on residents to keep their business activities confined to the local market" and thus denies taxpayers the "opportunity to make 'tax neutral' decisions"). The amici's focus shows precisely where locational neutrality leads us—a futile journey into the tangled underbrush. For the reasons discussed herein, the Court simply cannot eliminate tax discrimination if achieving that goal requires that states make business decisions "tax neutral."

21. *See* Edward A. Zelinsky, Wynne *and the Double Taxation of Dual Residents*, 73 ST. TAX NOTES 259, 264–65 (2014) (noting this possibility under the Maryland court's neutrality conception).

apportioned income to that other state.[22] It is immaterial that the taxpayer actually paid taxes to that other state in accordance with her legal obligation. The resident state would not grant a credit for such taxes because, in its view, allowing a credit in that situation would be ceding taxing authority over in-state income to the foreign jurisdiction.[23] This type of credit limitation is certainly logical, but it violates locational neutrality just as do non-refundable credits because it results in an additional tax burden for resident taxpayers engaging in interstate commerce. As a consequence, if the Court were to adopt locational neutrality as its non-discrimination standard, these state credit mechanisms would be unconstitutional as well.

Of course, the issues presented by adopting a locational-neutrality standard go much further. Achieving true locational neutrality would require an analysis of the *aggregate* tax burdens imposed on interstate commerce and would also require a look into the offsetting benefits provided by states.[24] Focusing on the neutrality impacts of a single tax is convenient, but ignores whether a state's policies cumulatively provide an unconstitutional preference to in-state activity.[25] Considering these issues, however, would lead the Court only deeper into the thicket.

The totality of this discussion establishes that the Maryland court's conception of non-discrimination does not provide a workable constitutional standard. True locational neutrality is possible only if the Court completely abandons its historic deference to state taxing autonomy and mandates either that states harmonize their tax systems (including their tax rates) or that states provide comprehensive, fully refundable credits to their residents. Either of those mandates would

22. HELLERSTEIN ET AL., *supra* note 15,, at ¶ 20.10[2]. Other states only allow credits for state-level taxes paid, but not for taxes imposed by sub-state governmental units like cities or counties. *See e.g.*, IDAHO ADMIN. R. 35.01.01.700.05 (2014); W. VA. CODE OF STATE RULES § 110-21-20.1 (2014). Those limitations violate locational neutrality in the same way as the Maryland partial-credit mechanism.

23. This is consistent with how the federal government limits foreign tax credits. *See* 26 U.S.C. § 904 (2012).

24. *See* Shaviro, *supra* note 3, at 907–09 (addressing the argument that differential government services may offset locational neutrality concerns, but concluding that "the difficulty of measuring the cost or value of government services received by different persons or in different areas" makes it reasonable to focus on the impact of tax rates on locational neutrality).

25. This analysis naturally starts to merge with ongoing debate regarding the overall efficacy of the Court's regulation of state taxation under the dormant Commerce Clause, including the practical difference (or lack thereof) between tax subsidies and direct subsidies. That discussion, however, goes well beyond the scope of this Essay. Interested readers can find many discussions of these issues. *See, e.g.*, Dan T. Coenen & Walter Hellerstein, *Suspect Linkage: The Interplay of State Taxing and Spending Measures in the Application of Constitutional Antidiscrimination Rules*, 95 MICH. L. REV. 2167 (1997); Enrich, *supra* note 3; Zelinsky & Denning, *supra* note 3.

represent such a fundamental shift in the role of the Court in state taxing matters that it is nearly impossible to consider as a realistic outcome in *Wynne*.

Of course, none of this analysis is intended to suggest that *no* theory would justify the Court striking down the Maryland partial-credit mechanism.[26] Rather, it is intended to merely make clear that doing so would require the Court to find a rationale other than the one followed by the court below. The Court cannot blindly pursue locational neutrality.

IV. AVOIDING THE THICKET

Given the issues noted above, it may seem as though the Court is destined to find itself embroiled in a futile attempt to provide a theoretically sound non-discrimination standard. That conclusion is certainly correct in so far as the Court (1) is inclined to follow a locational-neutrality principle but (2) is not simultaneously inclined to infringe upon states' historic taxing autonomy. However, there are many approaches that the Court could adopt to avoid that difficulty.[27] This Essay will briefly discuss two of those approaches.

26. Professors Knoll and Mason argue that the Court should invalidate the Maryland partial-credit mechanism because it violates the internal-consistency component of the Court's fair-apportionment requirement and a concept that they have labeled as "competitive neutrality." *See* Brief of Michael S. Knoll and Ruth Mason as Amici Curiae in Support of Respondents at *9–18, Md. State Comptroller of the Treasury v. Wynne, No. 13-485, (Sep. 20, 2014), 2014 WL 4895269 (citing Mason & Knoll, *supra* note 9) [hereinafter Brief of Michael S. Knoll and Ruth Mason]. There is an ongoing debate regarding the validity of the concept of competitive neutrality. *See generally* Michael J. Graetz & Alvin C. Warren, Jr., *Income Tax Discrimination: Still Stuck in the Labyrinth of Impossibility,* 121 YALE L.J. 1118 (2012); Ruth Mason & Michael S. Knoll, *Waiting for Perseus*, 67 TAX L. REV. 375 (2014). The purpose of this Essay is not to enter that debate, but the Court should understand that achieving "neutrality" under any pure economic formulation requires more than can be reasonably expected under our current federal structure. Even Professors Knoll and Mason note that achieving competitive neutrality, in the absence of global tax harmonization, would require states to either provide unlimited credits for source-state taxes or to adopt what they call an "ideal deduction" or the "ideal deduction method." Mason & Knoll, *supra* note 9, at 1060–72. This brings us back to the same point—neutrality cannot be achieved under this standard unless the Court was to infringe upon states' historic taxing autonomy.

27. Notable among these is that the Court could limit the discrimination prong to cases of facial discrimination or it could simply abandon its application of the dormant Commerce Clause to state taxes all together. These positions, of course, would not be new to the Court. *See* Camps Newfound/Owatonna v. Harrison, 520 U.S. 564, 610 (1997) (Thomas, J., dissenting); Goldberg v. Sweet, 488 U.S. 252, 271 (1989) (Scalia, J., concurring); Am. Trucking Ass'ns, Inc. v. Scheiner, 483 U.S. 266, 303–06 (1987) (Scalia, J., dissenting); *see also* Am. Trucking Ass'ns, Inc. v. Mich. Pub. Serv. Comm'n, 545 U.S. 429, 439 (2005) (Thomas, J., concurring) (quoting Hillside Dairy Inc. v. Lyons, 539 U.S. 59, 68 (2003)).

A. Pragmatic Non-Discrimination Principle

One straightforward option for the Court to avoid the difficulties that would result from the pursuit of locational neutrality would be for it to simply reject that futile goal and to instead adopt an imprecise standard as a matter of simple pragmatism.[28] Such an approach may seem unsatisfying or incomplete at first blush, but it would not be new for the Court. Indeed, the Court has previously recognized that achieving academic tidiness may take a back seat to providing a clear, workable standard with respect to state taxing authority. For example, in adopting its physical-presence rule under the substantial-nexus requirement of *Complete Auto*, the Court explicitly noted that its bright-line rule was artificial.[29] The Court was comforted, however, by the putative benefits that a bright-line rule provided, including the reduction of litigation and the provision of clear guidance to states.[30]

The Court could follow this approach for purposes of its non-discrimination analysis as well. The Court could recognize neutrality as the normative ideal, but provide explicit limitations on how far states must actually go. For example, the Court could require states to provide full credits for source-state taxes, but not require them to provide *refundable* credits. In doing so, it could use locational neutrality as its guidepost, but explicitly reject it as the constitutional standard. Of course, this approach would still require the Court to adopt a method for evaluating *other* state policies that prevent full locational neutrality, like differential apportionment mechanisms.[31] The key, however, would be that the Court would adopt a clear rule based on pragmatic concerns rather than on a theoretical neutrality norm that is unachievable. Such an approach would provide much more valuable guidance for taxpayers, taxing authorities, and lower courts and would reduce future litigation

28. There is, of course, a deeper debate regarding the role of pragmatism in constitutional adjudication. Without getting into that debate, I suggest that a pragmatic approach is less controversial when the Court is already determined to act in a quasi-legislative role under the dormant Commerce Clause.

29. Quill Corp. v. North Dakota *ex rel.* Heitkamp, 504 U.S. 298, 315 (1992).

30. *Id.*

31. Walter Hellerstein suggests that state credit mechanisms should be evaluated based upon their "reasonableness" and that the "Commerce Clause has a role to play" when states adopt sourcing rules that "run[] counter to generally accepted norms of source." HELLERSTEIN ET AL., *supra* note 15, at ¶ 20.10[2][b] (internal quotations omitted). This type of standard might resolve *Wynne*, but would hardly offer sufficient guidance to states going forward. It is also inconsistent with the Court's historic approach, which has refused to base the constitutionality of one state's tax on the structure of other states' taxes. *See* Moorman Mfg. v. Blair, 437 U.S. 267, 276–81 (1978) (declining to hold one state's apportionment method unconstitutional because its lack of uniformity with other states could have resulted in double taxation). This approach is therefore not without fault, but it could be considered as a model of a more practical approach.

in this area.[32] That approach would thus be preferable to one based on the pursuit of true locational neutrality.

B. Reserving the Question for Another Day

The meaning of tax discrimination is a difficult and contentious question that is currently receiving significant academic attention. Addressing that question on the facts presented in *Wynne* could produce a result that fundamentally alters the relationship between the federal and state governments and that undermines the historic taxing autonomy held by the latter. It may thus behoove the Court to hold the question for another day. Indeed, the precise issue raised by this case came into existence due to a highly unusual credit mechanism adopted by a single state. Political forces may work to sufficiently constrain other states from taking similar actions. To close this Essay, then, I wish to quickly discuss one additional avenue that the Court could take to decide the case without actually addressing the anti-discrimination question—the Court could simply hold that states have no obligation to harmonize their residency-based income taxes with source-based income taxes.[33]

This approach is initially concerning because it would explicitly permit greater tax burdens on persons engaged in interstate commerce than on those engaged in intrastate commerce. Notably, however, this would not be as unique as some might suggest because the Court has never required neutrality or harmonization of state tax systems at large. States are generally allowed to compete for business and residents through the provision of public goods and favorable taxing

32. In this vein, the Court could simply rely on its internal-consistency test. Following that test would not, in and of itself, ensure absolute neutrality, but its results may be similar enough. *See* Brief of Michael S. Knoll and Ruth Mason, *supra* note 26, at *9–18 (discussing the similarity in results when applying the internal-consistency test and the concept of competitive neutrality). Of course, adopting internal consistency as the standard for evaluating tax discrimination would collapse the non-discrimination requirement into the fair-apportionment requirement. One could thus fairly question whether *Complete Auto*'s third prong would serve merely to prohibit facially discriminatory tax statutes in accord with Justice Scalia's interpretation. *See supra* note 27.

33. Petitioner and supporting amici have suggested this theory as the proper method for resolving *Wynne*. *See* Brief for the Petitioner at *30–32, *37–39, Md. State Comptroller of the Treasury v. Wynne, No. 13-485 (Jul. 29, 2014), 2014 WL 3749508; Brief of the United States as Amicus Curiae in Support of Petitioner at *10–15, Md. State Comptroller of the Treasury v. Wynne, No. 13-485 (Aug. 1, 2014), 2014 WL 3811118; Brief of the Multistate Tax Commission as Amicus Curiae in Support of Petitioner at *11–15, Md. State Comptroller of the Treasury v. Wynne, No. 13-485 (Aug. 5, 2014), 2014 WL 3943824. Of course, this approach would only make sense if the Court were inclined to reverse the lower court and uphold Maryland's partial-credit system. If the Court were inclined to affirm the decision below, it could avoid the tax-discrimination issue by striking down the Maryland system based solely on the Wynne's fair-apportionment challenge.

structures. Texas and Florida are two notable examples of states that have foregone an income tax in favor of greater reliance on other taxes. A Florida resident consequently faces a greater aggregate tax burden if, instead of working in Florida, she provides services in Georgia and must pay Georgia's income tax in addition to her Florida taxes. Florida's decision to forgo an income tax thus creates a disincentive for its residents to provide services outside of the state. That type of locational non-neutrality, however, has never been considered as one involving a dormant Commerce Clause issue.

Indeed, neutralizing any and all location-based tax differentials would require uniformity to a degree completely incompatible with our federal system. In lieu of traveling down that rabbit hole, the Court has historically evaluated taxes' impacts on interstate commerce in isolation. The Court thus analyzes state corporate income-tax provisions with respect to how they impact taxpayers' aggregate state corporate income-tax burdens.[34] The Court has similarly required that states design gross receipts taxes to minimize the risk of duplicative taxation on those gross receipts.[35] The Court has not, however, required that states ensure that different types of taxes do not interact to create duplicative tax burdens. Rather, the Court has explicitly recognized that duplicative taxation resulting from the imposition of different types of taxes provides "no basis for complaint" even though the "actual burden on interstate commerce would [be] the same."[36] The Court's narrow focus on a single type of tax ignores economic reality, but is a concession to the Court's limited institutional capacity to broadly evaluate the aggregate impact of state taxation and spending programs.

The import of recognizing this limitation is that the Court could follow this more limited neutrality approach in *Wynne* by recognizing that state residency-based taxes are simply not equivalent to states' source-based income taxes. If the Court adopted that position, Maryland would be under no more of an obligation to provide a credit against its residency-based income tax for source-state income taxes than it would be to provide such a credit for other states' consumption or property taxes. The Maryland partial credit would therefore fall

34. *See* HELLERSTEIN ET AL., *supra* note 15, at ¶ 8.02.

35. Tyler Pipe Indus., Inc. v. Wash. Dep't of Rev., 483 U.S. 232 (1987).

36. *Moorman*, 437 U.S. at 280–81. Indeed, if Maryland had decided to tax S-corporations instead of respecting their pass-through status, the taxpayers in *Wynne* would have faced double taxation on their income from that entity, partly due to the classic double taxation that results solely from the addition of a corporate level of tax. Query, then, whether Maryland should be required to give the Wynnes a full tax credit, and eliminate their double taxation completely, simply because it chose to eliminate some of their potential double taxation. Having given them an inch, is it constitutionally required to give them the proverbial mile?

outside of the scope of the Court's anti-discrimination and fair-apportionment requirements and would not be constitutionally infirm.

The efficacy of this approach of course depends on whether residency- and source-based income taxes are indeed sufficiently different to warrant this treatment. They may just be. Residency taxes have been imposed throughout American history and have been consistently upheld by the Court under the Due Process Clause.[37] The rationale for residency taxes is based on the wide range of benefits that states provide to their residents. In contrast, source-state income taxes are based upon the source state's relationship to the nonresident's income. Source states generally provide the opportunity to earn income through access to a stable market, but provide none of the personal benefits that residency affords. Thus, although the *measure* of the tax is similar, the *object* is very different.[38]

This approach may also have value aside from allowing the Court to avoid the difficult tax-discrimination question. This case presents the Court with a stark reminder of the costs of tax neutrality. Achieving locational neutrality through full credits would mean that resident taxpayers could completely eliminate the income taxes that they owed to their resident states by paying an equivalent tax to a foreign jurisdiction. That result might create tax neutrality, but it might also fail to reflect the vast benefits that states provide to their residents. It could permit taxpayers to obtain all of the values of residency without sharing in the cost. Viewed in this way, the Maryland partial-credit mechanism could be justified as an attempt to ensure that all residents pay *something* in exchange for their residency benefits.[39]

This is not to say that this approach is without concern. To the extent that states are not required to harmonize their residency-based income taxes and source-state income taxes, taxpayers' incomes could be included in multiple tax bases. States across the nation could also completely eliminate the credits that they allow their residents for source-state taxes, which could have a substantial negative impact on interstate commerce. Of course, political forces would likely provide

37. HELLERSTEIN ET AL., *supra* note 15, at ¶ 20.04[1].

38. This distinction between the object of a tax and the measure of a tax has previously been offered as a basis on which the Court could base its dormant Commerce Clause doctrine. *See generally* Jesse H. Choper & Tung Yin, *State Taxation and the Dormant Commerce Clause: The Object-Measure Approach*, 1998 SUP. CT. REV. 193 (1998). The idea that residency-based income taxes and source-based income taxes are conceptually two different taxes is not new. *See* Glenn W. Fisher, *Toward a Theory of Personal Income Tax Jurisdiction*, 33 TAXES 373, 380–81 (1955) (suggesting a dual-tax theory).

39. *See* Brief for the Petitioner, *supra* note 5, at *20–24 (describing the benefits provided by the State of Maryland to its residents).

significant pressure against those moves because the elimination of credits would directly impact in-state residents who presumably have political voice and recourse.[40] Such a fundamental shift in state policy could also attract the attention of Congress, which has plenary power over matters impacting interstate commerce. In the end, this option carries risk, but political forces may mitigate the real danger to a significant degree.

V. CONCLUSION

The issues raised by *Wynne* are significant and difficult. This Essay simply suggests that the Court should be very aware that the Maryland court's non-discrimination analysis leads down a primrose path. The Maryland court adopted a locational-neutrality concept that simply is not an achievable goal and that leads to significant questions regarding other state credit practices. The Court would need to fundamentally alter the current status of state taxing autonomy if it were to simply affirm the lower court's decision. In the alternative, the Court could explicitly adopt a theoretically deficient, but pragmatic, non-discrimination standard or it could avoid the issue all together. If it chooses to avoid the issue, perhaps the historic and practical differences between residency-based income taxes and source-based income taxes are sufficient to justify wider state discretion in crafting the former.

40. *See generally* Zelinsky, *supra* note 21 (discussing the political aspects of the Court's dormant Commerce Clause jurisprudence).