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by Michael S. Knoll and Ruth Mason

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In this report, the authors respond to an article by professor Edward Zelinsky that recently appeared in *State Tax Notes*.

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In the November 13, 2017, issue of *State Tax Notes*,¹ professor Edward Zelinsky disagreed with our conclusion that the U.S. Supreme Court's

¹ Edward A. Zelinsky, "Double Taxing Dual Residents: A Response to Knoll and Mason," *State Tax Notes*, Nov. 13, 2017, p. 677.

reasoning in *Wynne* makes clear that New York's tax residence rule unconstitutionally violates the dormant commerce clause. The dormant commerce clause forbids state tax rules that discriminate against cross-border commerce, which, as the Supreme Court has long acknowledged, occurs when state tax rules discourage cross-border commerce relative to in-state commerce.

Zelinsky objects that *Wynne* is enigmatic because "its central conclusion — that tarifflike state tax polices discriminate for dormant commerce clause purposes — has no discernable limit." But the Supreme Court has confirmed that we can ferret out income taxes that function as tariffs via the easy-to-apply internal consistency test.² We have explained in other work both the connection between the internal consistency test and tariffs and how the internal consistency test can be applied to identify discriminatory tax policies.³

Tax rules violate the internal consistency test when, if imposed by every state, they would lead inevitably to double taxation. One of the advantages of the internal consistency test is that it allows a court to determine the constitutionality of a state tax by looking at that state's tax rules in isolation. It is not necessary for a court to consider how New York's state tax laws interact with New Jersey's — or Wyoming's — state tax laws.

² *Comptroller of the Treasury v. Wynne*, 135 S. Ct. 1787 (2015).

³ See Michael S. Knoll and Ruth Mason, "The Economic Foundation of the Dormant Commerce Clause," 103 *Va. L. Rev.* 309 (2017). We have sympathy for the other points Zelinsky makes — including that there is no compelling reason to treat subsidies differently from taxes under the dormant commerce clause. Although the different legal treatments of discriminatory taxes and discriminatory subsidies may not be satisfying intellectually, we disagree that it makes the dormant commerce clause limitless.

For the reasons we explained earlier, New York's residence rules are internally inconsistent.⁴ If all 50 states adopted New York's tax residence rules, dual residents would always be double-taxed on their income from intangibles.⁵ As a result, under the reasoning of *Wynne*, New York has a constitutional problem.

Moreover, the *Wynne* ruling is neither incoherent nor as broad as Zelinsky suggests. Zelinsky gives the example of Maryland reducing its personal income tax rate, which, as he points out, would encourage Maryland residents to retain more of their money at home (to take advantage of the reduced tax rate). According to Zelinsky, the Maryland rate reduction would operate as a tariff (because it encourages residents to invest at home) and would under the logic in *Wynne* be unconstitutional — even though to hold such a tax reduction unconstitutionally discriminatory would cause the *Wynne* majority to “recoil.”⁶

Such a bizarre result, however, is neither implied nor compelled by *Wynne*, which dictates the opposite result. An across-the-board rate reduction would not fail the internal consistency test. If, for example, Maryland reduced its personal income tax rate from 5 percent to 4 percent, then, applying the internal consistency test, all other states also would be assumed to tax personal income at 4 percent. Assuming Maryland either (1) taxed only in-state income or (2) taxed the in-state income of nonresidents and the worldwide income of residents and offered residents a full credit (a credit of up to 4 percent) for taxes paid to other states, then in-state and cross-border income would both be taxed at 4 percent, and hence the Maryland tax would be internally consistent.

Such a tax would not be discriminatory because it would not discourage cross-border commerce *relative to* in-state commerce. The

hypothetical Maryland tax change would encourage *both* residents and nonresidents to earn income in Maryland. In contrast, a discriminatory Maryland tax would simultaneously both *encourage* Maryland residents to earn income in Maryland and *discourage* Maryland nonresidents from earning income in Maryland. It is the simultaneous occurrence of those two opposing effects on residents and nonresidents that is the tarifflike impact that the internal consistency test ferrets out, and that is at the heart of a discrimination claim. Those opposing effects occurred in *Wynne*; they occurred in *Tamagni*;⁷ but they do not occur in Zelinsky's hypothetical.⁸

As for Zelinsky's claim that Supreme Court precedent would make it difficult for the Court to strike down New York's residence rule, neither *Worcester County Trust* nor *Cory v. White*, the cases Zelinsky cited as “standing in the way” of applying *Wynne* to New York's tax residence rule, involved the dormant commerce clause.⁹ Both involved executors' unsuccessful attempts to invoke the Federal Interpleader Act to dispose of two states' potentially conflicting claims of domicile over the same decedent.

In both cases, the Supreme Court held that the 11th Amendment barred the Court from preventing the state courts from coming to their own determinations as to the domicile status of the decedents, even though those determinations might conflict with each other. According to *Worcester County*, the executor's argument demanding interpleader “confuse[d] the possibility of conflict of decisions of the courts of the two states, which the Constitution does not forestall, with other types of action by state officers which, because it passes beyond the limits of a lawful authority, is within the reach of the federal judicial power, notwithstanding the Eleventh Amendment.”¹⁰ The *Worcester County* Court observed that neither due process nor full

⁴Knoll and Mason, “New York's Unconstitutional Tax Residence Rule,” *State Tax Notes*, Aug. 14, 2017, p. 707.

⁵New York law allows for tax residence both by domicile and by a statutory residence test that looks to physical presence and maintenance of an abode in New York. For both types of residents, New York taxes all their intangibles income without any double tax relief. If all states applied New York's rules, dual residents would be taxed on their intangibles income by both of their tax residence states without any credits or apportionment to relieve the overlap. *Id.*

⁶Zelinsky, *supra* note 1, at 683-684.

⁷*Tamagni v. Tax Appeals Tribunal of New York*, 673 N.Y.S.2d 44 (1998), cert. denied, 525 U.S. 931 (1998) (holding that New York's residence rule did not violate the dormant commerce clause).

⁸For the same reason, Zelinsky's other example of putative discrimination — direct expenditures (including those for job training or improved roads) — also do not necessarily involve discrimination in the dormant commerce clause sense.

⁹*Worcester County Trust Co. v. Riley*, 302 U.S. 292, 298 (1937); and *Cory v. White*, 457 U.S. 85 (1982).

¹⁰*Worcester County Trust*, 302 U.S. at 292, 298.

faith and credit require state courts to come to uniform decisions regarding domicile. The *Worcester County* Court specifically noted that “the present suit is not founded on the asserted unconstitutionality of any state statute and the consequent want of lawful authority for official action taken under it.”¹¹

Similarly, although the Supreme Court in *Cory v. White* noted that “inconsistent determinations by the courts of two States as to the domicile of a taxpayer did not raise a substantial federal constitutional question,” this analysis went to the appropriateness of federal judicial intervention to prevent conflicting state determinations regarding domicile.¹² Neither case involved a dormant commerce clause challenge of a state’s tax residence rules.

Because the 11th Amendment would have barred the state courts from taking unconstitutional actions, however, *Worcester County* is cited for the more general proposition that there is no constitutional bar to double domicile. As Zelinsky acknowledges, that view has been subject to criticism from members of the Court.¹³

More importantly, it is not the holding of *Wynne*, or our contention, that dual domicile is

necessarily unconstitutional. Thus, in full agreement with Zelinsky, we would not advocate for courts to simply pick a winner in the domicile contest. Thus, when Zelinsky points out that courts have upheld dual residence cases against constitutional challenges in the past, our response is that they may still do so in the future. That is because, even after *Wynne*, the dormant commerce clause does not per se forbid double taxation, and by implication, it does not per se forbid dual tax residence.

States’ definitions of tax residence may differ, resulting in dual residence and even unrelieved double taxation. The Constitution imposes no requirement that states use uniform tax residence rules. To satisfy the Constitution, however, a state’s tax residence rule must be internally consistent, such that if every state applied it, double taxation would not inevitably arise.¹⁴ Although *Worcester Country Trust* is silent on the matter, under the laws of both states in *Cory v. White*, a person could be domiciled in only one state at a time.¹⁵ Because each state had a statutory scheme that, if adopted by all the states, would assign a person to only one state at a time, each state’s domicile rule (whatever it was) was internally consistent because neither would lead to double taxation if adopted by all the states.

In contrast, as we showed in our earlier article, New York’s tax residence regime is internally inconsistent.¹⁶ If every state applied rules identical to New York’s, double taxation of people with cross-border economic activities would inevitably result. Thus, *Worcester County Trust* and *Cory v. White* dealt with issues that are different from the dormant commerce clause issue we raised regarding New York’s tax residence rules.

Zelinsky would prefer Congress to step in to referee dual tax residence disputes among the states. He’s probably right that federal legislation would lead to more rational and predictable results. But, until then, the dormant commerce clause safeguards our common market from states that would seek to take more than their

¹¹ *Worcester County Trust*, 302 at 300.

¹² *Cory v. White*, 457 U.S. at 89. The three dissenting justices in *Cory* worried that the majority was raising the bar for federal adjudication too high. *Id.* at 94 (“The Court must rely on a double contingency: first, that both States *might* win judgments in their own courts that Hughes was a domiciliary subject to estate taxation; and second, that in such a case the Hughes estate *might* not be large enough to satisfy both claims.”) (emphasis in original).

¹³ In his concurrence in *Cory v. White*, Justice Brennan noted that “later cases, construing the Due Process Clause, have undermined *Worcester County*’s holding that the unfairness of double taxation on the basis of conflicting determinations of domicile does not rise to constitutional dimensions.” *Cory v. White*, 457 U.S. at 92 (Brennan, J., concurring). *Id.* (“And Justice POWELL is surely correct in observing that “[t]he threat of multiple taxation based solely on domicile simply is incompatible with the structural principles of a federal system recognizing as ‘fundamental’ a constitutional right to travel”) (quoting *Texas v. Florida*, 306 U.S. 398, 59 S. Ct. 563, 83 L. Ed. 817 (1939)). See also *id.* (Powell, Marshall, and Stevens, dissenting) (“Rigidly applying an aged and indefensible precedent, the Court denies the administrator and heirs of an estate any federal forum in which to resolve incompatible claims of domicile.”). *Id.* (“The premise, accepted by *Worcester County*, that multiple taxation on the basis of domicile does not offend the Constitution — even in a case in which both of the taxing States concede that a person may have but one domicile . . . [i]n my view . . . is wrong. I now would be prepared to overrule *Worcester County* on this point and to hold that multiple taxation on the basis of domicile — at least insofar as ‘domicile’ is treated as indivisible, so that a person can be the domiciliary of but one State — is incompatible with the structure of our federal system.”). See *id.* at 97 (arguing that “multiple taxation based on domicile is prohibited by the Due Process Clause”).

¹⁴ Cf. *Wynne* (approving the internal inconsistency as a test for dormant commerce clause violations).

¹⁵ *Cory v. White*, 457 U.S. at 86 (“Under the laws of Texas and California, an individual has but one domicile at any time.”).

¹⁶ See discussion, *supra* note 7.

share from interstate commerce. In setting the limits of the dormant commerce clause, the Supreme Court has struck a careful balance between promoting interstate commerce and state tax sovereignty.

Zelinsky argues that if dual domicile cases must be resolved by the courts rather than through the legislature, then the right solution is apportionment. Although we suggested an internally consistent apportionment rule as one way for New York to resolve the constitutional infirmity in its tax residence rule, in our view the states, not the courts, are entitled to choose such features of their tax laws, provided they do not violate the Constitution.

We would note, however, that Zelinsky draws a false dichotomy between dormant commerce clause apportionment rules and dormant commerce clause nondiscrimination rules.¹⁷ The principle embedded in the dormant commerce clause is that the states must not impose tarifflike taxes that distort competition between taxpayers on the basis of their state of residence or engagement in cross-border economic activity. That requirement applies to *all* tax rules, including apportionment rules. ■

¹⁷ Zelinsky, *supra* note 1, at 685 (“If the problem [of dual tax residence] is to be addressed judicially, the dormant commerce clause concept of apportionment provides a more convincing approach . . . than does the unsatisfactory notion of dormant commerce clause nondiscrimination.”).

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