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The Commuter: Residents v. Non-Residents

By: *Glenn Newman*

The hottest New York tax issue in the last few years has nothing to do with the New York State and City Tax Tribunals—or does it? As is widely known, New York State amended the New York City Nonresident Earnings Tax¹ ("Commuter Tax") to eliminate it for residents of New York State—but not for residents of other states. Oddly, the amendment² also provides that, in the event it is determined that the taxing of residents of New Jersey, Connecticut and other states who commute to work in New York City without similarly taxing residents of New York State is unconstitutional, then the entire New York City Nonresident Earnings Tax is to be repealed.

Constitutional Challenges

The constitutionality of these amendments to the Commuter Tax was challenged immediately. Four actions have been commenced³ in New York State Supreme Court, New York County, challenging the imposition of the Commuter Tax on out-of-state residents. In addition, the City of New York has brought suit challenging the repeal of the Commuter Tax as to New York State residents. This suit raises "home-rule" issues and procedural irregularities relating to the enactment of the amendment. The four suits regarding the out-of-state residents will be consolidated procedurally and all five suits will be heard by Justice Barry A. Cozier.

The Tax Tribunals

What does all of this have to do with the Tax Tribunals? These cases were brought immediately and directly in New York State Supreme Court, rather than following the normal procedure of challenging the tax in proceedings before the Tribunal. Clearly, taxpayers from New Jersey, Connecticut and elsewhere could refuse to pay the Commuter Tax and protest any assessments issued by the State Tax Department or pay the tax and claim refunds. But, there are significant reasons that the plaintiffs chose to go directly to the Supreme Court of the State of New York⁴ rather than follow the normal path to the Tax Appeals Tribunal.

First and foremost, is the fact that the Tax Appeals Tribunals cannot declare a statute unconstitutional on its face.⁵ Although The Tribunal has defined its jurisdiction as including a determination that a tax is unconstitutionally applied, it has stated that it cannot declare a statute unconstitutional on its face. What we have in S.5594-B is a statute that, on its face, calls for application of a tax to commuters from states other than New York but not to commuters from New York State and, as asserted in the complaints, is claimed to be unconstitutional both as written and as applied.

In addition, the normal path to the Tax Tribunal is a process that takes years before a case would come before an Administrative Law Judge, much less the Tribunal. There are hundreds of thousands of commuters against which the Tax Department would have to assess the tax or deny refund claims. Similarly, there are tens of thousands of businesses that the Tax Department would have to proceed against if they failed to withhold the tax from out-of-state commuters.

The Route Taken by Lunding

Certainly, taxpayers could await assessments of the tax or denial of refund claims and litigate their Privileges and Immunities, Equal Protection and Interstate Commerce Clause claims under the U.S. Constitution before the Tribunal. Actually, this was the process chosen in *Lunding v. State of New York*⁶. In *Lunding*, a resident of Connecticut challenged the denial of an alimony deduction to a nonresident under the New York Personal Income Tax that was available to residents.

As expected, the Administrative Law Judge and the State Tax Appeals Tribunal held in *Lunding* that they were precluded from addressing the claim that the statute denying the deduction was unconstitutional on its face. However, anticipating that position, the taxpayer also argued, that under the doctrines of collateral estoppel and stare decisis, the Tribunal was bound to follow the holding in an earlier case⁷ and find the statute invalid as violating the Privileges and Immunities Clause. The Tribunal did not agree that the case cited provided the authority for them to find for the taxpayer. The Tribunal suggested that, while the administrative interpretation invalidated in the earlier case might not be constitutional, the same discrimination might be constitutional if legislatively imposed.

From the Tribunal, *Lunding* progressed to the Appellate Division, which agreed that the statute violated the Privileges and Immunities Clause. However, the Court of Appeals reversed the Appellate Division⁸.

The Court of Appeals found two reasons to sustain the disallowance of the alimony deduction:

- The disallowance of alimony "is fully justified in light of the disparate treatment of income: non-residents are taxed only on income earned in New York, while residents are taxed on all income earned from whatever sources. Focusing on the practical effect and operation of the challenged tax it is clear that the advantage granted residents is offset by the additional burden of being taxed on all sources of income."
- The second basis was that the "disallowance is substantially justified by the fact that petitioner's alimony payments are...wholly linked to personal activities outside the State."

The U.S. Supreme Court granted the taxpayer's petition for certiorari and ultimately held for Mr. Lunding on the grounds that the denial of the alimony deduction for nonresidents of New York while granting such a deduction for residents violated the Privileges and Immunities Clause of the U.S. Constitution. The special nature of alimony as having a relation to both personal and business elements (although alimony is generally considered a personal item, it is frequently determined by reference to the business income or wages of the payor) made the *Lunding* case somewhat difficult to decide.

All things considered, it is important to note that it took Mr. Lunding six years to establish his right to a refund of \$3,724 (before expenses).

The Fast Track

In the alternative, a much faster adjudication is available—with the possibility of class action certification, issuance of a declaratory judgment, and injunctive relief—by way of initiating an action in State Supreme Court. Contrary to the recent decision in Supreme Court, Albany County,⁹ in which a declaratory judgment was denied because the court found factual issues in dispute, the State Supreme Court can determine the facial constitutionality of the statute and, if necessary, hold a hearing on any disputed factual issues. Significantly, one commentator discusses the availability of a jury trial in an action for a declaratory judgment clearly anticipating disputed facts.¹⁰

The relief of issuing a declaratory judgment declaring the statute unconstitutional and enjoining its enforcement are not remedies that the Tax Appeals Tribunals can grant. In fact, in a series of cases involving sales tax on waste disposal services, the State Tax Department continued to litigate cases against other taxpayers after the Tax Appeals Tribunal had held several times that the sales tax had been unconstitutionally applied.¹¹

Bases for Challenges

There are several bases for the constitutional challenge to the amendments to the Commuter Tax. Imposing the Commuter Tax only on commuters who are non-New York State residents violates the Privileges and Immunities Clause of the Constitution; violates the Equal Protection Clause of the Constitution and violates the Commerce Clause of the Constitution. By this action, the State of New York has denied out-of-state residents their civil rights in violation 42 U.S.C. Search7RH1983.

The four cases challenging the amendments to the Commuter Tax will be consolidated procedurally. The plaintiffs plan to make motions for summary judgment in the cases by June 9th, with argument on those motions to be heard before the end of the month. The fifth case, brought by the City of New York, challenging the repeal of the Commuter Tax as to New York State residents will also be heard by Justice Cozier on an expedited basis.

The papers in the four pending challenges have much in common. In order to explore the arguments, I will explain them in the context of the Complaint submitted by my firm in *Lary S. Wolf and Ellen S. Brody v. State of New York*. The constitutionality of the legislation is challenged on three bases: the Privileges and Immunities Clause, the Equal Protection Clause and the Commerce Clause of the U.S. Constitution.

Constitutional Issues

The U.S. Constitution provides: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States."¹² Basically this clause provides that no State may deny citizens of another state the privileges and immunities it affords its own citizens.

We argued that the Commuter Tax as amended violates the Privileges and Immunities Clause because it "immunizes" from tax residents of New York State who commute to the City to work while "infecting" residents of other states.

The U.S. Constitution provides: "No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty

or property without due process of law; *nor deny to any person within its jurisdiction the equal protection of the laws.*"¹³ (Emphasis added.) Equal Protection prohibits improper classifications based upon race, creed or, in this case, state of residence.

We argued that the Commuter Tax as amended violates the Equal Protection Clause because it classifies taxpayers strictly on the basis of the state in which they reside. While all tax statutes have classifications, such classifications must be rationally related to the purpose of the tax and cannot unreasonably discriminate. Discrimination on the basis of the state of residence is suspect and, clearly, cannot be supported. All who commute to New York City to work obtain benefits and services from the City. New York State residents pay a State personal income tax on their income; nonresidents pay New York State personal income tax on their income from New York sources at the same rate as residents. There is no additional burden on commuters from Nassau, Suffolk, Westchester or other counties within New York State that is not also borne by residents of other states.

The U.S. Constitution provides: "The Congress shall have Power... To regulate Commerce with Foreign Nations, and among the several States, and with the Indian Tribes."¹⁴ The Commerce Clause, in its "dormant" or "negative" aspect, prohibits states from erecting barriers to interstate commerce or unduly preferring its own citizens or businesses to the detriment of citizens or businesses of other states.

We argued that the Commuter Tax as amended violates the Commerce Clause because it subjects out-of-state residents to an additional cost for working in the City that is not imposed upon New York residents. The clearest example is that a New Jersey resident working in New York City would save the amount of the Commuter Tax simply by moving to a suburban New York State location. Therefore, the State is clearly making its business climate more attractive to New York State residents and more burdensome on residents of other states.

Timetable for Action

Plaintiff's motions for Summary Judgment were heard June 11, 1999. The State's responses are due June 18, 1999 with replies due on June 23rd. Final arguments are scheduled for June 25, 1999. Decisions before the July 1, 1999 effective date of the amendments are possible, something that could never be achieved under the statutory scheme of the Tax Tribunal.

¹ Authorized by Article 2-E of the General City Law and Tax Law Search7RH1301 et seq.

² S.5594-B.

³ The author is representing an employee and a partner at his law firm in one of these actions, *Lary S. Wolf and Ellen S. Brody v. State of New York, et al.*, (Sup. Ct. NY Co. Index No. 111272/99).

⁴ Litigation in Federal courts would be precluded by the so-called Tax Injunction Act (28 U.S.C. Search7RH1341) as long as a plain, speedy and efficient remedy is available in state courts.

⁵ See *Matter of Fourth Day Enterprises*, (NYS Tax Tribunal, decided October 27, 1988); *Matter of General Electric Company*, (NYS Tax Tribunal, decided March 5, 1992).

⁶ *Christopher H. Lunding, et. Ux. v. New York Tax Appeals Tribunal et al.*, 1998 U.S. Lexis 637, 66 U.S.L.W. 4080, (Jan. 21, 1998), *rev'g* 89 N.Y. 283, 675 N.E. 2d 816 (1996), which had *rev'd* 218 A.D. 2d 269 (3d Dept 1996), which had *rev'd* 1995-1 New York Tax Cases T-298, which had *aff'd* 1994-1 New York Tax Cases J-1016.

⁷ *Friedsam. v. State Tax Comm.*, 64 N.Y. 2d 76 (1984).

⁸ *Lunding v. New York State Department of Taxation & Finance*, 89 N.Y. 2d 283, 290-291 (1996).

⁹ *Tennessee Gas Pipeline Co., Inc. v. New York State Department of Taxation and Finance*, (Sup. Ct. Albany Co., April 28, 1999).

¹⁰ Siegel, *New York Practice*, Second Edition, Search7RHSearch7RH436 and 439.

¹¹ See *Matter of General Electric Company* (NYS Tax Tribunal decided March 5, 1992); *Matter of Waste Conversion, Inc.*, (NYS Tax Tribunal decided August 25, 1994); *Matter of Bristol-Myers Co. Indus. Div.*, (NYS Tax Tribunal decided September 1, 1994).

¹² U.S. Constitution, Article IV, Section 2.

¹³ U.S. Constitution, Fourteenth Amendment, Section 1.

¹⁴ U.S. Constitution, Article I, Section 8, Clause 3.

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