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INTRODUCTION TO TAXATION

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INTRODUCTION TO TAXATION

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Chapter 1

TAX BASE, TAX RATES, AND TAXABLE UNITS

1.01 Tax Base

[B] Types of Deductions

Page 7, add the following

The election to itemize state and local general sales taxes in lieu of deducting state and local income taxes has been made permanent by the Protecting Americans From Tax Hikes Act of 2015 (hereafter referred to as PATH of 2015).

PATH of 2015 also made permanent an above-the-line deduction for elementary and secondary-school teachers' classroom expenses. The deduction amount is capped at $250, adjusted for inflation beginning in 2016. There is no inflation-adjustment for 2017.

[D] Inflation Adjustments

Page 7

The following are the inflation-adjusted figures for tax year 2017.

Standard deduction:

Single individual	$ 6,350
Married couple, filing jointly	12,700
Head of household	9,350

Personal exemption deduction: $ 4,050

1.02 Tax Rates

[A] Progressivity; Marginal Tax Rates

Page 8

The following are the inflation-adjusted figures for tax year 2017.

Taxable income		Tax rates
Married-file jointly	Single	
> 470,700	> 418,400	39.6%
> 416,700 to 470,700	> 416,700 to 418,400	35%
> 233,350 to 416,700	> 191,650 to 416,700	33%
> 153,100 to 233,350	> 91,900 to 191,650	28%
> 75,900 to 153,100	> 37,950 to 91,900	25%
> 18,650 to 75,900	> 9,325 to 37,950	15%
Not over $18,650	Not over 9,325	10%

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[C] "Phantom" Marginal Tax Rates

Pages 10–11 add the following

The threshold amounts of adjusted gross income (AGI) above which the deductions will disappear for 2017 are the same for both the personal exemption and itemized deductions. They are: **$313,800** for married taxpayers; **$261,500** for single individuals. The phase-out ends at **$436,300** (married) and **$384,000** (single) respectively.

1.03 Deduction for Dependents

Page 12, add the following

The casebook states that a dependent child must receive more than one-half of his or her support from the taxpayer in order for the taxpayer to be entitled to a dependent deduction. That is no longer true under an amendment to **sec. 152(c)(1)(D)**. All that is necessary is that a child who otherwise meets the requirements for being a dependent must not provide more than one half of his or her own support. In most cases, that will be true *because* the parents who claim the dependent deduction will have provided more than half the child's support but it does not have to be true. For example, if the child's support provided through Food Stamps, needs-tested government welfare benefits, or foster care payments equals or exceeds one half of the child's support, the child can be a dependent of the parents even though the parent's do not provide more than one-half of the child's support. In such cases, the child does not provide more than half his or her support and **sec. 152(c)(1)(D)** is satisfied.

[A] Dependent Children and the Taxable Unit

Page 13, add the following

The $750 figure used to compute the standard deduction of a dependent child and to compute the kiddie tax, and the $250 figure used to compute the standard deduction of a dependent child, are both adjusted for inflation. For tax year 2017 the figures are **$1,050** and **$350** respectively.

The figures for the "kiddie tax" are also adjusted for inflation. For 2017, the parent's tax rate is applied to the child's investment income that is twice $1,050 – that is **$2,100**.

1.05 Earned Income Credit

Pages 25–26, add the following (dealing, primarily, with inflation adjustments)

PATH of 2105 made two EIC provisions permanent: the increase in the upward adjustment of the phase-out threshold for married taxpayers; and the 45% credit percentage for taxpayers with three or more children.

The inflation-adjusted amounts for the earned income credit for tax year 2017 are as follows. The figures include an upward adjustment to the phase-out threshold for married couples, in an effort to reduce the marriage tax penalty. The penalty is the result of the phase-out threshold for a married couple being less than double the phase-out threshold for a single taxpayer.

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Earned income base amount:

No children	$ 6,670
One child	10,000
More than one child	14,040

Phase-out thresholds:

Married, filing jointly:	
No children	$ 13,930
One or more children	23,930
Other taxpayers:	
No children	$ 8,340
One or more children	18,340

For 2017 the inflation-adjusted amount of *disqualified* income above which the EIC is denied equals **$3,450.**

1.06 Child Tax Credit

Page 27, add the following

d. The reduced $3,000 earned income threshold amount for purposes of computing a refundable child tax credit is made permanent by PATH of 2015.

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Chapter 3

DEFINING INCOME

3.04 Capital Gains Preference

[B] History of Preferential Treatment

Page 57, add the following

There is a 100% exclusion from income of the gain on the sale of "qualified small business stock." **Section 1202**. This provision was made permanent by PATH of 2015.

3.06 What Is Income – Accession to Wealth

[A] From "Sources" to "Accession to Wealth"

[4] Nontaxable Compensation for Loss

Page 74, add the following

5. In Cosentino v. Commissioner, 108 T.C.M. (CCH) 273 (2014), the court *excluded* from income an amount received as damages by taxpayers from an accounting firm for advising them to invest in an abusive tax shelter that did not in fact reduce their taxes. References in the following excerpt to a sec. 1031 like-kind exchange and to boot refer to a provision in the tax law (discussed later) that defers tax on an exchange of like-kind property as long as no *non*like-kind property (often cash) is received. The reference to stepped-up basis refers to a provision that gives a taxpayer a basis equal to value at death, thereby permanently exempting any appreciation in value from income tax.

The court relied on the *Clark* and *Concord Instruments* decisions, stating:

> Petitioners (1) paid more in Federal income tax and State income tax than they would have paid and (2) paid other expenses that they would not have paid if they had not followed the advice of their accountants [] and used the tax-avoidance plan that that firm recommended they use. In reliance on that advice, petitioners implemented the tax-avoidance plan in an attempt to increase [their] basis in the [certain] property . . . . Petitioners did not know at the time that they implemented the tax-avoidance plan that it was an abusive tax shelter. If petitioners had known that the tax-avoidance plan was an abusive tax shelter, they would not have implemented it in an attempt to increase [] basis . . . . Instead, petitioners would have [] dispose[d] of the [] property [without receiving boot in a sec. 1031 exchange] and [would have deferred] tax on any gain realized on that disposition by implementing only a sec. 1031 like-kind exchange without boot, as had been done before. . . .
>
> . . . [U]nder petitioners' plan, we believe that the respective amounts of Federal income tax and State income tax that would have been deferred if the [] property had been disposed of pursuant to that plan by implementing only a sec. 1031 like-kind exchange without boot would in all likelihood never have been required to be paid. That is because under petitioners' plan petitioners intended to defer indefinitely tax on any gain realized on the dispositions of appreciated properties by implementing sec. 1031

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like-kind exchanges without boot. As a result, any appreciated property that they owned at their deaths would have passed to or for the benefit of their permanently disabled adult daughter with a so-called stepped-up basis determined pursuant to sec. 1014(a).

3.06 What Is Income – Accession to Wealth

[C] Discharge of Indebtedness

[1] Defer Taxation of Income; Basis Adjustment

[b] Solvent Debtors

Page 81, add the following

The exclusion from income resulting from a discharge of indebtedness on a principal residence is extended through 2016 by PATH of 2015.

3.07 What Is Income – Accession to Wealth

[C] Barter Clubs

Page 87, add the following

The receipt of virtual currency, such as Bitcoin, is similar to a barter receipt. In both instances, the taxpayer receives property includible in gross income in the amount of its fair market value. The property has a basis equal to that fair market value and a sale or exchange of the virtual currency is taxed in the same manner as any sale or exchange of property. IRS Notice 2014-21, 2014-16 I.R.B. 1.

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Chapter 4

GIFTS

4.04 Death

[E] Gift Tax

Pages 97–98, add the following

The gift tax exclusion for 2017 remains at **$14,000** (unchanged from 2016).

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Chapter 6

LEGISLATIVE PROCESS, ADMINISTRATIVE RULEMAKING, THE ADJUDICATION SYSTEM, AND PROFESSIONAL ETHICS

6.01 Legislative Process

[B] How Congress Legislatives Tax Law

[2] Legislative History; Committee Reports

Page 122, add the following

In United States v. Woods, 134 S.Ct. 557 (2013), Justice Scalia's majority opinion was very dismissive of the Blue Book. He stated:

> [The taxpayer] contends [] that a document known as the "Blue Book" compels a different result. Blue Books are prepared by the staff of the Joint Committee on Taxation as commentaries on recently passed tax laws. They are "written after passage of the legislation and therefore d[o] not inform the decisions of the members of Congress who vot[e] in favor of the [law]." We have held that such "[p]ost-enactment legislative history (a contradiction in terms) is not a legitimate tool of statutory interpretation." While we have relied on similar documents in the past, our more recent precedents disapprove of that practice. Of course the Blue Book, like a law review article, may be relevant to the extent it is persuasive. But the passage at issue here does not persuade.

6.03 Tax Law Adjudication

[B] Court Level

Page 145, add the following

In Kuretski v. Commissioner, 755 F.3d 929 (D.C.Cir. 2014), the taxpayer argued that the President's power to remove Tax Court judges for good cause unconstitutionally interfered with the court's independence. The court rejected the taxpayer's argument, engaging in some very fancy judicial footwork. It agreed that a Presidential power to remove an Article III judge would be unconstitutional, but it concluded that, although Tax Court judges exercised a judicial power, they did not exercise an Article III judicial power. Next, the court addressed the taxpayer's claim that the Presidential power of removal violated Separation of Powers because the Tax Court was part of the legislative branch, having been created as an Article I court. The court held that the fact that Congress had created the court under Article I did not make the judges members of the Legislative Branch. The court went on to conclude that Tax Court judges were part of the Executive Branch, even though they exercise judicial power and even though the Tax Court was created as an Article I court. Therefore, they could be removed by the President without violating the Constitution.

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Chapter 7

INCOME IN-KIND

7.02 Employee Fringe Benefits

[C] The Statutory Exclusion Rules

[3] Parking

Page 169, add the following

The inflation-adjusted exclusion for the parking fringe benefit is **$255** for 2017.

7.04 Employee fringe benefits

Page 177, add the following

[D] ABLE Program for Disabled

Another interesting feature of **529** is the spawning of copycat provisions, which accomplish different purposes but use the same statutory structure as the provision giving tax breaks for financing future education. **529A**, adopted in 2014, allows for cash contributions to an ABLE program (except that total annual contributions cannot exceed the gift tax exclusion amount). Both the program and its distributions are tax exempt if they meet certain requirements for helping the disabled. The program must be established by an eligible individual – (1) someone who became blind or disabled before the age of 26 and is entitled to receive benefits from Social Security because of blindness or disability or (2) someone who is certified as disabled based on a physician's diagnosis that the impairment began before the age of 26 and will result in death or has lasted or will last at least 12 months. Distributions to a designated beneficiary – either the eligible individual who established the ABLE account or certain eligible individuals who are members of the same family (siblings) – are tax free if used for "qualified disability expenses." Expenses qualify if they are related to the individual's blindness or disability and include expenses for education, housing, transportation, employment training, health, financial management, legal fees, and funerals.

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Chapter 10

CHARITY

10.04 Noncash Gifts

[A] Appreciated Property

Page 275, add the following

The relaxation of the rule reducing value to basis for charitable gifts of food has been made permanent by PATH of 2015.

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Chapter 11

DEPRECIATION

11.02 Depreciation Under the Statute

[B] Tax Reform Act of 1986, as Amended in 1993 (MACRS)

Page 287, add the following

Bonus depreciation has been extended by PATH of 2105, as follows: 50% for 2015-2017; 40% for 2018; and 30% for 2019.

11.03 Other Investment Incentives

[A] Expensing and Short-Period Depreciation

[2] Section 179

Page 299, add the following

The benefit of higher expensing limits under sec. 179 has been made permanent by PATH of 2015. The $500,000 expending limit and the $2 million phase-out threshold will be adjusted for inflation beginning in 2016. For 2017, the expensing limit is **$510,000** and the phase-out threshold is **$2.01 million**.

[B] Tax Credits

Page 299, add the following

Other business credits. PATH of 2015 made the research credit permanent. It also extended the Work Opportunity Credit through 2019; and extended the **section 25C** residential energy property credit through 2016.

Adoption. The adoption expenses eligible for the credit and income exclusion in 2017 are **$13,570** and the phase-out threshold is **$203,540**.

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Chapter 13

CAPITAL EXPENDITURE VS. CURRENT EXPENSE

13.04 Education Expenditures

[C] Education Tax Subsidies

[1] Hope Scholarship (renamed American Opportunity Tax Credit – AOTC) and Lifetime Learning Credits; Section 25A

Page 347, add the following

The AOTC was made permanent by PATH of 2015.

Lifetime credit. The **Lifetime** credit is phased out based on a modified AGI figure that is adjusted for inflation. For 2017, the phase-out range for single individuals is **$56,000–$66,000** and for married taxpayers is **$112,000–$132,000**.

[3] Deduction for Qualified Higher Education Expenses; Section 222

Page 349, add the following

PATH of 2015 extended the **section 222** deduction through 2016.

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Chapter 14

PUBLIC POLICY

§ 14.02 Illegal Activity

[D] Costs – Defining Gross Income

Page 369, add the following

Medical marijuana. In Olive v. Commissioner, 792 F.3d 1146 (9th Cir. 2015), the court relied on **§ 280E** to disallow the deduction of business expenses related to the sale of medical marijuana, which was legal under California law but continued to be illegal under federal law. The court did not consider whether the expenditures could be added to cost of goods sold.

§ 14.03 Political Expenditures

[F] Taxing Political Recipients and Organizations

Page 381, add the following

[2] Taxing Political Organizations

[c] Section 501(c)(4) Organizations

Citizens United v. Federal Election Commission, 558 U.S. 310 (2010), held that it was unconstitutional to place dollar limits on contributions to PACs that acted independently of candidate control. Consequently, there is no longer any need for a PAC to pretend it is engaging in issue advocacy. However, a tax issue remains. If the PAC is a **section 501(c)(4)** ("social welfare") organization, it is tax exempt. Moreover, **section 501(c)(4)** organizations enjoy an important non-tax benefit; unlike other organizations that support political candidates, there is no requirement to divulge the names of their contributors. It is commonly understood that an organization that otherwise engages in "social welfare" activities can retain its **section 501(c)(4)** status as long as it spends less than 50% of its money on politics.

The IRS allegedly looked closely at **section 501(c)(4)** organizations when they supported conservative causes. Whether or not that charge was accurate, Congress reacted to limit the IRS' ability to question their tax-exempt status. The Fiscal Year 2016 omnibus budget law prohibits the IRS from issuing new regulations, revenue rulings, or other guidance during 2016 about whether an organization qualifies under **section 501(c)(4)**. In addition, PATH of 2015 extends the declaratory judgment procedure of **section 7428** (already available for **section 501(c)(3)** organizations) to the initial determination and continuing classification of the tax-exempt status of a **section 501(c)(4)**) organization.

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Chapter 18

THE ALTERNATIVE MINIMUM TAX

§ 18.02 Mechanics

[A] Tax Rates

Page 455, add the following

The rate brackets for the alternative minimum tax for individuals are adjusted for inflation. In 2017, the 26% rate applies to the first **$187,800** of alternative minimum taxable income; the rate is 28% on income over that amount.

Pages 458–59, add the following

[C] Exemptions — § 55(d)

[1] Amounts

The exemption amount for individuals is adjusted for inflation. For 2017, the amount is **$84,500** for a married couple and **$54,300** for an individual.

[2] Phase-Out

In 2017, the inflation-adjusted exemption amounts for individuals are phased out at the rate of 25 cents per dollar of alternative minimum taxable income above **$160,900** for a married couple and above **$120,700** for a single individual.

[3] Kiddie Tax

Recall the kiddie tax under the regular income tax (Chapter 1.03[A]), designed to prevent one member of the family from shifting investment income to a child. **Section 59(j)** provides that any child who would be subject to the kiddie tax under **§ 1(g)** shall be entitled to no more than a reduced personal exemption amount under the AMT — specifically, earned income plus $5,000 (inflation-adjusted to **$7,500** for 2017).

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Chapter 20

CAPITAL GAINS AND LOSSES – DEFINITION

§ 20.07 "Sale or Exchange"

[A] In general

Page 505, add the following

In CRI-Leslie, LLC v. Commissioner, 147 T.C. # 8 (2016), the issue was whether a taxpayer could treat the gain on the termination of a sales contract as capital gain when the underlying sale property was sec. 1231 property. The taxpayer had received a deposit from a prospective buyer of the property and retained the deposit when the buyer defaulted.

The court refused to treat the gain on the deposit as capital gain under sec. 1234A, relying on the plain meaning of the statute. Although the decision appears to stick to the plain meaning approach to interpreting the tax law, two features of the opinion give a nod to intentionalism. First, the court said that there was no legislative history indicating that a right to sell sec. 1231 property was covered by sec. 1234A. Second, the purpose of sec. 1234A would not be served in all cases by treating the termination of the sales contract as the sale of a capital asset. The purpose of sec. 1234A was to equate termination of the right with sale of the underlying property. When the underlying asset is a capital asset, its sale will always produce capital gain or loss. But sale of sec. 1231 property could result in either capital gain or ordinary loss depending on the circumstances.

A curious feature of the Tax Court's opinion is that there was in fact legislative history suggesting that sec. 1234A applied to a sale when the underlying property was sec. 1231 property. That history stated that the section was meant to change the results in two cases, both of which involved sec. 1231 property (although the legislative history did not mention that these cases involved sec. 1231 property). The taxpayer had explicitly noted this history but it was not mentioned in the court's opinion. A more sophisticated analysis that took account of this history would have had to choose between evidence of legislative intent (derived from legislative history) and evidence of legislative purpose, which would pull in different directions.

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Chapter 24

CASH METHOD

24.06 Qualified Retirement Plans

[B] No Tax Now; Taxable Later

[2] Traditional IRAs

Page 564, add the following

The $5,000 maximum annual deduction for contributions to a traditional IRA is adjusted for inflation. The amount is **$5,500** for 2017. The "catch-up" amount for 2017 is **$6,500**. For a taxpayer who *is* an active participant in a qualified retirement plan, the inflation-adjusted income phase-out range for 2017 is **$62,000–$72,000** for single taxpayers and **$99,000–$119,000** for married couples. If the taxpayer is *not* a participant in a qualified retirement plan but the spouse is an active participant, the inflation-adjusted phase-out range for 2017 is **$186,000–$196,000.**

[C] Nondeductible Now; Exempt Later

[1] Roth IRAs

Page 565, add the following

For 2017 the inflation-adjusted contribution ceiling is **$5,500**. For 2017 the inflation-adjusted phase-out threshold above which the tax break for contributions to a Roth IRA begins to disappear is **$118,000** for single taxpayers and **$186,000** for married couples.

[5] Qualified Charitable Distributions from IRAs

Page 565, add the following

PATH of 2015 made permanent the opportunity for a taxpayer aged 70 1/2 or older to distribute up to $100,000 from an IRA to a charitable organization without recognizing the distribution in income.

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Chapter 27

ESTATE AND GIFT TAX

§ 27.01 A Brief Explanation

[B] Exemptions

Page 616, add the following

For 2017 the inflation-adjusted estate tax exemption is **$5.49** million.

§ 27.02 Gift Tax

[C] Exclusions

Page 618, add the following

The gift tax exclusion for 2017 is **$14,000** (unchanged from 2016).

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Chapter 28

SOCIAL SECURITY TAX

28.01 In General

Page 633, add the following

The inflation-adjusted maximum earnings subject to the social security tax for 2017 is **$127,200**.

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Chapter 29

SALES TAX

29.05 Use Tax and Constitutional Law

[B] Collection Problems—Interstate Issues

[1] In General

Page 682, add the following

In Direct Marketing Ass'n v. Brohl, 135 S.Ct. 1124, 1134-35 (2015), Justice Kennedy wrote a concurring opinion stating that, in view of technological and social changes, it was time to revisit the decision in *Quill* that the Commerce Clause required a physical presence in the state before the state could impose a use tax.

[2] Use of Independent Contractors

Page 686, add the following

The U.S. Supreme Court refused to hear the appeal in the *Amazon* case; 134 S.Ct. 682 (2013).

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Chapter 34

INTERNATIONAL TAXATION

34.03 Undertaxing International Income

[C] Tax Havens

[2] Typical Tax Haven Income

[c] Foreign Personal Holding Company Income

Page 776, add the following

PATH of 2015 extends the look through rule for payments of dividends, etc. between related controlled foreign corporations through 2019.

Page 777, add the following

34.04 "Inversions"

An "inversion" is a technique by which a U.S. corporation (US) transfers substantially all of its property to a foreign corporation (FC) in an effort to avoid the impact of U.S. law that taxes the worldwide income of its taxpayers. Assume US has both U.S. and foreign income. If the inversion works, the United States will only be able to tax FC's U.S. income. That is because FC is a foreign corporation and U.S. law typically defines the residence of a foreign corporation as the place of incorporation; the foreign income previously earned by US will now be FC's income, beyond the reach of the United States tax law. In addition, FC is usually organized in a low-tax country and/or a country that does not tax foreign earnings with a permanent establishment outside the country in which FC is organized.

Sec. 7874 prevents this tax avoidance technique under specified circumstances. (The statute refers to the U.S. corporation as an "expatriated entity" and to the foreign corporate acquirer as a "surrogate foreign corporation.") Here is a simplified skeletal summary of what sec. 7874 accomplishes.

First, if the former shareholders of US own 80% or more of FC (by reason of owning US's stock), FC is treated as a U.S. corporation and the inversion is ineffective to avoid U.S. tax on FC's foreign income. (The transaction itself is treated as an "F" reorganization with no tax consequences to US or its shareholders.)

Second, if the former shareholders of US own 60% or more of FC (but not 80%) and FC does *not* conduct "substantial business activity" in the foreign jurisdiction where FC was created, then the inversion is subject to the following adverse tax consequences. The gain on the transfer of property to FC is taxable by the United States. Moreover, US cannot reduce its gain by any net operating loss that might otherwise be available to offset tax on the gain.

The percentage ownership of stock specified in these provisions is determined by either vote or value. Moreover, these provisions supersede the rules provided in a tax treaty.

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The statute prevents the bulking up of FC's ownership through a public offering in an attempt to achieve the reduced percentage ownership by US's shareholders that would avoid the adverse tax consequences of sec. 7874.

Complex regulations (which are likely to be challenged as not authorized by the governing statute) elaborate on the statutory rule preventing the bulking up of FC's ownership and the definition of what constitutes "substantial business activity" in the FC jurisdiction. The government will undoubtedly cite sec. 7874(g) to defend its Regulations; that section authorizes regulations that "are necessary to prevent the avoidance of the purposes" of sec.7874.

US may also attempt to engage in "earnings stripping" – by borrowing money from FC and paying the lender-FC deductible interest. This technique is not addressed by sec. 7874, but the Treasury has recently attempted to use sec. 385 to recharacterize the debt as equity so that the interest becomes a nondeductible dividend. That section has long been considered a dead letter after several attempts at proposed regulations were considered too controversial and were withdrawn. It remains to be seen whether the government can successfully use sec. 385 in the inversion context.

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Chapter 35

INTERSTATE TAXATION

35.02 Federal Constitutional Limits

[A] Introduction: The Due Process/Commerce Clause Framework

[2] Constitutional Requirements – Connection/Nexus; Nondiscrimination

Page 785, add the following

[c] Professional Athlete

Professional athletes can be taxed by a state in which they play games. The problem is to allocate a portion of their total income to the jurisdiction in which the performance occurs. A professional football player played one game per year in the City of Cleveland. The City used as the denominator in the allocation fraction the total number of games played in the year (around 20), resulting in a 5% allocation of income to Cleveland. The athlete argued that the denominator should have been the total duty days – that is, work days. Total work days in the year were around 160, two of which were in Cleveland; that produced an allocation of a little more than 1% of the total income to Cleveland. The Ohio Supreme Court upheld the athlete's claim that Cleveland's formula violated Due Process because it "reache[d] income that was performed outside Cleveland." Hillenmeyer v. Cleveland Board of Review, 41 N.E.3d 1164 (Ohio 2015).

35.02 Federal Constitutional Limits

[B] Fair Apportionment; Internal and External Consistency

[1] Income Tax

Page 795, add the following

COMMENT ON INTERNAL CONSISTENCY

In Comptroller of the Treasury of Maryland v. Wynne, 135 S.Ct. 1787 (2015), the Court struck down the following Maryland tax scheme as a violation of the dormant Commerce Clause, analogizing it to an impermissible tariff on out-of-state activities. (Justice Alito's opinion was joined by Roberts, Kennedy, Breyer, and Sotomayor.) Like many states, Maryland taxed income earned by its residents both within and outside the state, and taxed income earned by nonresidents within Maryland. But Maryland, unlike many states, did not offer a full credit for taxes paid to other states. (More precisely, Maryland provided a credit against its state income tax, but not its county tax, for taxes paid to other states.) This double tax scheme encouraged Maryland residents to choose *intra*state activities rather than out-of-state activities.

The Court applied the "internal consistency" standard introduced in the *Container Corp.* case, as follows:

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> Maryland's income tax scheme fails the internal consistency test. A simple example illustrates the point. Assume that every State imposed the following taxes, which are similar to Maryland's "county" and "special nonresident" taxes: (1) a 1.25% tax on income that residents earn in State, (2) a 1.25% tax on income that residents earn in other jurisdictions, and (3) a 1.25% tax on income that nonresidents earn in State. Assume further that two taxpayers, April and Bob, both live in State A, but that April earns her income in State A whereas Bob earns his income in State B. In this circumstance, Bob will pay more income tax than April solely because he earns income interstate. Specifically, April will have to pay a 1.25% tax only once, to State A. But Bob will have to pay a 1.25% tax twice: once to State A, where he resides, and once to State B, where he earns the income.

The Court explained that Maryland could cure its violation of the internal consistency standard either by giving a credit for out-of-state taxes or by repealing its tax on a nonresident's income. The repeal of the tax on a nonresident's income avoids violating internal consistency because it *assumes* that the other state also does not tax nonresident income, whether or not that is the case.

Justices Scalia and Thomas dissented (in part) on the ground that the dormant Commerce Clause jurisprudence was "a judicial fraud." As for the argument that the dormant Commerce Clause had "deep roots," Scalia noted that so do "many weeds" and that "age alone does not make up for brazen invention," and that, in any event, it was "not so old." Justice Ginsburg (joined by Scalia and Kagan) wrote a long dissent, arguing that the Court was, in effect, forcing either the resident or the source state to recede its taxing claims in order to avoid double taxation.