

DAVID S. & JUDITH W. ANTZIS	*	IN THE
Petitioners	*	MARYLAND TAX COURT
v.	*	APPEAL NO. 05-IN-00-0486
COMPTROLLER OF THE TREASURY	*	
Respondent	*	
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TIMOTHY A. & MARY S. FREY	*	IN THE
Petitioners	*	MARYLAND TAX COURT
v.	*	APPEAL NO. 05-IN-00-0487
COMPTROLLER OF THE TREASURY	*	
Respondent	*	
* * * * *	*	* * * * *
RUDOLPH GARCIA & RANDI E. PASTOR-GARCIA	*	IN THE
Petitioners	*	MARYLAND TAX COURT
v.	*	APPEAL NO. 05-IN-00-0485
COMPTROLLER OF THE TREASURY	*	
Respondent	*	
* * * * *	*	* * * * *

OPINION

This case presents constitutional challenges to the nonresident tax on Maryland income required by Tax-General Art. §10-106.1.¹ This income tax is not levied upon Maryland residents and this Court must decide whether it violates either the United States

¹ All future references shall be to the Tax-General Article, unless otherwise noted.

Constitution or the Maryland Constitution and Declaration of Rights. After reviewing the filings by all parties, giving careful consideration to counsels' arguments, and reviewing the relevant caselaw, the Court holds that it does not.

FACTS

Petitioners are three married couples that reside in Pennsylvania and file joint nonresident Maryland income tax returns. The returns are filed because in each case the husband is a partner in a multi-state law firm with Maryland and Pennsylvania operations. The partnership apportions its income among the states in which it does business, and this creates Maryland taxable income for each Petitioner pursuant to §10-210. There also exists a withholding obligation for the partnership under §10-102.1. These taxes are not in dispute.

In 2004, the General Assembly of Maryland enacted a special tax applicable to non-residents. The tax requires non-residents to pay income tax equal to the state rate (4.75%) imposed by §10-105, "plus an amount equal to the lowest county income tax rate set by any Maryland county in accordance with §10-106.1 of this subtitle." Sec. 4, Ch. 430, 2004 Session Laws; Tax-General Art. §10-106.1. Petitioners did not pay the amount required by §10-106.1 and were assessed accordingly. Petitioners' contention is that the tax imposed by §10-106.1 is unconstitutional.

Maryland income taxes on both residents and non-residents can be described as follows. The resident taxpayers' payment is split between two separate taxes, namely the state income tax portion that goes into the General Fund of Maryland, and a local tax portion that goes to the taxpayer's county of residence, or to Baltimore City in the case of a city resident. The local tax revenues are used to fund local services. By contrast, the non-resident taxpayers' tax consists of the state income tax portion at the same rate paid by residents, plus the special non-resident tax, both of which go into the General Fund. Non-residents pay no local income tax because they have no local county of residence. As stated earlier, residents do not pay the special non-resident tax prescribed by §10-106.1.

Petitioners contend that imposing the special non-resident tax exclusively on non-residents, coupled with the differences in how the tax revenue is allocated, equates to discrimination against the non-resident in violation of both the United States Constitution and the Maryland Constitution and Declaration of Rights. To support these contentions, the Petitioners assert that the state income tax and the local income tax are different taxes and cannot be combined to determine whether residents and non-residents are being taxed equally.

QUESTIONS PRESENTED

Petitioners have raised several questions:

1. Whether the special non-resident tax is a violation of the Interstate Commerce and Equal Protection Clauses of the United States Constitution because this special tax is imposed exclusively on non-resident taxpayers and causes non-residents to be subject to Maryland state tax at higher rates than are imposed on residents.
2. Whether the special non-resident tax also violates the Privileges and Immunities Clause of the United States Constitution because it is a discriminatory tax that is only imposed on non-residents
3. Whether the special non-resident tax also violates the Maryland Constitution and the Declaration of Rights because it is discriminatory against a special class of taxpayers.
4. Whether the penalties assessed against each of the Petitioners should be waived pursuant to §13-714 of the Tax-General Article because of reasonable cause.
5. Whether the interest assessed against each of the Petitioners should be abated because of reasonable cause pursuant to §13-606 of the Tax-General Article.

ANALYSIS

The Petitioners argue that §10-106.1 is discriminatory on its face by imposing the special non-resident tax exclusively on non-resident income and, therefore, is in violation of both the United States Constitution and the Maryland Constitution and Declaration of Rights. They assert that the differences in how the tax revenue is allocated equate to discrimination against the non-resident because the special non-resident tax levy adds to

the non-resident tax burden over and above any similar burden borne by a Maryland resident.

Petitioners cite the United States Supreme Court's recent ruling in *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996), which found that that the state laws discriminating against interstate commerce on their face are "virtually per se invalid." They contend that Tax-General Art. §10-106.1. is just such a statute in that it expressly discriminates against nonresidents by levying a tax on nonresident income which has no direct corollary with respect to residents. At first blush, §10-106.1. does indeed appear to discriminate against the out-of-state taxpayer, arguably interfering with the free flow of commerce mandated by the Commerce Clause, as well as violating the privileges and immunities guaranteed by the Privileges and Immunities Clause of the United States Constitution. Taken on its face, this would make the statute unconstitutional as to the United States Constitution, as well as the Maryland Constitution and Declaration of Rights. This appearance of discrimination on the surface, however, does not end the inquiry. *Fulton* noted further that a tax provision which is facially discriminatory may nonetheless avoid being declared null and void where the government is able to overcome the presumption of invalidity "by showing that the statute is a 'compensatory tax' designed simply to make interstate commerce bear a burden already borne by intrastate commerce." *Id.* at 331 (citations omitted).

For a tax to be considered a valid compensatory tax, it is incumbent upon the governmental entity to establish three things. First, as a threshold matter, the government must identify the intrastate tax burden for which the facially discriminatory tax is compensating. *Fulton*, 516 U.S. at 332. This prong cannot be met unless the government establishes that the tax on interstate commerce "is fairly related to the services provided by the State [which benefit interstate commerce]." *Id.* at 334 (citations omitted). Second, the "tax on interstate commerce must be shown roughly to approximate -- but not exceed -- the amount of the tax on intrastate commerce." *Id.* at 332-33 (citations and internal quotation marks omitted). Finally, the government must show that "the events on which the interstate and intrastate taxes are imposed must be 'substantially equivalent'; that is, they must be sufficiently similar in substance to serve as mutually exclusive 'prox[ies] for each other.'" *Id.* at 333 (citations omitted). The three prong *Fulton* test is stated in the

conjunctive; thus, failure to meet one of any of the three prongs results in a finding that the governmental entity has failed to meet its burden in establishing that the discriminatory tax is nonetheless valid as a compensatory tax.

As to prong one of the three prong *Fulton* test, the Comptroller asserts that §10-106.1., strives to equalize the income tax burden between residents and non-residents, and that non-residents will not pay more than residents who are also subject to a county tax. The Comptroller contends that this alone is sufficient to justify imposing the special non-resident tax. Not surprisingly, Petitioners argue that the special non-resident tax is not compensating for any burden imposed on intrastate commerce for which residents are paying the county tax, and fails, therefore, to satisfy the first prong of identifying the intrastate tax burden for which the facially discriminatory tax is compensating. *Fulton*, 516 U.S. at 332. Petitioners argue that the special tax compensates for nothing, and cannot be “fairly related to the services provided by the State [which benefit interstate commerce].” Id.

To fully explore these contrasting points-of-view, this Court questioned counsel as to whether a nonresident taxpayer gains any direct or indirect benefit from local services being provided by a Maryland county or by Baltimore City. Such local services traditionally include police and fire protection, waste disposal, water and sewer services, and the myriad of other local governmental activities on behalf of people within each local jurisdiction. It was conceded that such local benefits do, in fact, accrue both directly and indirectly to nonresidents while they are present or doing business in a jurisdiction. Obviously, both residents and nonresident receive these local governmental benefits by mere virtue of their physical presence within a jurisdiction, either in person or as part of a business entity doing business within the jurisdiction. It seems perfectly reasonable, therefore, for the State to seek compensation for these services from non-residents through the tax system. Although there is no direct mechanism to allocate the special non-resident tax revenue to a particular county, the General Fund of Maryland exists to provide funding for the benefit of all Maryland counties and Baltimore City, selectively, through legislation and through the legislative budgeting process. In this regard, the evidence is clear that the burden on intrastate commerce for which §10-106.1., is compensating, is the burden of providing local governmental services, directly or

indirectly, to all persons or entities physically situate or doing business within its local borders.

The second prong of the compensatory tax test requires that the Comptroller establish that the tax imposed by the facially discriminatory tax on non-residents roughly approximates, but does not exceed, the amount of the tax burden imposed on residents. *Fulton*, 516 U.S. at 332-33. The Comptroller contends that “Tax-General Art. §10-106.1. does not violate the constitutional provisions regulating state taxation of non-resident income . . . because residents and non-residents pay at least the same tax rate on the same income. They pay this identical amount on the same type of tax return, and to the same entity; and for resident and non-resident alike the amount paid is required by state – not local – statute.” It is clear from the language of the statute, coupled with the existence of county income taxes paid by residents, that non-residents pay no more, and in most cases less, than their resident counterparts.

Petitioners argue that the facial discrimination against non-resident taxpayers is in no way cured or offset by the fact that, in addition to Maryland state income tax, resident taxpayers are also subject to county income taxes. Petitioners find significance in the fact that county income taxes are imposed by each separate county in Maryland, and not by the State of Maryland. Likewise, the counties set their own local tax rate. Petitioners add that the proceeds of all county taxes are remitted to the counties that impose them, and are used exclusively to provide governmental services to residents of those counties. In contrast, the special non-resident tax is imposed by the State of Maryland, and all proceeds from this tax are distributed to the General Fund of the State of Maryland. In support of this distinction, Petitioners cite *Comptroller of The Treasury v. Edward L. Blanton, Jr., et al.*, 390 Md. 528 (2006) where the Court of Appeals of Maryland, upholding a Tax Court finding, make it clear that the County income taxes are not just an element of the State income tax, but are rather separate and distinct taxes.

Although it is clear from *Blanton* that the State income tax and the county income tax are separate taxes, this distinction does little to answer the question of whether §10-106.1., as applied, is unconstitutional. The Court finds the distinction between the state and county income taxes to be irrelevant to the constitutional issue. The facts reveal that the non-resident taxpayers are paying the same rate overall as the resident taxpayers,

based on their Maryland income. Viewing this from a federal perspective, the burden on each class of taxpayer is the same overall. For example, if one looks at the border between Maryland and other jurisdictions and asks . . . is a non-resident outsider paying more income tax than an inside resident, simply because he is a non-resident outsider . . . the answer is no, he is not paying more. There is merit, therefore, in the Comptroller's assertion that what matters is not where the revenue is allocated, but rather whether there is a discriminatory burden on non-residents.

The Comptroller states that numerous cases have sustained state taxes against claims of discrimination, even though the taxes are calculated in different ways for residents and non-residents. Thus in *Shaffer v. Carter*, 252 U.S. 37 (1920), the court sustained a tax calculation method that was different for a non-resident and only allowed him to deduct losses from operations within the taxing state. Under this rule, states are free to limit non-residents to deductions related to income within the taxing state, even if deductions allowed to residents are not so limited. Additional case examples were cited which need not be described here.

The Comptroller's position is that a distinction in the direction of funds does not affect the amount Petitioners pay, and therefore cannot be unconstitutional discrimination. In support of this assertion, the Comptroller cites *Lundig v. N.Y. Tax Appeals Tribunal*, 522 U.S. 287 (1998) for the proposition that states must be afforded a "considerable amount of leeway in aligning the tax burden of nonresidents to in-state activities." Indeed, a reference in *Fulton* supports this same contention. Quoting Justice Cardozo in *Gregg Dyeing Co. v. Query*, 286 U.S. 472, 480 (1932), explaining a compensatory tax scheme, "the stranger from afar is subject to no greater burdens as a consequence of ownership than the dweller within the gates. The one pays upon one activity or incident, and the other upon another, but the sum is the same when the reckoning is closed." §10-106.1. ensures that non-residents pay Maryland income taxes at the same rate or a lesser rate as Maryland residents, albeit the revenue derived from this taxation is distributed differently once collected.

The third prong of the compensatory tax doctrine requires that "the events on which the interstate and intrastate taxes are imposed must be 'substantially equivalent'; that is, they must be sufficiently similar in substance to serve as mutually exclusive

'prox[ies] for each other.'" *Fulton*, 516 U.S. at 333. With respect to §10-106.1., income is the event on which the tax is based for both residents and non-residents. Being the same event for both classes of taxpayer, it meets the test for "substantially equivalent." Hence, the third prong of the three-part test under *Fulton* is also satisfied, and this Court finds that §10-106.1. is a valid compensatory tax.

As to each of the constitutional questions 1 – 3 posed by the Petitioners in this Appeal, this Court finds that §10-106.1. serves a rational purpose to create parity in the income tax burdens between Maryland residents and non-residents. There is no extra tax burden that would deter a non-resident from free and open commerce inside or outside the state, and there is no extra tax burden that might be construed to violate the privileges and immunities, and equal protection accorded to everyone. Accordingly, §10-106.1. does not violate the Interstate Commerce Clause of the United States Constitution, the Equal Protection Clause of the United States Constitution, the Privileges and Immunities Clause of the United States Constitution, or the Maryland Constitution and the Declaration of Rights.

As to question 4 involving the potential abatement of penalties assessed, this Court believes the Appeal was taken in good faith without any intent to avoid or delay the proper payment of all taxes legitimately owed. Accordingly, penalties are hereby abated with respect to all Petitioners in this case.

As to question 5 involving the potential abatement of accrued interest, this Court does not have the authority to abate interest.