No. 18-1570

IN THE
Supreme Court of the United States

SAMUEL EDELMAN, *et ux.*,
Petitioners,
v.
NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the New York Supreme Court, Appellate Division, First Department

BRIEF OF THE TAX FOUNDATION AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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INTEREST OF *AMICUS CURIAE*[1]

[1] Pursuant to Supreme Court Rule 37.6, counsel for *Amicus* represents that it authored this brief in its entirety and that none of the parties or their counsel, nor any other person or entity other than *Amicus* or its counsel, made a monetary contribution intended to fund the preparation or submission of this brief. Pursuant to Rule 37.2(a), counsel for *Amicus* represents that all parties were provided notice of *Amicus*'s intention to file this brief on July 3, 2019. Letters from the parties consenting to the filing of the brief have been obtained and filed with the Clerk of Court.

The Tax Foundation submits this brief as *amicus curiae* in support of Petitioners in the above-captioned matter.

The Tax Foundation is a non-profit, non-partisan research organization founded in 1937 to educate taxpayers on tax policy. Based in Washington, D.C., the Tax Foundation seeks to make information about government finance more accessible to the general public. This analysis is guided by the principles of sound tax policy: simplicity, neutrality, transparency, and stability. The Tax Foundation's Center for Legal Reform furthers these goals by educating the legal community on economics and principled tax policy.

Amicus seeks to complement Petitioners' Writ of Certiorari by placing the problems with the New York court's decision in the context of the larger tax system and tax policy. A tax law, like the one challenged here, that promotes the taxation of the same income by two or more states with no credit for taxes paid to the other states is inconsistent with at least two of the Tax Foundation's core principles. It is not neutral as it favors intrastate commerce over interstate commerce. It is not stable because it ignores this Court's precedent and encourages states to leap over constitutional boundaries, safe in a quest for more revenue. Because *Amicus* has researched and written extensively on the issues involved in this case, because state legislators and courts will continue to be confronted by this issue, and because any decision will significantly impact taxpayers and state tax administration, *Amicus* has an institutional interest in this Court's ruling.

SUMMARY OF ARGUMENT

This case presents the New York courts' repudiation of this Court's very recent decision in *Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787 (2015), and highlights the risk that, absent intervention by this Court, states will blithely circumscribe *Wynne* by focusing on irrelevant facts in the quest to nullify *Wynne*'s meaning and its value. This case also presents a situation in which this Court has a heighted obligation to intervene – the legislative process cannot protect Petitioners because even though they are being taxed as state residents, they have absolutely no voice in the state legislative process that lead to the extraction of the unconstitutional tax.

The constitutional problem is clear. In both *Wynne* and in this case the challenged state tax law, if applied in multiple jurisdictions, results in the taxpayers' income being taxed at least twice. And in this case, the income actually was taxed twice. The problem with the New York court's decision is also clear. The only difference between *Wynne* and this case is the type of income being subject to multiple taxation. In concluding that the rule articulated in *Wynne* is operative only for income earned from active work (such as from employment or running a business), the court below disregarded *Wynne*'s underlying rationale and exposed income from owning intangibles (such as dividends or gains from the sale of a business) to taxation by multiple states. This is not a distinction the Constitution or the decisions of this Court support.

New York had options regarding how to tax this income, options soundly rooted in the rulings of this Court and in long established state tax policy. Instead, New York chose an unconstitutional - yet lucrative - path. If New York's law is left intact, other state and local jurisdictions will surely follow suit – the only questions are to what extent and how great the damage to interstate commerce will be. *Amicus* asks that this Court recognize the risk and prevent New York and any copycat states from taking the unconstitutional path, a path that unquestionably discriminates against interstate commerce.

ARGUMENT

THIS COURT SHOULD GRANT CERTIORARI TO PREVENT NEW YORK – AND CONSEQUENTLY OTHER LIKE-MINDED STATES – FROM DISREGARDING THIS COURT'S PRECEDENT ANNOUNCED IN *WYNNE.*

Like many states, New York imposes its personal income tax on the total income earned not only by domiciliaries but also by "statutory residents" who are domiciled in another state but meet certain New York statutory tests.[2] A person who is a statutory resident of New York is therefore a resident of two states – New York and the state of domicile. New York taxes 100% of a

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[2] To be a statutory resident, an individual must have a permanent place of abode in the state and be present for any part of more than 183 days in the state (with certain exceptions not relevant here). N.Y. Tax Law: Sections 605(b)(1)(B).

resident's income from whatever source, regardless of whether the taxpayer is a resident because of domicile or because of the statutory factors. New York provides a credit for taxes paid to other states, but only if under New York's own law the income is "sourced" to that other state. New York does not provide a credit for taxes paid on intangible income, such as dividends, interest, and capital gains, under the theory that intangible income has no geographic source and therefore is properly taxed by one or more states of "residence" – both the state of domicile and the state of statutory residence. Thus, New York taxes both its domiciliaries and its statutory residents on 100% of intangible income, even if other states also tax this income. Of course, it is far from inconceivable that an individual could be a "resident" of three or four states since states feel free to define a "resident" in any way they choose.

The court below – New York Supreme Court, Appellate Division, First Department – following precedent from the New York Court of Appeals that predates this Court's decision in *Wynne*, condoned this practice. While a straight application of this Court's internal consistency test, which this Court has repeatedly used to determine whether a state tax imposition engenders a risk of multiple taxation and therefore violates the Commerce Clause, would hold the New York practice unconstitutional, the court below found otherwise, concluding that this Court's *Wynne* decision applies only to income earned by active work, not to income earned from owning passive investments. We urge this court to hold that there is no basis in law, tax policy, or logic in making this distinction and, accordingly,

find the New York practice a violation of the Commerce Clause.

A. New York's tax scheme fails the internal consistency test, a test used to ensure that a state tax imposition does not impose an undue burden on interstate commerce.

New York's tax scheme fails the internal consistency test as articulated in *Wynne*. It subjects participants in interstate commerce to a higher tax burden than those who participate exclusively in intrastate commerce, effectively producing the same economic effect as an interstate tariff. *See Comptroller of Treasury of Md. v. Wynne*, 135 S. Ct. 1787, 1804 (2015) ("Maryland's tax scheme is inherently discriminatory and operates as a tariff."). A New York "statutory resident" is by definition domiciled in another state and under New York's tax system would pay tax on intangible income to both states while a similarly situated individual with activities limited to a single state would pay tax on intangible income to only one state, the state of domicile. Under standard economic principles, this system discourages individuals from traveling across state lines for work or leisure, lest they trigger statutory resident thresholds thereby increasing their tax liability. The choice to perform activities in more than one state incurs a cost that limiting the activities to a single state does not.

This increased cost from crossing state lines has many interstate commerce ramifications. It discourages statutory residents from making investments that yield intangible income, thereby

changing the national investment marketplace. This law discourages individuals from maintaining more than one place of abode – changing the real estate market. It imposes non-monetary costs at both the individual level and for society. For example, it could place more people on the roads leading to more congestion; road wear and tear; and car accidents because maintaining a pied-à-terre near a New York office is more expensive. The overall result of these attempts to avoid multiple tax liability would be deadweight loss to the economy.

It is instructive to note that the issue here is not one affecting only a limited set of high-income individuals. Consider a barista working in Brooklyn, still living with her parents in New Jersey but who has a key to her best friend's flat in Brooklyn, can stay over on late nights whenever she wants, and pays for part of the utilities in that apartment. She has a small bank account at home in New Jersey, earning some interest. She could be a statutory resident of New York and, if New Jersey were to follow the same law as the one at issue here, subject to tax on that interest by two states. Other taxes could also be affected if New York's position is allowed to stand. Frequently, certain types of intangible income earned by corporations and classified by state statute as "non-business income" are taxed by the state of the corporation's headquarters. If a state were to define "headquarters" to be both where the company is managed and where it has more employees than any other state, a business could have more than one state taxing this income. The upshot is that what New York has done is not limited to a unique aspect of New York's tax law

affecting a small number of taxpayers. The unconstitutionality of New York's position has widespread application if left unchecked.

A. *Relying on the concept of "residence" does not insulate a state from Commerce Clause scrutiny.*

States are not insulated from Commerce Clause scrutiny whenever they tax residents, especially when states create and implement their own definition of "resident." If the concept of residence made a difference, states could define residence so broadly as to capture a dizzying array of activities. The District of Columbia already defines a resident as someone who maintains a permanent place of abode in the District for more than 183 days, D.C. Code § 47–1801.04(17) – providing no requirement for substantial presence of the person in the jurisdiction. Even under New York's current definition, a person could be a non-domiciled statutory resident of more than one state. A CEO maintaining a summer home in upstate New York, a family home in Connecticut and an efficiency apartment near her company's warehouse in New Jersey could be a resident of three states under New York's law if she spent mornings at the office in New York and afternoons at the warehouse in New Jersey. The result being that under New York's law three states would tax 100% of the CEO's income from having made investments in intangibles.

The court below appears to have used Due Process principles to feign Commerce Clause compliance. This mistakenly conflates the

Commerce Clause with the Due Process Clause and resurrects an argument repeatedly rejected by this Court. The "raw power" of states to tax residents exists under the Due Process Clause, but that power—like any state power—cannot infringe on federal autonomy over interstate commerce. *See Wynne*, 135 S. Ct. at 1799 (holding that Maryland's "raw power to tax its residents' out-of-state income" did not satisfy a Commerce Clause inquiry); *Quill Corp. v. North Dakota*, 504 U.S. 298, 312 (1992) (emphasizing that the two clauses are "animated by different constitutional concerns and policies"). *Wynne* reaffirms that "while a State may, consistent with the Due Process Clause, have the authority to tax a particular taxpayer, imposition of the tax may nonetheless violate the Commerce Clause." *Wynne*, 135 S. Ct. at 1798. Pointing to a state's unbridled power to tax residents, especially in light of states' ability to define "resident" in any manner they choose, is a thinly veiled attempt to circumvent this Court's precedent and immunize New York's tax scheme from Commerce Clause scrutiny. In *Wynne*, this Court held that courts should consider the effect, not the form, of a state tax when analyzing the impact on interstate commerce. This is what the internal consistency test achieves, "isolate[ing] the effect of a defendant State's tax scheme." *Id.* That a state levies taxes solely on residents does not mean the effects end at the state's borders. *See Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (striking down an intangibles tax levied exclusively on state residents because it discriminated against interstate commerce). Likewise, taxes that "have the advantage of appearing nondiscriminatory"

are not presumed valid. *Wynne*, 135 S. Ct. at 1804–1805. Because the Commerce Clause and Due Process Clause are separate inquiries, the fact that these taxes are based on the taxpayer's residence instead of the income's source is not dispositive on the commerce question.

Defining "resident" to include those that do not have the right type of contacts to allow them to vote in the state is particularly pernicious if the tax scheme imposed on the non-voting resident does not also adversely affect voting taxpayers. Individuals can only vote in one state but under New York's system they are taxed on the same income in multiple states. Taxpayers domiciled in New York do not have the same interests as statutory residents and thus there is no voice in the legislative process for statutory residents. There is no advocate for statutory residents to address the unconstitutional tax system through use of the legislative process.

B. *The type of income involved does not insulate a state from Commerce Clause scrutiny.*

After paying lip service to this Court's precedent, the court below undermines it by reasoning that income earned from owning intangibles can be doubly taxed because it is not "sourced" to another state. This logic is circular and raises a superficial distinction. Intangible income is defined largely by its inability to be sourced to an identifiable situs, which is why intangible income is understood to "follow the person." *See Mobil Oil Corp. v. Comm'r of Taxes*,

445 U.S. 425, 445 (1980) (discussing the concept of *mobilia sequuntur personam*). Emphasizing that intangible income "has no identifiable situs, cannot be traced to any jurisdiction outside New York, and is subject to taxation by New York as the State of residence" is simply a roundabout way of saying that the income is residence-based rather than source-based; moreover, since New York has itself defined "resident," this principle is rendered meaningless. *See Edelman v. N.Y. State Dept. of Taxation & Fin.*, 80 N.Y.S.3d 241, 242, 162 A.D.3d 574, 575 (N.Y. App. Div. 2018), *cert. denied*, 32 N.Y.3d 1216 (2019) (internal quotations omitted). This Court made plain in *Wynne* that such an argument has no merit.

C. *If a tax fails the internal consistency test, it by definition burdens interstate commerce in violation of the Commerce Clause.*

The court below held that "there is no need for a test determining whether the statute unduly burdens interstate commerce" when the statute does not affect interstate commerce. *Edelman*, 80 N.Y.S.3d at 243, 162 A.D.3d at 575–576. This reasoning finds simply ignores the underpinnings of *Wynne*. In fact, the internal consistency test exists precisely to identify state infringement on interstate commerce. *Wynne* declared that the test "helps courts identify tax schemes that discriminate against interstate commerce." *Wynne*, 135 S. Ct. at 1802. This is intuitive because identifying discrimination against interstate commerce necessarily entails comparison. The internal consistency test

facilitates that comparison by placing interstate and intrastate commerce on equal footing. The interstate consequences of multiple taxation can often be revealed only by hypothetically applying the identical tax structure to every state. Holding that courts need not apply the internal consistency test to examine potential multiple taxation disempowers the tool tailored to the task.

Even a casual review of New York's tax scheme reveals that it "place[s] interstate commerce at a disadvantage as compared with commerce intrastate." *See id.* at 1803. Statutory residence laws assume that the taxpayer's domicile is in a different state. Becoming a New York statutory resident necessarily requires travel across state lines, an effect that implicates interstate commerce. *See, e.g., Heart of Atlanta Motel v. United States*, 379 U.S. 241, 254–256 (1964). Travel across state lines and the accompanying economic realities are inevitable whenever dealing with dual residency. Moreover, that New York offers tax credits to residents for tax paid to other states on income that is sourced to that other state using New York's law clearly (but not for tax paid to other states on non-sourced income, such as that derived from owning intangibles) demonstrates that New York acknowledges the state-to-state implications of its statutory residency regime. It would be farcical to ignore the far-reaching, cross-border consequences of New York's tax scheme and believe it to have exclusively local ramifications.

Offering tax credits only for income derived from active work is insufficient to satisfy the test. Maryland also offered partial tax credits, but its failure to provide a credit for the taxes paid by

nonresidents to other states rendered the overall income tax scheme unconstitutional. *Id.* at 1793, 1806. The court below points out that New York already provides tax credits for all income earned outside of the state, *Edelman*, 80 N.Y.S.3d at 242, 162 A.D.3d at 575, but that is merely another appeal to the state's authority to tax residents by reiterating that income from intangibles is not source-based. New York cannot blindly defer to its own statutory regime that concludes intangible income is not sourced to another state unless derived from "property employed in a business, trade or profession carried on" in the other state. *See* N.Y. Comp. Codes R. & Regs. Tit. 20, § 120.4(d). *Wynne* held that a state's self-imposed definitions do not shield the state from accounting for the effect of the tax. *See Wynne*, 135 S. Ct. at 1803 n. 8. Dividend, interest, and gain income is still traceable to the person, and multiple states cannot have constitutional authority to tax one hundred percent of that person's income. Tax credits are not the only way to remedy New York's constitutional defect, but it is an obvious remedy here. *See Wynne*, 135 S. Ct. at 1801, 1806 (highlighting the "near-universal practice" in providing tax credits for taxes paid to other states as well as the possibility to comply with the Commerce Clause through other means). At the very least, *Wynne* compels New York to enact some change to its taxation of intangible personal income.

B. New York had options if it wanted to constitutionally tax the income at issue but it chose the unconstitutional path thereby maximizing revenue.

Amicus is not arguing that New York cannot tax this income, only that it cannot tax this income in such a way that risks, and here actually imposes, double taxation. Just one of several possible tweaks to New York's tax system would result in a constitutional tax. For example, New York's problem could be viewed as a sourcing issue. New York's position is it cannot classify this income as sourced to another state because intangible income has no source. This is wrong; other states, and New York in other contexts, absolutely source income from intangibles to a specific jurisdiction. E.g., Cal. Rev. & Tax. Code § 25136("Sales from intangible property are in this state to the extent the property is used in this state. In the case of marketable securities, sales are in this state if the customer is in this state."); Cal. Code Regs. tit. 18, § 25136-2(d)(providing for specific rules for sourcing "sales from intangible property" to California, including receipts from the sale of stock or an ownership interest in a pass-through entity and dividends); Md. Code Regs. 03.04.03.08.C(3)(d)("Gross income from intangible items such as dividends, interest, royalties, and capital gains from the sale of intangible property shall be included in the numerator based upon the average of the property and payroll factors."); Tex. Admin. Code § 3.591(providing for specific rules for sourcing income from intangibles to Texas, including dividends and net gains and losses from the sale

of investments and capital assets). If income is sourced to a single, identified location for tax purposes, the internal consistency test will not be violated. New York could source interest income from an individual's bank account to that individual's state of domicile. New York could source income from the sale of business, like the one at issue here, based on where the business was headquartered. New York could define the source of the income as the location of the entity buying the business. New York could define the source as the domicile of the person selling the business (but that would have precluded the tax at issue here). However, these scenarios would mean New York could not tax proceeds from sales of businesses sourced outside the state without providing a credit. If New York did not want to use a credit regime, it could source the income based on the apportionment factors of the business sold. Any system that reasonably assigned the income to a single jurisdiction would fix the issue (as long as the sourcing rule was the same for statutory residents and domiciliaries). New York could choose the sourcing rule most advantageous to its fisc and that would be constitutional even if another state had a different sourcing rule resulting in actual double taxation. What New York cannot do is tax both domiciliaries and statutory residents on income from intangibles and refuse to source the income at all, resulting in the double taxation problem here. Of course, in a given situation one or more interests of Complete Auto Transit other than internal consistency could be implicated and thus cause a certain tax imposition to be constitutionally infirm.

Other potential fixes to the problem would not require the State to define the source of intangible income. If New York determined no sourcing rule was valid, it could still have a constitutional tax imposition if it provided a credit for all taxes paid to other states (regardless of source). It could tax income from intangibles if only domiciliaries were required to include such income in the tax base. But once New York decided to tax residents that under New York law were also residents of another state and both states could tax the income the internal consistency test is triggered and the tax system fails.

C. This Court should act to prevent other states from seeking to undermine *Wynne's* protection against multiple taxation of personal income.

Condoning New York's tax scheme by declining to review and invalidate New York's law creates a harmful incentive for other states to subject their residents to multiple taxation. The specious distinctions invented in this case would be replicated and embolden states to conjure new superficial distinctions. The temptation to mimic New York's approach would extend to any state interested in collecting more tax revenue. The temptation would be greatest among states with populations who travel frequently across state lines for work or otherwise, thereby amplifying the overall damage to interstate commerce. States would be encouraged to make residency definitions as inclusive as possible in order to tap into the full amount of each new resident's intangible personal income. Similarly, states could broaden the types of income with no source

taxed to a resident without a countervailing credit. With every state looking to widen its tax base through this end run around *Wynne*, the effects on interstate commerce and investments that yield intangible income would reverberate far beyond New York's borders.

As this case demonstrates, states cannot always be trusted to enforce federal constitutional limits on their own taxing power. In instances of revenue collection, states have a strong interest in expanding that power, particularly against those that have no voice in the government process. This Court has a duty to step in to correct the abuses that inevitably arise when the fox guards the henhouse and the hens cannot fire the fox. This major carve out of *Wynne* must be repudiated before other states follow suit.

CONCLUSION

For the foregoing reasons, *Amicus* respectfully requests that this Court grant the petition for a writ of certiorari.

Respectfully submitted,

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