

# New York High Court Rejects Challenge to Credit Denial

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By Andrea Muse

New York's highest court has dismissed a challenge to the state's denial of a credit for taxes on intangible investment income paid to another state.

The New York Court of Appeals on March 26 [dismissed appeals](#) in [Edelman v. Department of Taxation and Finance](#) and [Chamberlain v. Department of Taxation and Finance](#), finding that “no substantial constitutional question is directly involved.”

The decision leaves intact the rulings of the Supreme Court of the State of New York, Appellate Division, First and Third departments, that [New York's tax scheme](#) permitting both New York and Connecticut to tax intangible investment income without a credit for taxes paid to Connecticut does not affect interstate commerce and is constitutional.

Alyse McLoughlin of McDermott Will & Emery told *Tax Notes* March 27 that the high court's decision not to take up the appeals was disappointing because the court is supposed to hear appeals from appellate division decisions when there is a constitutional matter at issue.

“To say that the constitutional issue here is not substantial after the U.S. Supreme Court's issuance of its decision in *Wynne* is surprising,” McLoughlin said. “Pursuant to *Wynne*, there is no question that the commerce clause does apply to a state's personal income tax laws, and analysis of New York's imposition of a personal income tax on a statutory resident's income from intangibles is internally inconsistent when that individual is domiciled in another state.”

The taxpayers in *Edelman* and *Chamberlain* were domiciled in Connecticut but had permanent places of abode in and spent more than 183 days per year in New York. Both sets of taxpayers had intangible investment income that was taxed by Connecticut and by New York after the latter determined that the taxpayers were statutory residents of New York.

New York allows a credit for taxes paid to other states on income earned in that state, but the taxpayers were denied a credit for taxes on income from investments and intangibles paid to Connecticut because the income was not earned in Connecticut.

The First Department held on June 26, 2018, in *Edelman* that a 1998 decision on similar facts — [Matter of Tamagni v. Tax Appeals Tribunal of New York](#) — controlled and the denial of the credits was constitutional.

In *Tamagni*, the court of appeals ruled that the commerce clause wasn't implicated by a tax based on residency and that disallowance of the credit for taxes paid on investment and intangible income was constitutional. Even if the commerce clause was implicated, the court held, the tax didn't facially discriminate against interstate commerce.

Challenging the denial of the credit, the taxpayers argued that the U.S. Supreme Court's 2015 decision in [Comptroller of the Treasury of Maryland v. Wynne](#) abrogated the state ruling in *Tamagni*. In *Wynne*, the Court held that Maryland's failure to provide a credit for the local portion of a couple's individual income tax for taxes paid to other states violated the dormant commerce clause because it failed the internal consistency test.

But the First Department held that *Wynne* didn't apply to the facts of *Edelman* because *Wynne* involved business income that was traceable to an out-of-state source and did not involve individuals who faced double taxation on intangible investment income because they are domiciled in one state and statutory residents of another. The court ruled that there was no reason to apply the internal consistency test because the statute at issue did not affect interstate commerce.

The Third Department on November 1, 2018, found the First Department's analysis in *Edelman* persuasive and ruled against the taxpayers in *Chamberlain* on the same grounds.

Timothy Noonan of Hodgson Russ LLP, who represented the taxpayers, told *Tax Notes* March 27 that the taxpayers wanted the court of appeals to "take another look at *Tamagni* through the lens of *Wynne*."

"To deny these taxpayers the right to address this important constitutional question on the grounds that the *Tamagni* case still controls allows the court to essentially decide the constitutional question on the merits without ever actually giving the taxpayers the right to appeal that the law guarantees in constitutional cases," Noonan continued.

Noonan said that he and his clients are investigating whether a petition for cert to the U.S. Supreme Court would be the appropriate next step. He said they still believe that both cases address important post-*Wynne* questions, and that they're encouraged by all the support they've received from the legal and tax community.

Ruth Mason, professor of law at the University of Virginia School of Law, said that in her view, New York's tax residence rule violates the dormant commerce clause because it is internally inconsistent. Mason provided an expert opinion supporting the taxpayers in the cases.

Mason said the lower courts had essentially applied pre-*Wynne* law by using the *Tamagni* analysis. "I think it's a pity because in *Wynne* the Supreme Court went to a lot of effort to rationalize its dormant commerce clause doctrine, and the New York courts are essentially ignoring the implications of *Wynne*," Mason added.

Mason said she believes that the U.S. Supreme Court would presumably want to correct the decisions but that the issue would be if the Court would grant cert. "I think that the New York courts got it wrong and they got it pretty plainly wrong," Mason added.