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In this installment of Commerce Crossroads, Wilford argues that a recent Pennsylvania Supreme Court decision conflicts with the judicial precedent regarding multiple taxation.

Few phrases strike fear in the heart of the American taxpayer quite like "multiple taxation." Offending not just one's sense of justice and fairness but also long-standing legal precedents, efforts by two states to tax the same income are theoretically impermissible under the Constitution and decades of judicial precedent. Nevertheless, states and their sub-jurisdictions continue to see how far they can stretch their jurisdiction without violating this taxation taboo.

A recent decision by the Pennsylvania Supreme Court in *Zilka* potentially opens the door to further pushing of this proverbial envelope.[1] By deciding that local jurisdictions can apply their taxes without regard to state-level taxes for apportionment and credit purposes, the court has created a shortsighted and illogical justification for discriminatory tax treatment of nonresident taxpayers.

Background

In 1977 the U.S. Supreme Court's decision in *Complete Auto* set out a four-pronged test for whether a tax complied with the commerce clause. This test found a tax to be constitutional "when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State."[2] Failure to satisfy any of these four prongs meant that the tax in question violated the clause.

Yet there remained substantial uncertainty about how this test was to be applied. For instance, did the requirements to "fairly apportion" taxes to each state and "not discriminate against interstate commerce" apply separately at the state and local levels, or should those taxes be considered in aggregate?

The 2015 Supreme Court decision in *Wynne* aimed to definitively answer this question.[3] In *Wynne*, a couple who earned income in multiple states had been permitted by Maryland to credit their income taxes paid to other states against their Maryland state income tax, but not against their local county income tax. Maryland argued that the taxes were separate and that credits need only be provided between like jurisdictions.

The majority in *Wynne* disagreed with Maryland's assessment. Counties failing to provide a credit for state-level taxes in other states meant that nonresident income was taxed at a higher rate than resident income. In effect, the Court found Maryland's scheme functioned as a tariff. After all, the distinction between a state and its local taxing jurisdiction is insignificant from a

[1] *Zilka v. Tax Review Board of City of Philadelphia*, Nos. 31 EAL 2022, 32 EAL 2022 (Pa. Nov. 22, 2023).

[2] *Complete Auto Transit Inc. v. Brady*, 430 U.S. 274 (1977).

[3] *Comptroller of the Treasury of Maryland v. Wynne*, 575 U.S. 542 (2015).

constitutional perspective. Local jurisdictions' taxing powers are merely a devolution of states' own powers of taxation.

To illustrate this, consider the two possible approaches states can take to funding local jurisdictions: one that involves collecting taxes at the state level and passing a portion along to its sub-jurisdictions to fund local priorities, and one that allows local jurisdictions to simply assess their own local taxes. Which approach to use is up to each state; effectively, it's just a matter of how the state wishes to apply its taxing powers.

But had the Court decided differently in *Wynne*, the latter approach would result in greater income tax revenue from nonresidents than the former approach, and taxpayers who engaged in commerce across state lines would have faced higher tax rates than taxpayers who restricted their activities to a single state. Not only would this result be unfair, it would represent exactly the kind of restriction on interstate commerce that the commerce clause exists to prevent.

What's more, this would have created an arbitrary incentive for states to collect less revenue at the state level and encourage their sub-jurisdictions to raise their *own* taxes, to collect more revenue from nonresidents. States that prioritized taxes at the state level would not only be forgoing the opportunity to skim a little extra from nonresidents, but their own residents would face extra tax burdens for engaging in economic activity outside the state.

While *Wynne* alluded to the idea that states should consider state tax codes in aggregate with their sub-jurisdictions, it did not explicitly lay that out. That left the questions in *Zilka* unanswered.

Zilka

While *Wynne* seemed to answer the question whether taxes must be aggregated between state and local levels, the case concerned whether local jurisdictions must provide credits for income taxes paid to another state. But do local jurisdictions have to consider their *own* state's tax rates as well?

Diane Zilka is a Philadelphia resident who works in Wilmington, Delaware. Consequently, she owes income taxes to four jurisdictions: 3.922 percent to Philadelphia, 3.07 percent to Pennsylvania, 1.25 percent to Wilmington, and 5 percent to Delaware.

Zilka argued that the state and local tax rates should be aggregated. As such, she sought to apply the 1.93 percent difference between Delaware's 5 percent income tax rate and Pennsylvania's 3.07 income tax rate as a credit against her Philadelphia income tax liability, in addition to the 1.25 percent tax paid to Wilmington. In other words, she argued that her total 6.25 percent Delaware tax rate should be creditable against her total 6.992 percent Pennsylvania tax rate, without regard to whether taxes were assessed at the state or local levels.

Philadelphia took the position that credits should be applied separately. Consequently, it permitted a credit for the 1.25 percent income tax paid to Wilmington but not the 1.93 percent difference between Delaware and Pennsylvania income tax rates.

The Pennsylvania Supreme Court issued a 3-2 decision that state and local income taxes did not need to be considered in aggregate. One justice in the majority authored a concurrence arguing that while the decision was unfair to Zilka and created a burden on interstate commerce, it was up to the U.S. Supreme Court to expand on its decision in *Wynne* if it intended courts to consider state and local tax jurisdictions in the aggregate.[4] This represents a failure of imagination. Such a narrow interpretation of *Wynne* leaves it up to the Supreme Court to enunciate every possible violation of the commerce clause before lower courts can be responsible for striking them down.

As the dissent suggests, the *Zilka* majority should instead have taken responsibility for recognizing that the effect of Philadelphia's interpretation is much the same as the effect of the tax scheme struck down under *Wynne*.[5] Even though *Wynne* did not explicitly *require* courts to consider state and local income taxes in aggregate for determining the constitutionality of a tax, it struck down the tax scheme in *Wynne* for creating an imbalance in taxes owed between taxpayers engaged in interstate commerce and taxpayers engaged in intrastate commerce.

[4] *Zilka*, Nos. 31 EAL 2022, 32 EAL 2022 (Wecht, J., concurring).

[5] *Zilka*, Nos. 31 EAL 2022, 32 EAL 2022 (Dougherty, J., dissenting).

That is also the case in *Zilka*. Waiting on guidance from the Supreme Court for striking down an application of tax that violates the commerce clause is entirely backward — instead, courts should err on the side of striking down tax schemes that appear to unconstitutionally burden interstate commerce unless explicitly told otherwise by the Court.

Broader Implications

While the U.S. Supreme Court may feel hesitant to take up a case so similar to *Wynne*, it has an obligation to do so in order to prevent *Zilka* from fatally undermining the protections against multiple taxation that were provided under that opinion. Indeed, the concurrence practically asks the Court to grant certiorari on any future appeals by Zilka, noting that "this case may be worthy of certiorari so that the Court can consider whether the internal consistency test should be applied as a state-level inquiry."

Absent further clarification from the highest court in the land, other localities will likely adopt Philadelphia's position regarding credits. Broader uptake of Philadelphia's position will lead to a net increase in tax rates across the country for taxpayers engaging in commerce across state lines, a consequence that alone should prompt a reevaluation of the Pennsylvania decision.

Failure to answer this lingering question also risks multiple taxation for other tax applications. This represents a risk to taxpayers caught between overlapping jurisdictions, particularly when one of the two states believes the other is wrongly claiming nexus. Generally, in these cases, one of the two states reluctantly provides a credit for taxes paid to the other state. But absent specific direction from courts to the contrary, they may be more inclined to draw these disputes out, to affected taxpayers' detriment.

Conclusion

Zilka can only be described as disappointing for taxpayers. Failure to extend the logic behind *Wynne* to Zilka's circumstances led to a decision that contravenes both *Wynne* and the commerce clause. A precedent that allows more burdensome taxation to apply to interstate commerce is not just unfair and legally dubious, but also harmful to the country and the economy. Taxpayers should be free to conduct their business and livelihood across state lines without being placed at a tax disadvantage compared with local residents.

Zilka should not be the final word on how states and localities provide income tax credits. If the Pennsylvania Supreme Court is unwilling to take it upon itself to ensure a fair and proper application of the commerce clause, the U.S. Supreme Court should do so. ■