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New Hampshire v. Massachusetts: Taxation Without Representation?

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New Hampshire v. Massachusetts: Taxation Without Representation?

By Richard D. Pomp

Richard D. Pomp examines what may be the most closely watched SALT case this year: New Hampshire v. Massachusetts.

Readers of this JOURNAL are well aware of New Hampshire's pending motion in the U.S. Supreme Court for leave to file its bill of complaint against Massachusetts.[1] At the end of January, the Court invited the Acting Solicitor General to file a brief expressing the views of the United States.[2] A response is likely to await the President's appointment of the new Solicitor General.

The issue in that case is whether Massachusetts may constitutionally subject nonresidents to its state income tax when they perform services outside the state that were formerly provided in the state.[3] Does the taxing sovereignty of Massachusetts extend to nonresidents working outside that state, a telecommuter, just because they once worked in the state?[4] Some might describe this as "nexus on steroids."

That nonresidents who earn their income *within* a state can be taxed by it is uncontroverted. Cases under the Due Process Clause,[5] the Commerce Clause, and the Privileges and Immunities Clause make this clear.[6] Put simply, the state of source can tax a nonresident's income earned in that state or derived from sources in that state.[7]

This essay deals with a more fundamental question. As a jurisprudential question, *why* can the source state tax a nonresident's income from sources in that state? After all, nonresidents cannot vote in the source state so does not a tax on their income violate what the country fought for in the American Revolution, "No Taxation Without Representation?"

The answer partly lies in the prohibition of a state tax that discriminates against interstate commerce.[8] As long as the source state's income tax cannot discriminate against nonresidents, they must be treated the same as residents. Consequently, as residents pursue their self-interest in ensuring that the rates of tax and the rules for defining the income tax base are acceptable, they are simultaneously protecting the interests of the nonresidents. Provided the rates and rules are the same for both residents and nonresidents—which constitutionally they must be—the interests of the residents protect the interests of the nonresidents. Nonresidents may not vote, but the residents serve as their proxies. When the

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residents vote on how much income tax they are willing to bear, they are also voting on behalf of, and thereby protecting, nonresidents.

This safeguard, however, breaks down when it comes to issues of jurisdiction, like nexus, which is at the heart of New Hampshire's motion. Now the interests of the residents and nonresidents conflict. The residents are taxed on their worldwide income, so issues of nexus are not their immediate concern. Nonetheless, they may not be totally indifferent to jurisdictional issues because the more taxes that can be raised from nonresidents who do not vote, the less the legislature will have to raise from residents, who do vote. Legislators share this same perspective. Expansive and aggressive views of nexus serve the interests of residents—not those of nonresidents.

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The previous convergence of interests over rates and the tax base breaks down over issues of jurisdiction. The only safeguards that nonresidents have are the courts (and less likely to act—the Congress).[9] And time is of the essence to resolve these issues as other states have rules like those of Massachusetts and more can be expected to follow suit to fill in deficits by taxing nonvoters.[10]

New Hampshire is asking the Supreme Court to hear its case under the original jurisdiction clause of the U.S. Constitution. The Constitution includes within the Court's original jurisdiction "all Cases … in which a State shall be Party."[11] This jurisdiction has been interpreted as discretionary.[12] The Court has exercised its discretion "most frequently" to consider disputes "sounding in sovereignty and property, such as those between states in controversies concerning boundaries, and the manner of use of the waters of interstate lakes and rivers."[13]

New Hampshire v. Massachusetts is such a case. Nexus involves issues of sovereignty of the type of the Court has heard under its original jurisdiction. A "tax base" is a resource like that of a lake or river. The more one state draws down that resource, the less that is available for other states to tap, especially the state of residency.

Another case the Supreme Court heard under its original jurisdiction powers involved the right of Virginia to withdraw water from a river to the detriment of Maryland residents.[14] New Hampshire would view a similar issue as being raised in its motion: does Massachusetts have the right to withdraw financial resources from New Hampshire residents to their state's detriment?

The normal political safeguards are missing in the case of boundary disputes and the use of natural resources, and this has required the Court's intervention. These political safeguards are also missing when Massachusetts asserts the right to tax nonresidents whose interests are not being protected by Massachusetts voters.

Just the way *South Dakota v. Wayfair, Inc*,[15] modernized the rules on the interstate collection of sales and use taxes, New Hampshire's motion invites the Court to do the same for personal income taxes. Indeed, the substantial increase in remote work and telecommuting is just another manifestation of how the digital age is challenging longstanding jurisdictional norms, exactly what the Court confronted—and resolved—in Wayfair.

ENDNOTES

1 Motion for Leave to File Bill of Complaint, *New Hampshire v. Massachusetts*, No. 22O154 (U.S. Oct. 19, 2020).

2 *New Hampshire v. Massachusetts*, 141 SCt 1262 (2021).

3 For a superb analysis of the issues, *see* Brief of Professor Edward A. Zelinsky as Amicus Curiae in Support of Plaintiff's Motion for Leave, *New Hampshire v. Massachusetts*, No. 22O154 (U.S. Dec. 10, 2020) (hereinafter "Amicus Brief"). Professor Zelinsky has more than an academic interest in the matter. *See Zelinsky v. Tax Appeals Tribunal*, 1 NY3d 85 (2003), *cert. denied* 541 US 1009 (2004). He states the issue before the Court rather colorfully: "Can a state leap over its border to tax a nonresident remote worker who never sets foot in the taxing state?" Amicus Brief at 2.

4 830 CMR 62.5A.3. The regulation applies, *inter alia*, to any work arrangement in which an employee who performed services at a location in Massachusetts prior to the Massachusetts COVID-19 state of emergency performs such services for the employer from a location outside Massachusetts during a period in which [the regulation] is in effect.

5 Under the Due Process Clause, a state "generally may tax only income earned within" it. *Okla. Tax Comm'n v. Chickasaw Nation*, 515 US 450, 463 n. 11 (1995); *Shaffer v. Carter*, 252 US 37, 57 (1920) (a state's taxing power over nonresidents extends only to the "property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources"); *Travis v. Yale & Towne Mfg. Co.*, 252 US 60, 75 (1920) (a state can tax "the incomes of non-residents arising from any business, trade, profession, or occupation carried on within its borders … ").

6 *MeadWestvaco Corp. v. Ill. Dep't of Revenue*, 553 US 16, 24 (2008) ("The Commerce Clause

forbids the States to levy … unfairly apportioned taxation"); *Complete Auto Transit, Inc. v. Brady*, 430 US 274, 287 (1977) (state tax must be "fairly apportioned" to the taxing state); *Okla. Tax Comm'n v. Jefferson Lines*, 514 US 175, 207 (1995) (Breyer, J., dissenting) ("reaffirm[ing] the Central Greyhound principle" of apportionment); *Central Greyhound Lines, Inc. v. Mealey*, 334 US 653, 663 (1948) ("gross receipts" tax must be "fairly apportioned" to business done in New York); *Comptroller of Treasury of Maryland v. Wynne*, 575 US 542, 588 (2015) (Ginsberg, J., dissenting) (it is well established that states may generally "tax nonresidents on 'income earned within the [sovereign's] jurisdiction'") (quoting *Oklahoma Tax Comm'n v. Chickasaw Nation*, 515 US 450, 463, n. 11 (1995)); Richard D. Pomp, State and Local Taxation, 9th ed. 2019, Ch. 4 (Privileges and Immunities Clause).

[7] The state of residency can tax the worldwide income of its residents. *Lawrence v. State Tax Comm'n of Mississippi*, 286 US 276, 279 (1932) (states are generally "unrestricted in their power to tax those domiciled within them … ").

[8] *Complete Auto Transit, Inc. v. Brady*, 430 US 274, 287 (1977) (state tax must not "discriminate[] against interstate commerce").

[9] Congress is the best-suited institution to develop a systemic solution to the taxation of nonresidents by source jurisdictions, but presumably it will not act before the Supreme Court decides whether to hear the case. If the Court hears the motion and endorses New Hampshire's views, thus reinforcing the status quo ante, Congress is unlikely to intervene. A decision for Massachusetts, on the other hand, is more likely to mobilize telecommuters, their employers, and their states of residency, which will lose revenue by granting a credit for the source state's income tax. If the Court rejects the motion, there would be little pressure on the Biden administration to act, which already has a full federal tax reform agenda. To be sure, bills predating the Biden administration have been introduced to prohibit the taxation of services performed outside a jurisdiction that is attempting to assert source jurisdiction. Some of these bills reflected the efforts of Professor Zelinsky, but none has had any traction. *See* Amicus Brief, at 21 n. 22.

[10] Arkansas, Connecticut, Delaware, Nebraska, New York, and Pennsylvania each have similar provisions under their "convenience of the employer approach," which should be irrelevant when there is no office in the taxing state to which the taxpayer can return. Lauren Loricchio, *Uniformity Needed in State Teleworking Guidance, Practitioners Say*, Tax Notes State (Jan. 25, 2021). Connecticut's convenience of the employer test applies only to non-resident taxpayers whose "state of domicile uses a similar test." Conn. Gen. Stat. §12-711(b)(3). These states had adopted their rules before Massachusetts.

Massachusetts, *inter alia*, argues that the nonresidents receive benefits from Massachusetts notwithstanding that they are not working within the state. Brief in Opposition to Motion for Leave to File Complaint, *New Hampshire v. Massachusetts*, No. 22O154 (US Dec. 11, 2020), at 30–31. The Massachusetts tax, however, would fail the external consistency test under the fair apportionment prong of Commerce Clause analysis. "External consistency … looks to the economic justification for the state's claim upon the value taxed, to discover whether a state's tax reaches beyond that portion of value that is *fairly attributable to economic activity within the taxing state*." *Oklahoma Tax Comm'n v. Jefferson Line, Inc.*, 514 US 175, 185 (emphasis added) (1995). No matter how Massachusetts tries to justify its tax on a person who performed no services in the state, the simple truth is that the nonresident was not performing any economic activity in the state that could justify a tax. Its approach would eviscerate the doctrine and leave it toothless.

[11] U.S. Const. Art. III, §2, Cl. 2.

[12] Since the First Judiciary Act, Congress has provided by statute that the Supreme Court has "original and exclusive jurisdiction of all controversies between two or more States." 28 USC 1251(a); *see* Judiciary Act of 1789, ch. 20, §13, 7 1 Stat. 80-81; *see also* Stephen M. Shapiro *et al.*, Supreme Court Practice §10.1, at 618–621 (10th ed. 2013). The Court has "interpreted the Constitution and [Section] 1251(a) as making [its] original jurisdiction 'obligatory only in appropriate cases,'" Mississippi, 506 US at 76 (quoting *Illinois v. City of Milwaukee*, 406 US 91, 93 (1972)), and therefore "as providing [the Court] 'with substantial discretion to make case-by-case judgments as to the practical necessity of an original forum in this Court,'" *id*. (quoting *Texas v. New Mexico*, 462 US 554, 570 (1983)).

[13] Supreme Court Practice §10.2, at 622 (collecting cases).

[14] *Virginia v. Maryland*, 540 US 56 (2003).

[15] *South Dakota v. Wayfair, Inc*, 138 SCt 2080 (2018).