



## MEMORANDUM

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**To** Missouri Senator Kurt Schaefer

**FROM** Neal Kumar Katyal  
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**CC** Missouri General Assembly

**DATE** January 14, 2016

**SUBJECT** St. Louis and Kansas City’s Earnings Taxes Are Unconstitutional Under The U.S. Constitution’s Dormant Commerce Clause

The Constitution’s dormant Commerce Clause guarantees that Missourians can sell their goods and services as part of a “national common market.” *Hunt v. Washington State Apple Advertising Comm’n*, 432 U.S. 333, 350 (1977). But when a Missourian works or does business in another State—such as an Illinois commuter or a partner at a national law firm—he runs the risk of being taxed twice on the same dollar of income. That is because Missouri will want to tax its resident’s entire income, while the State where the worker is employed or does business will want to tax the part of his income earned in the State. Without some accommodation, the Missouri resident will pay more in taxes simply because he does business across state lines, a result that impedes the national free trade zone envisioned by the dormant Commerce Clause.

In the recent case of *Comptroller of the Treasury of Maryland v. Wynne*, 135 S. Ct. 1787, 1792 (2015), the U.S. Supreme Court held that the State where a worker lives cannot levy a tax on all of the resident’s income without some mechanism to ensure that the worker’s income is not double taxed. Without such a mechanism, the Court explained, the State’s tax scheme effectively acts as a tariff on interstate commerce—“the quintessential evil targeted by the dormant Commerce Clause.” *Id.* at 1792. Generally, States comply with this obligation by giving resident taxpayers a credit for taxes paid to other States and localities. Indeed, that is what Missouri does at the state level. Mo. Rev. Stat. § 143.081.

But the St. Louis and Kansas City earnings taxes do not follow the State’s sensible lead. St. Louis does not give *any* credit for taxes paid to other jurisdictions. And although Kansas City gives a credit for taxes paid to other cities, it does not provide a credit for taxes paid to political subdivisions other than cities, such as counties or school districts. That is important because States like Indiana, Ohio, and Pennsylvania levy non-city local income taxes for which a taxpayer earning income in those States would not receive a credit in Kansas City. *See Joseph*

Henchman & Jason Sepia, *Tax Foundation Fiscal Fact No. 280* (2011) (collecting local taxes imposed by other States), available at <http://goo.gl/RSzmcI>.

St. Louis and Kansas City's failure to give taxpayers a full credit for taxes paid to other States makes those taxes unconstitutional. For St. Louis, the local earnings tax flunks what the Supreme Court has termed the "internal consistency" test. *Wynne*, 135 S. Ct. at 1802-03. We explain the math in the attached addendum, but the test boils down to this: A St. Louis resident who works at Scott Air Force Base in Illinois will pay more taxes than a neighbor who is identical in every way except that he earns *his* income is earned at the Jefferson Barracks Military Post in Missouri. The dormant Commerce Clause was intended to prevent precisely this discriminatory result.

Kansas City's earnings tax fails the Supreme Court's separate "external consistency" test, which asks whether a resident has been subject to "[t]he threat of real multiple taxation." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 514 U.S. 175, 185 (1995). Consider a law firm partner in Kansas City whose firm has offices in Indianapolis, where Marion County imposes a 1.62% local income tax. Because Kansas City does not give a credit for taxes paid to non-city localities, the partner will pay taxes on that portion of his income twice—once to Marion County and again to Kansas City. The dormant Commerce Clause, again, forbids that result.

These rules are more than abstract legal principles. They have real effects for cities whose taxes are successfully challenged. In the wake of *Wynne*, for instance, Maryland's counties will have to pay \$200 million in refunds to taxpayers who were illegally taxed. Erin Cox & Michael Dresser, *Hogan Urges People To Collect Tax Refunds*, The Baltimore Sun, Sept. 28, 2015, available at <http://goo.gl/FT9CII>. Repealing St. Louis's and Kansas City's earnings taxes now will avoid a similarly painful result if and when they are struck down.

## About the Authors

**Neal Kumar Katyal** is the co-chair of Hogan Lovells's Appellate and Supreme Court practice group, the Paul and Patricia Saunders Professor of National Security Law at the Georgetown University Law Center, and a former acting Solicitor General of the United States. He has argued 27 cases before the U.S. Supreme Court and was lead counsel for the successful taxpayers in *Maryland Comptroller of the Currency v. Wynne*.

**Sean Marotta** is an associate in Hogan Lovells's Appellate and Supreme Court practice group. He drafted the winning briefs in *Maryland Comptroller of the Currency v. Wynne* and regularly counsels clients on dormant Commerce Clause issues.

The views expressed in this memorandum are those of the authors alone, and not those of Georgetown University, Hogan Lovells, or its clients.

**Addendum: St. Louis's Earnings Tax Fails The Supreme Court's "Internal Consistency" Test.**

In this addendum, we lay out the technical calculations behind our conclusion that St. Louis's earnings tax is unconstitutional under the Supreme Court's internal consistency test.

1. The internal consistency test "helps courts identify tax schemes that discriminate against interstate commerce" and "looks to the structure of the tax at issue to see whether its identical application to every State in the Union would place interstate commerce at a disadvantage interstate commerce compared with commerce intrastate." *Wynne*, 135 S. Ct. at 1802. The test does so "[b]y hypothetically assuming that every State has the same tax structure," which "allows courts to isolate the effect of a defendant's State's tax scheme" and distinguish between "(1) tax schemes that inherently discriminate against interstate commerce" and "(2) tax schemes that create disparate incentives to engage in interstate commerce . . . only as a result of the interaction of two different but nondiscriminatory . . . schemes." *Id.*
2. Assume, for our stylized hypothetical, that Missouri has a 10% tax on income and St. Louis has a 1% tax on income. The internal consistency test, as applied to the St. Louis earnings tax, proceeds as follows:
  - a. Every state and city has the same income tax schemes as Missouri and St. Louis.
  - b. Alice lives in St. Louis and earns \$100,000 entirely in St. Louis. She pays \$10,000 in Missouri state taxes ( $\$100,000 \times 0.1$ ) and \$1,000 in St. Louis local taxes ( $\$100,000 \times 0.01$ ). Alice's total tax bill is \$11,000.
  - c. Bob lives in St. Louis and earns \$100,000 in Belleville, Illinois, where Scott Air Force Base is located. He is assessed \$10,000 in Missouri state taxes ( $\$100,000 \times 0.1$ ) and \$1,000 in St. Louis local taxes ( $\$100,000 \times 0.01$ ). He also pays \$10,000 in Illinois state taxes ( $\$100,000 \times 0.1$ ) and \$1,000 in Belleville local taxes ( $\$100,000 \times 0.01$ ). (Recall that even though Illinois's tax rate may be different from Missouri's and Belleville does not have a local earnings tax, the internal consistency test assumes that all States have an identical tax system). Bob owes a total of \$11,000 in Illinois state and local taxes.
3. This example demonstrates that Bob pays more than Alice in taxes for no other reason than Bob does business across state lines and Alice does not. That means St. Louis's earnings tax discriminates against interstate commerce and is unconstitutional under the dormant Commerce Clause and *Wynne*.