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May 28, 2015
2015-069

flash Alert

A Publication for Global Mobility and Tax Professionals by KPMG's Global Mobility Services Practice

United States – Supreme Court Holds Maryland Tax Law Unconstitutional

by KPMG LLP's Washington National Tax practice, Washington, D.C. (KPMG LLP in the United States is a KPMG International member firm)

In a 5-4 ruling, the U.S. Supreme Court held on May 18, 2015, that a Maryland income tax law is unconstitutional because it does not provide a full tax credit to residents for income tax paid outside the state.[1]

Why This Matters

Affected taxpayers may be eligible for refunds, with interest. If an affected taxpayer was or is tax protected or equalized by his employer as part of an assignment program, that refund may belong to his employer, depending upon the policy.

In order to receive the refund, affected taxpayers must file a refund claim within three years of filing the original timely filed return, or within two years of payment, if later. Tax years 2012 through 2014 are open for refund claims. Additionally, a 2011 Maryland tax return that was filed on extension could still be open for a refund claim if the 2011 return was timely filed after May 19, 2012.

Going forward, Maryland residents who pay out-of-state income taxes will be able to apply those taxes as a credit against both the state and county portions of their Maryland income tax.

Like many states, Maryland taxes the income its residents earn both within and outside the state, as well as the income that nonresidents earn from sources within Maryland. The tax that Maryland imposes on its residents has two parts: a "state" income tax, which is set at a graduated rate, and a "county" income tax, which is set at a rate that varies by county but is capped at 3.2 percent.

Maryland offers its residents a credit against state income taxes paid to other states. However, Maryland does not allow taxes paid to other states that exceed the taxes paid to the state of Maryland to be used to offset the county income tax. As a result, Maryland residents can be double-taxed on income from out of state.

According to the U.S. Supreme Court, this tax scheme violates the Constitution's Commerce Clause by discouraging interstate commerce.[2]

KPMG Note

Over 50,000 Maryland taxpayers are likely affected by the ruling, and officials from the Comptroller of Maryland estimate refunds could total $200 million with interest.

This ruling could potentially impact other states that have similar laws.

Footnotes:

1 *Comptroller of Treasury of Maryland v. Wynne*, 575 U.S. ___ (S. Ct. May 18, 2015) at: http://www.supremecourt.gov/opinions/14pdf/13-485_o7jp.pdf.

2 For a more detailed analysis of the Court's holding, see "U.S. Supreme Court - Maryland's Law Not Allowing Individuals a Credit against County Income Taxes for Taxes Paid to Other States Is Unconstitutional," in KPMG LLP's *TaxNewsFlash* (May 18, 2015). Click here.

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