

SALT ALERT – US SUPREME COURT DECISION IN WYNNE MAY IMPACT TAXPAYERS OUTSIDE OF MARYLAND

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The United States Supreme Court, in a 5-4 decision, recently issued its decision in *Comptroller of the Treasury of Maryland v. Wynne et ux*. According to the Court, Maryland's personal income tax scheme violates the dormant Commerce Clause of the Constitution of the United States.

The impulse to interpret this ruling, on its surface, as simply *double taxation is unconstitutional* is understandable. From a thorough review of the Court's analysis and decision, however, taxpayers resting on this impulse may be left waiting only for answers.

The *Wynne* case involves the constitutionality of an unusual feature of Maryland's personal income tax scheme. The income tax that Maryland imposes upon its own residents has two parts: a "state" income tax, which is set at a graduated rate, and a so-called "county" income tax, which is set at a rate that varies by county but is capped at 3.2%. Despite the names that Maryland has assigned to these taxes, both are State taxes, and both are collected by the State's Comptroller of the Treasury.

Of course, some Maryland residents earn income in other States, and some of those States also tax this income. If Maryland residents pay income tax to another jurisdiction for income earned there, Maryland allows them a credit against the "state" tax but not the "county" tax. As a result, part of the income that a Maryland resident earns outside the State may be taxed twice.

Maryland also taxes the income of nonresidents. This tax has two parts. First, nonresidents must pay the "state" income tax on all the income that they earn from sources within Maryland. Second, nonresidents not subject to the county tax must pay a "special nonresident tax" in lieu of the "county" tax. The "special nonresident tax" is levied on income earned from sources within Maryland, and its rate is equal to the lowest county income tax rate set by any Maryland county. Maryland does not tax the income that nonresidents earn from sources outside Maryland.

The Wynnes earned income passed through to them from an S corporation of which they were shareholders. On their Maryland tax return, they claimed an income tax credit for the income taxes they paid to other States. Petitioner, the Maryland State Comptroller of the Treasury, allowed a credit against the state portion of income tax but not against the county portion of income tax, and they assessed a tax deficiency. The United States Supreme Court, in the *Wynne* holding, held this taxing scheme unconstitutionally discriminated against interstate commerce. The Court reached this decision, chiefly, by applying the internal consistency test, which helps courts identify tax schemes that discriminate against interstate commerce.

Potential Tax Planning

As a result of this decision, taxpayers in other states and localities who have their taxes doubled with no applicable credits may seek refunds for similar double taxation found in *Wynne*. For example, a domiciliary of New York State and City that earns income from sources outside of New York State will receive a credit from New York State based on the portion of taxes paid on the income sourced to the other State, but the taxpayer will not receive a credit from New York City for any portion of taxes paid to the other State. In addition, Yonkers imposes a tax on nonresidents without offering them a credit for other state taxes paid.

In both scenarios, the taxpayer is paying double taxes, and the Yonkers tax is similar to the Maryland county tax under *Wynne*. Taxpayers under these circumstances may, therefore, wish to consider applying for a refund for all open years under the three year statute of limitations.

However, while the New York State Department of Taxation and Finance collects the New York City income tax, not every resident of New York State is subject to the New York City income tax. Since the New York City tax does not tax nonresidents like the county tax in Maryland does, the New York City taxing scheme may be constitutional based on the *Wynne* decision.

Lastly, while there is also a double tax in the instance of a taxpayer who is a domiciliary of New York State and City and a statutory resident of another State, with respect to the taxes paid on unearned income, the *Wynne* case provides no insight for such taxpayers as to the constitutionality of such a taxing scheme. What is more, New York's highest court ruled on the constitutionality of this double taxing scheme in *In the Matter of John Tamagni v. Tax Appeals Tribunal of the State of New York*, 91 N.Y. 2d 530 (1998), holding that New York State's taxing scheme did not fail the internal consistency test and thus was constitutional.

Since *Wynne* did not address the matter of dual-residency taxing schemes, New York State and City are likely to push back and not grant any refunds. A taxpayer's recourse under such circumstances may be to file a refund claim and if denied, seek a legal determination from the State courts as to the constitutionality of New York's taxing scheme.

Even though the Court in *Wynne* did not address the issue of statutory resident taxpayers, the *Wynne* case may render the *Tamagni* decision inapplicable since the New York court did not think the dormant Commerce Clause applied to personal income taxes. The US Supreme Court in *Wynne* was very clear that the dormant Commerce Clause applies to personal income taxes.

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