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TAX & WEALTH ADVISOR ALERT: UNITED STATES SUPREME COURT DECLARES MARYLAND TAX SCHEME UNCONSTITUTIONAL

On Monday, May 18, 2015, in *Comptroller of the Treasury of Maryland v. Wynne*, the United States Supreme Court declared Maryland's income tax scheme unconstitutional. The Supreme Court justices voted 5 to 4 to affirm a Maryland Court of Appeals ruling that Maryland's income tax scheme results in improper double taxation on income earned in other states and creates an incentive for taxpayers to opt for intrastate versus interstate economic activity.

Like most states, Maryland imposes a personal income tax on income earned both within the state of Maryland and in other states. Maryland's income tax is imposed on its residents in the form of both a state income tax and a so-called "county" income tax. Because income is also taxed in the state where it is earned, state tax laws usually give residents a full credit for income taxes paid on their out-of-state earnings to prevent double taxation. Maryland, however, allows its residents a credit against state income taxes, but not "county" income taxes. As a result, some of the income earned by Maryland residents outside the state of Maryland is taxed twice; once in the state where it is earned, and again in Maryland where the credit is withheld.

The Commerce Clause of the Federal Constitution gives Congress the power to regulate commerce among the states. The United States Supreme Court reasoned that the dormant Commerce Clause prohibits a state from taxing a transaction or incident more heavily when it involves commerce across state lines than when it occurs entirely within the boundaries of one state, and further prohibits a state from imposing a tax which discriminates against interstate commerce by, among other things, subjecting interstate commerce to multiple taxations.

Maryland argued that it has the right to tax the income of its residents, regardless of where it is earned, under the due process clause of the Constitution. It argued that withholding the credit from the "county" income tax would require all residents to pay an equitable share for local government services. The Court rejected this argument, stating that states have historically offered a similar credit for out-of-state taxes paid by corporations, which are also beneficiaries of such government services.

The Court notes that the Maryland tax scheme fails what has been termed the “internal consistency test.” The test analyzes whether interstate commerce would be at a disadvantage as compared with intrastate commerce if every state adopted the tax scheme in question. Because residents earning income from outside state would pay more in income taxes than residents who earned income solely within the state, the Court found such tax scheme to be “inherently discriminatory” and operating as a tariff.

According to the Court, by giving less than a full credit to its residents for income earned and taxed in other states, Maryland’s income tax scheme violates the dormant Commerce Clause.

In addition to significant loss of future revenue as a result of the Court’s decision, individuals who tried to claim the credit on their county income tax returns in the last several years may be entitled to refunds, which could cost several million dollars. Additionally, other states, such as New York and Pennsylvania, have schemes similar to the one ruled unconstitutional in Maryland. The Court’s decision will doubtless have significant and far-reaching economic consequences.

If you have any questions, please contact Attorney Megan O. Harried at O’Neil, Cannon, Hollman, DeJong & Laing S.C. at 414-276-5000.