

State Tax and Teleworkers: New York's Unconstitutional Rule Plucks Nonresident Taxpayers

by
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*The art of taxation consists in so plucking the goose
as to obtain the largest possible amount of feathers
with the smallest possible amount of hissing.*
— Jean Baptiste Colbert (1619–83)^{*??}

Better yet, pluck geese that cannot hiss.
— Anonymous

ABSTRACT

Over a number of years, the New York courts converted a relatively standard “source of income” decision into a doctrinaire tool that treats some nonresidents’ out-of-state income as New York source income. The rule, particularly as applied, violates Due Process, Commerce Clause, Equal Protection, and Privileges and Immunities principles. It causes selected nonresidents’ income to be taxed twice, once by the taxpayer’s residence state (constitutionally) and a second time by New York (unconstitutionally). The arguments employed by New York administrators and courts to “support” the doctrine equally support imposing New York’s income tax on all persons who receive payments from New York-based persons or entities, whenever the recipient has had any contact with New York that meets minimal Due Process requirements.

The rule’s application is especially significant for the growing number of “telecommuters” and “teleworkers” who work from their residence. If the rule were to spread to other states, the result would place those workers at a significant disadvantage by imposing a penalty equal to one state’s tax on the resulting income. Despite its patent unconstitutionality, in the past 18 months the U.S. Supreme Court has denied certiorari twice in cases challenging the New York rule. Either the current Court’s members support state taxation so long as it can be rationalized, even by obviously spurious arguments, or until that taxation harms a sufficient number of voters to make it a political problem.

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²THE HOME BOOK OF QUOTATIONS 2300f (Burton Stevenson, ed., 10th ed. 1967).

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I. INTRODUCTION

The government officials most attuned to hissing taxpayers are the ones who think about re-election. Naturally, their attention is focused on pleasing voters. Nonresidents cannot vote. Politicians (and administrators wanting to please to them) are not concerned about nonresident geese that cannot hiss effectively. More importantly, plucking nonresident geese can mollify resident ones, if nothing else because more feathers plucked from nonresidents means fewer feathers plucked from residents. It is not unusual for all government employees, even elected judges, to have an orientation similar to politicians'. Administrators and courts depend on legislators for salaries and other things, as well as being voters and resident taxpayers. If legislators were not hampered by such inconvenient things as limitations on sovereignty and the U.S. Constitution, they would probably collect taxes only from nonresidents and other non-voters.

Since legal and constitutional boundaries are not so precise as geographic ones, government officials constantly test legal boundaries – pushing as far and hard as possible. Sometimes they knowingly go beyond even clear boundaries, reaping the benefit until all appeals are exhausted. To obtain a final court decision, a taxpayer must do much more than hiss. Unless she, he, or it is a very big taxpayer, it will often be more economically rational to hiss loud and long, even if ineffectively, but shed the feathers and hope a more affluent taxpayer will litigate.

In tax controversies, a disgruntled taxpayer must normally go through a two- or three-year administrative adjudication process to gain the right to address a court. It appeals and additional years to reach a final court decision. While a controversy is making its slow and expensive way through the adjudication process, the geese are still being plucked. In addition, the courts are part of the same government as the legislators and administrators. State judges are elected by state voters or appointed by state politicians and paid from state tax revenues.³ It is probable that the taxpayer will not have the opportunity to present arguments to a totally neutral decision-maker short of the U.S. Supreme Court – if then. For a state tax controversy to gain the attention of the U.S. Supreme Court it must have implications far beyond the individual and state directly involved.⁴

New products, new methods, and new technology presents new challenges and opportunities for legislation, including taxation. When those new things facilitate cross-border activities, the opportunity for cross-border taxation is also facilitated. Cross-border employment (traveling between states while traveling from home to workplace) has long been facilitated by transportation and communication technology, so it is not a new topic. However, advancements in communications technology are changing the character and quality of cross-border activities – and increasing the potential for cross-border goose plucking.

The synergistic evolution of computers and communication technology has made it possible for persons to perform many tasks from a distance. Currently, the more feasible tasks involve manipulation

³This is not intended as critical of New York, or any other, administrative or judicial official. No doubt the vast majority of them strive for impartiality. Human beings are immersed in, and influenced by, the time, place, and society in which they live and work.

⁴While this may reflect a somewhat cynical attitude, that is what has occurred in New York concerning the subject of this article. The issue is significant for the nonresident individuals who work for New York employers. Since the tax rule discussed here is applied only in New York, the broader implications may become significant beyond this one state and small group only in the future, if at all. The *Zelinsky* case (discussed later) was denied a writ of certiorari in 2004, most probably because it was of minor national significance.

of digitalized information (computer programs, numbers, text, audio, video, etc.). There is no reason to believe current limitations will continue indefinitely. Such things as a “virtual reality suit” used to control a distant robot – which a short time ago was in the realm of science fiction – now challenges engineering ability more than credibility. The types of tasks that can be accomplished at a distance via electronics will continue to increase, probably exponentially. Imagination, or wishful thinking, may outrun technology but even current computer-aided communication is more limited by infrastructure than geography. Using “the internet” one can easily and quickly interact with persons and computers that have access to the communications network at any location around, and beyond, the world. Both geographic distance and political boundaries are essentially nonexistent in “Cyberspace”.⁵

The ability to electronically bypass political boundaries presents significant challenges to geography-bound governments. Current laws, local, interstate and international, are based on the assumption that political boundaries are real, controllable, barriers that can be crossed only with the knowledge and consent of governments.⁶ Tax laws are limited by political boundaries, no different than other laws. Over centuries, legal rules, including tax rules, have developed generally accepted patterns for dealing with transborder events. Those rules are based, in significant part, on common, shared assumptions concerning political-physical boundaries. Therefore, the ability to transcend political boundaries via Cyberspace challenges governments’ ability to apply and enforce tax rules. If all tax-law-significant portions of an activity occur in one political jurisdiction, no particular problem arises – the same law applies to all parts of the event. But, when one process includes tax-law-significant events in more than one political jurisdiction, more than one government may claim the right to tax, of course most energetically against nonresidents.

This article discusses only one aspect of tax rules challenged by transborder Cyberspace activities. Specifically, the taxation of income earned by individuals who live in one state and work, in whole or in part, in one or more other states. Specifically, it discusses rules employed to determine the state to which the individual’s income is taxable. As set out in detail later, a small minority of states, essentially only

⁵“Cyberspace” is a term from science fiction (*see* WILLIAM GOLDING, *NEUROMANCER* (1984)) that has been adopted as a label for the “communications space” within which Internet communications take place, even though the Cyberspace posited by Golding does not yet exist. Currently, in some situations, geography-limited governments restrict a significant portion of electronic communications. However, given sufficient access to current technology and incentive, it is possible to avoid those limitations. There is little reason to believe that government censorship will triumph in the long run, at least against persons who are not impressed with governmental threats. *See Philip Morris USA, Inc. v. Otamedia Ltd.*, 331 F. Supp. 3d 228 (S.D.N.Y. 2004), and <http://www.yesmoke.ch>, for an example of the ineffectiveness of court orders in the international internet commerce setting.

⁶A fundamental postulate of state sovereignty is that political boundaries have existence and meaning. There are, of course, political boundaries that are more or less ignored in reality where governments do not have the resources, or will, to fully control crossings. There are also laws specifically intended to discourage unapproved crossing, such as those against “smuggling.” Those laws assume the reality and significance of law-created “boundaries” dividing the physical landscape. Events and activities that move or communicate from one physical location to another without passing through physical barriers along the imaginary boundaries cannot be controlled by rules or means that rely on physical barriers. Smuggling has been around as long as “legitimate” commerce and in numerous times and places, such as the English colonies in North America, has been, and is, considered honorable. There is no reason to believe electronic smuggling will be any more respectful of governments.

New York, attempt to localize to themselves individuals' wage income even though the physical income-earning activities take place beyond state boundaries. While that may sound like a topic of limited interest, it has the potential for much wider, and more fiscally significant, interest as the number of persons "telecommuting" or "teleworking," and the distance between worker and employer, increases.

Part II describes state rules used to localize ("source") individual wage income, with particular attention to rules (especially New York's) that attempt to localize that income to a place other than where the income-producing activities take place. Part III tests those rules and their justifications against established constitutional restrictions on state taxation. Part IV summarizes the discussion and suggests how income from transborder wage income might reasonably, and enforceably, be taxed.

II. STATE "CONVENIENCE OF THE EMPLOYER" RULES

A. Transborder Feather Removal

I. IN GENERAL

Under commonly accepted jurisdiction rules a government can tax: (a) persons associated with that government through citizenship, nationalization, or long-term presence within the government's territorial boundaries, and (b) property, persons, and events within its physical boundaries.⁷ Those two propositions both define and limit governmental powers to tax or regulate. Therefore, as set out in *McCullough v. Maryland*,⁸ states of the United States can tax all income of a resident, citizen, or domiciliary, without limitation on how or where the income was earned.⁹ Such a tax can be imposed because of the political relationship between the state and the individual. When that political relationship does not exist, the state can impose a tax only when the person or event producing income is within its boundaries.¹⁰ Those powers are, of course, subject to the U.S. Constitution. This article deals, principally, with the second type of jurisdiction to tax. More precisely, it deals with states' ability to tax nonresidents' wage and salary income.¹¹

In income tax parlance, the term "source" indicates the physical location (political jurisdiction) in which the event occurs that results in potentially taxable income to a taxpayer.¹² States tax residents'

⁷See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 411, 412 (1987) (hereafter "REST. (3d) FOREIGN REL.>").

⁸17 U.S. (4 Wheat.) 316, 429 (1819).

⁹See, e.g., *New York ex rel. Cohn v. Graves*, 300 U.S. 308 (1937), *Lawrence v. State Tax Comm'n*, 286 U.S. 276 (1932).

¹⁰*Id.* See also *International Harvester Co. v. Wisconsin Dep't of Tax'n*, 322 U.S. 435, 441-42 (1944):

A state may tax such part of the income of a non-resident as is fairly attributable either to property located in the state or to events or transactions which, occurring there, are subject to state regulation and which are within the protection of the state and entitled to the numerous other benefits which it confers

¹¹Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming do not impose tax on individual income. New Hampshire imposes an individual income tax only on interest and dividend income.

¹²REST. (3d) FOREIGN REL., *supra* note , § 412, rptr. note 6.

world-wide income and nonresidents' income produced within ("sourced to") the state.¹³ For residents, source rules are important only with respect to income earned in other states. Most states allow a credit for taxes paid to another state with respect to income sourced to that other state.¹⁴ With respect to residents, the issue is what income is properly sourced to another state. With respect to nonresidents, the issue is what income is properly sourced to the taxing state. Fortunately, state income source rules for individuals' wage are *almost* uniform. In most states, individuals' wage income is sourced to the jurisdiction where the individual physically performed the acts creating the right to receive income.¹⁵

Historically, individuals worked near their homes. Physical work requirements and available transportation limited the practical distance between work site and home. Developments in transportation technology increased the practical distance between home and work. That increased the possibility that an individual might cross jurisdictional boundaries between home and work or while working, and increased the importance of uniform source rules. Current developments in communication technology further increase the need for uniformity. Variations in the states' respective sourcing rules create the possibility of double taxation.

Under generally accepted source rules, effective priority goes to the jurisdiction to which income is sourced.¹⁶ A state taxes its residents' increase in wealth, regardless of where the increase originates. However, a residence-state credit for taxes paid to another jurisdiction with respect to income sourced there recognizes that the resident's increase in wealth from out-of-state-earned income is net of the other state's tax. If the residence state source rules do not recognize the other state's right to priority, a lesser (or no) credit results and the individual pays a greater total tax.¹⁷ Some states' rules significantly limit the physical-work-location source rule.

¹³*See, e.g.*, ARIZ. ADMIN. CODE 15-2C-601 (2004), CAL. CODE REGS. tit. 18, § 17951-5 (2004), CONN. GEN. STAT. § 12-711(b) (2004), GA. CODE ANN. § 48-7-30 (2004), IOWA CODE § 422.8, subsec. 2.a (2004), 103 KY. ADMIN. REGS. 17:060.3 (2004). That obviously exercises the full extent of the states' constitutional and jurisdictional powers.

¹⁴*See, e.g., id.* The result is that the state to which income is sourced has priority. The resident-state's revenue is reduced to the extent of the credit granted. The net economic effect on individual taxpayers depends on a number of factors, most particularly the relative tax rates of the states involved.

¹⁵*See note , supra.*

¹⁶JEROME R. HELLERSTEIN, WALTER HELLERSTEIN, STATE TAXATION ¶ 20.05[4][a] (1992): carried on in another State. *See also* REST. (3d) FOREIGN REL., *supra* note , § 413 and comment *a*.

In our State

¹⁷States also generally limit the amount of credit allowed for nonresident-state taxes to the lesser of (a) nonresident-state tax actually paid, or (b) the credit-granting state's tax on the amount sourced to the other state under the credit-granting state's source rules. One constant result of the resident credit is a reduction in the resident-state's tax revenues. If a taxpayer's income is all sourced to another state, the residence state will realize tax revenue only if its tax rate is higher.

New York¹⁸ and Delaware¹⁹ tax regulations, and maybe Nebraska's²⁰ and Pennsylvania's,²¹ are inconsistent with the generally accepted wage-income source rules. Their tax rules provide, in differing degrees, that when a nonresident taxpayer physically works partly within and partly without the state, income from out-of-state work is sourced to the work location *only* if the employee is *not* working in that other state for her personal "convenience."²² Probably due to the fact that so many nonresidents work in the New York City metro area, decisions applying these aberrant rules are found almost exclusively in New York.

2. NEW YORK

New York Tax Law § 631 imposes tax on a nonresident individual's "[i]tems of income, gain, loss and deduction derived from or connected with New York sources. . . ."²³ The "items" connected with New York sources are identified as those attributable to "a business, trade or profession or occupation carried on" within New York.²⁴ Sec. 631 provides that when a "business, trade or profession" is carried on partly within and partly without New York, the income must be apportioned as provided by regulation.²⁵

New York's regulations divide nonresident employees into three categories, (1) those who never physically work outside the state, (2) those who never physically work within the state, and (3) those who physically work both within and outside the state.²⁶ All income of nonresidents who never physically work outside the state is New York-source income and the employer's location is irrelevant.²⁷ The income of nonresidents who never physically work within the state are not taxed by New York even though their employer is based in New York and their wages are paid from New York.²⁸

The third category (work both within and without) is the principal subject of this discussion. Nonresident taxpayers in this category are required to allocate their total income in proportion to the

¹⁸N.Y. CODE, R. & REGS., tit. 20, § 132.18 (2004).

¹⁹DEL. DEPT. OF REV., SCH. W (2003), *available at* <http://www.state.de.us/revenue/taxform-main.htm>.

²⁰316 NEB. ADMIN. CODE § 21-003C(1) (2004).

²¹61 PA. CODE § 109.8 (2004).

²²See Part II.B., *infra*.

²³N.Y. TAX LAW § 631(a) (Consol. 2004).

²⁴*Id.* at § 631(b).

²⁵*Id.* at § 631(c). The statute provides no guidance or limitations.

²⁶N.Y. CODE, R. & REGS., tit. 20, § 132.4 (2004). Section 132.4(b), *inter alia*, states the general rule that a nonresident's earnings are taxable in New York "only if, and to the extent that, his services are rendered within New York State".

²⁷*Id.* at 132.4(a).

²⁸*Id.* at § 132.4(b). *See, e.g.,* Lopez Edwards Frank & Co., TSB-A-99(4)(I), N.Y. TAX RPTR. (CCH) ¶ 403-429 (1999) (N.Y. Tax Comm'r Adv. Op.).

number of their total annual working days that they were “employed within New York.”²⁹ To this point, New York’s regulations confirm to generally accepted allocation rules. But the regulation adds a proviso:

However, any *allowance* claimed for days worked outside of New York State must be based upon the performance of services which of necessity, as distinguished from convenience, obligate the employee to out-of-state duties in the service of his [or her] employer.³⁰

This proviso is generally called the “convenience of the employer” rule.³¹

In one of its decisions applying the “convenience of the employer” rule, the Tax Appeals Tribunal asserted that New York’s rule was justified because Pennsylvania and Nebraska have the same rule.³² Without current comment on logic, the referenced rules are not so parallel as the Tax Appeals Tribunal suggests.

3. NEBRASKA

Nebraska statute provides that a nonresident must pay Nebraska income tax on his or her “income derived from sources within this state.”³³ Nebraska regulations provide generally that income from services is Nebraska source income if the services are “directly related to a business, trade, or profession carried on within Nebraska.”³⁴ The provision to which the New York Tax Appeals Tribunal apparently referred states:

If the nonresident's service is performed without Nebraska for his or her convenience, *but the service is directly related to a business, trade, or profession carried on within Nebraska* and except for the nonresident's convenience, the service could have been performed within Nebraska, the compensation for such services shall be Nebraska source income.³⁵

²⁹N.Y. CODE, R. & REGS., tit. 20, § 132.18(a) (2004). Note that the phrase “employed within” in this regulation’s context can legally only mean “physically working within.”

³⁰*Id.* (emphasis added).

³¹*See, e.g.* Speno v. Gallman, 35 N.Y.2d 256, 319 N.E.2d 180 (1974). The New York Court of Appeals (highest court in New York) recently commented that the “convenience of the employer” rule would be more aptly called the “necessity of the employer” rule. Zelinsky v. Tax App. Trib., 1 N.Y.3d 85, 801 N.E.2d 840, *cert. denied* ___ U.S. ___, 124 S.Ct. 2068 (2004). The Court of Appeals’ suggested characterization is much too mild. As applied in New York, it should be called the “unequivocal job necessity” rule. Despite its misleading implications, the “convenience of the employer” shorthand will be used because that is the commonly used term and adopting something different would create confusion, not clarification.

³²*See In re Zelinsky*, DTA No. 817065, N.Y. TAX RPTR. (CCH) ¶ 404-854, n.4 (Tax App. Trib. 2001), *citing* “316 NEB. ADMIN. CODE § 22-003[C][1] [sic.], 61 PA. CODE § 109.8.” Neither citation included the year consulted, so one might assume the citations were to the regulations in existence in 2000 or 2001. The Tax Appeals Tribunal did not note the Delaware rule.

³³NEB. REV. STAT. § 77-2715(3) (2004).

³⁴316 NEB. ADMIN. CODE § 22-003.01C(1) (2004) (emphasis added).

³⁵*Id.* [third unnumbered paragraph].

This paragraph does not expressly apply to wage income from services rendered as an employee. A fair interpretation of the paragraph, in context, is that when a nonresident entrepreneur provides services from a Nebraska location, the resulting income is sourced to Nebraska, even if some of the related work is done in another state for personal convenience. That is nothing more than the normal rule concerning business income.

A later provision in the same regulation expressly deals with employees who work in Nebraska “at intervals during the year.” That regulation requires allocation based on “the number of hours, days, weeks or months” (depending on the employee’s pay intervals) employed in the state compared to the taxpayer’s total annual work hours, days, etc., at all locations.³⁶

Considered in conjunction with related regulations, questions arise. Reg. § 22-003.01C(1) containing the “convenience” language may or may not apply to services rendered as an employee. If it applies to employees, one must somehow distinguish between employees in general who work both in and outside Nebraska and employees “employed periodically in” Nebraska. While § 22-003.01C(1) does not contain a cross-reference to withholding regulations, other subsections expressly covering employees do. The most likely interpretation of the regulations, taken as a whole, is that the section including the “convenience” language does not apply to employees, but to entrepreneurs.³⁷ Current Nebraska tax forms do not support any inference that Nebraska has or applies a “convenience of the employer” rule.³⁸ Nonresidents are required to allocate income to the state using Form 1040N, Sch. III.³⁹ That schedule requires the taxpayer to enter the total amount of income “derived from Nebr. sources”, which is used to calculate the ratio of state-taxable income. The relevant instructions state that wage and salary income is included based on separate accounting, volume of business transacted, or “days worked in Nebraska”.⁴⁰ There is no indication that the reasons why the taxpayer may be working in another state are relevant in any manner.

There are significant questions about just how Nebraska’s regulations might be interpreted in the average telework situation. The dearth of Nebraska authority on the subject makes prediction quite difficult. Nebraska’s tax return forms do not support any inference that Nebraska has or applies a “convenience of the employer” rule. Careful reading of all the Nebraska regulations relating to employees does not provide any greater support.

4. PENNSYLVANIA

Pennsylvania’s provisions concerning nonresident individuals are also, at least in the current context, not a model of clarity. The statutory provisions expressly limit Pennsylvania source wage income of nonresident individuals to that which results from a trade or occupation “carried on in,” or from “personal

³⁶*Id.* at § 21-003.01C(3). This regulation includes a cross-reference to the withholding regulations requiring employees to make a specific allocation of their time on an official form, and give that form to the employer. *See id.*, §§ 22-006.02, .04. The withholding regulations do not mention any “personal convenience” limitation.

³⁷Other regulations make specific provisions for particular categories of employees, including athletes and entertainers (§ 22-003.01C(6)), railroad workers (§ 22-003.01C(9)), interstate truckers (§ 22-003.01C(10)), and airline employees (§ 22-003.01C(11)).

³⁸Nebraska forms are available at: <http://www.revenue.state.ne.us/tax/current/current.htm>

³⁹http://www.revenue.state.ne.us/tax/current/1040n_sch.pdf

⁴⁰*Nebraska Sch. III – Computation of Nebraska Tax*, p. 15, http://www.revenue.state.ne.us/tax/current/1040n_ins.pdf.

services performed in,” Pennsylvania.⁴¹ The Pennsylvania Department of Revenue is authorized to adopt allocation regulations with respect to nonresidents who have income from both Pennsylvania and other jurisdictions, but only when Pennsylvania’s portion “cannot readily or accurately be ascertained.”⁴²

If one looks only at the Pennsylvania regulation that the N.Y. Tax Appeals Tribunal cited, it appears that Pennsylvania does have a “convenience of the employer” rule. However, when considered in context, that provision is an aberration, inconsistent with the underlying statute and the principal regulations.

With specific reference to nonresidents’ taxable income from personal services, Pennsylvania’s principal “source” regulation repeats the statutory provision that Pennsylvania source income of nonresidents is only that “. . . for rendition of personal services performed” in the state.⁴³ Pennsylvania Reg. § 101.8 establishes the same three categories as New York’s: (1) nonresidents who perform services only within the state, (2) nonresidents who perform services only outside the state, and (3) nonresidents who perform services both within the state and elsewhere.⁴⁴ The rules applied to those three groups are also like New York’s. Services performed wholly within the state produce only Pennsylvania source income, without regard to the employer’s or client’s location. Services performed wholly without the state produce no Pennsylvania source income, again without regard to the employer’s or client’s location. For the third category, the regulation states:

If the personal services are performed within and without this Commonwealth, the portion of the compensation attributable to the services performed within this Commonwealth shall be determined in accordance with [regulation] § 109(3) (relating to business carried on wholly within this Commonwealth.)⁴⁵

The referenced regulation, § 109.3, states that a “business, trade, profession or occupation” produces Pennsylvania source income if its taxable-income producing activities are carried on within the state, even though some activities are physically performed in another state.⁴⁶ The following two regulation sections deal with situations in which the taxpayer has taxable-income producing activities in Pennsylvania and

⁴¹See 72 PA. STAT. ANN. § 7301(k) (2004).

⁴²72 PA. STAT. ANN. § 7310 (2004), in full, states:

Where a nonresident taxpayer earns, receives or acquires income from sources partly within and partly without this Commonwealth or engages in a business, trade, profession or occupation partly within and partly without this Commonwealth, and, as a result thereof or for other reasons *that portion of the income derived from or connected with sources within this Commonwealth cannot readily or accurately be ascertained*, the department shall by regulation prescribe uniform rules for apportionment or allocation of so much of such taxpayer's income as fairly and equitably represents income, derived from sources within this Commonwealth and subject to tax under this article.

(emphasis added).

⁴³61 PA. ADMIN. CODE § 101.8(a)(2) (2004).

⁴⁴*Id.* at § 101.8(e).

⁴⁵*Id.* (parentheses in original).

⁴⁶61 PA. ADMIN. CODE § 109.3 (2004). This is not inconsistent with the generally accepted idea that a business generally produces income at its base of operations, even when some acts are performed elsewhere.

elsewhere and allocate income between states either on a separate accounting basis or through a three-factor formula.⁴⁷

However, Reg. § 109.4 and Reg. § 109.5 (which complement Reg. § 109.3), both “distinguish” between a “business, trade, profession or occupation” and “personal services as an employee.” With respect to personal services as an employee, those regulations direct one back to Reg. § 101.8(a)(2), which expressly provides that only personal services “performed in” Pennsylvania produce Pennsylvania source income.

Into this circular but otherwise only slightly muddy situation, the Pennsylvania Department of Revenue inserted Reg. § 109.8, which also, but exclusively, deals with income of nonresident employees. That section allocates a nonresident employee’s income to Pennsylvania based on the proportion of days worked in Pennsylvania, then adds:

However, any allowance claimed for days worked outside of this Commonwealth shall be based upon the performance of services which, of necessity, obligate the employee . . . to perform out-of-State duties in the service of his employer. . . .⁴⁸

Nothing in Reg. § 109.8 requires uncertainty in allocating income based on the taxpayer’s work location, which is the express condition on the regulatory power granted by the legislature. Instead, the quoted sentence *creates* uncertainty by imposing a subjective limitation on an easily determined objective situation.

Multiple database searches produced only one in-state reference to Pennsylvania Reg. § 109.8, a Chief Counsel’s letter ruling.⁴⁹ That letter responds to a request concerning a Florida-based employer’s withholding of Pennsylvania income tax on wages its employees earned while working in Pennsylvania and elsewhere. The letter quotes Reg. § 109.8 but totally ignores the “necessity of the employer” sentence. The principal focus is on the withholding regulations, which require employer withholding based on the employee’s physical work location. The ruling states that withholding must be based on the proportionate number of days physically worked in the state.⁵⁰

..... Current Pennsylvania income tax forms⁵¹ require nonresidents with Pennsylvania-taxable income to complete a Form PA-40, Sch. NRH apportioning their income, *if their employer did not report the*

⁴⁷61 PA. ADMIN. CODE §§ 109.4, 109.5 (2004). Section 109.5(b) states that if the taxpayer’s records are sufficient, those will be used to allocate income. Resort to formula apportionment is allowed only when those records are inadequate. If the taxpayer’s records (perhaps affirmed by her or his employer’s) show the location where she or he worked at any particular time, that is a sufficient basis for allocation under the express terms of the authorized regulation. Using some other allocation method is inconsistent with the regulation’s unambiguous meaning.

⁴⁸*Id.* at § 109.8 (second of three sentences). The regulation language is identical to New York’s.

⁴⁹PA. DEPT OF REV., OFFICE OF CHIEF COUNSEL, LTR. RUL. PIT-99-014, PA. TAX RPTR. (CCH) ¶ 20040321122 (Feb. 18, 1999).

.....⁵⁰61 PA. ADMIN. CODE § 113.2(2)(ii)(A) (2004). Interestingly, this withholding provision is essentially a verbatim rendition of the comparable regulations in New York and Nebraska. See 316 NEB. ADMIN. CODE §§ 21-006.03B (wages, per hour allocation), .03D (salary, per day allocation); and N.Y. CODE R. & REGS., tit. 20, § 171.6(b)(2)(ii) (per day allocation).

⁵¹Pennsylvania tax forms are available at: <http://www.revenue.state.pa.us/revenue>

taxpayer's Pennsylvania income.⁵² The form instructions include under "working day basis" the statement:

NOTE: You are deemed to have worked outside Pennsylvania if your employer required you to perform your job duties outside Pennsylvania. If you work outside Pennsylvania for your own personal convenience or for tax purposes, such work days are to be included in the total for this ["worked within Pennsylvania"] line.⁵³

The instruction terms are very similar to New York's "convenience of the employer" rule, but with an important difference. The Pennsylvania instruction makes it clear that the employer's decision controls, the characteristics of the tasks done is not a factor.

5. DELAWARE

Delaware's statute defining nonresidents' Delaware-source income states, in relevant part:

Items of income . . . derived from, or connected with, sources within this State are those items attributable to:

- (1) Compensation . . . as an employee in the conduct of the business of an employer, for personal services (I) rendered in this State, or (ii) attributable to employment in this State and not required to be performed elsewhere;⁵⁴

Apparently, Delaware has no formal regulations on this subject. However, instructions included in its Schedule W, "Apportionment [of Wage Income] Worksheet," the Delaware Department of Revenue states: "Any allowance claimed [for days worked outside the state] must be based on necessity of work outside the state of Delaware in performance of duties for the employer, as opposed to solely for the convenience of the employee."⁵⁵

This instruction is considered a regulation, at least by the Delaware State Tax Board. In *State Tax Board Docket No. 277*,⁵⁶ the taxpayer worked for a number of days while he was in the hospital in Pennsylvania and also worked at his Pennsylvania home on weekends. The Board noted that an employee could count as days worked outside the state only those "required of an employee in connection with his job."⁵⁷ The Board concluded:

Commendable as it was for an executive employee such as Petitioner to work on weekends, during vacations, and even while he was in the hospital, yet it was voluntary on his part and was

⁵²<http://www.revenue.state.pa.us/revenue/lib/revenue/pa-40nrh.pdf>

⁵³*Id.*, FORM PA-40, SCH. NRH, *Instructions*, p. 1.

⁵⁴DEL. CODE ANN. tit. 30, § 1124(b) (2004).

⁵⁵DEL. DEPT. OF REV., SCH. W (2004), *available at* <http://www.state.de.us/revenue/taxform-main.htm>. The forms and instructions do not create the probability of error built into New York's (see Part III.E.). Simplicity is sometimes beneficial.

⁵⁶DEL. TAX RPTR. (CCH) ¶ 200-113 (1965). The Delaware State Tax Board does not publish the taxpayer's name, thus only the docket number is available for reference.

⁵⁷*Id.*

done, of course, with the hope of advancement and additional remuneration by way of bonus or fringe benefits.⁵⁸

Since the taxpayer could not allocate that work to Pennsylvania, his salary remained apportioned to Delaware.⁵⁹

A few years later, *State Tax Board Docket No. 305*,⁶⁰ involved a taxpayer who was physically disabled and therefore often worked at home. The State Tax Board expressly followed the decision in *Docket No. 277* with respect to evenings, weekends and days during which the taxpayer was on paid sick leave. The State Tax Board then held:

However, he is entitled to fully deduct [allocate to Pennsylvania] those days, occurring on regular workdays, when he worked at his [Pennsylvania] home rather than in the laboratory in Delaware, *either upon the direction of his employer or with its permission*.⁶¹

Thus, as applied in Delaware, the “convenience of the employer” rule prevents allocation of wage income to another state when the employee voluntarily works on weekends, vacations, sick leave, or the like (times she is not required to work at all). But, if the employee works outside Delaware, during regular work days and hours, at the direction, or with the permission, of the employer, the resulting income is not Delaware-source income. In essence, Delaware does not conclusively presume that the employer and employee are colluding to deprive the state of tax revenue.

In summary, there is serious doubt about the assertion that Nebraska’s and Pennsylvania’s regulations parallel New York’s. It is unlikely that Nebraska has an equivalent of a “convenience of the employer” rule. While Pennsylvania and Delaware do have such rules, their application is more measured, allowing employees to rely on the instructions and/or permissions of their employers rather than theoretically objective task requirements. Enforcement of those states’ rules are not limited to times when the employee works at home. Certainly it would be highly inappropriate to conclude, without significantly more concrete evidence, that those states would interpret and enforce their regulations in the same questionable way New York does. That leaves New York as the only state that has a “convenience of the employer” rule taxing nonresidents on out-of-state-earned wage income unless there is irrefutable third-party proof that objective task requirements remove any possibility of choice of work location by either the employee or employer.

B. Reflex, Repetition and Reality

I. INDIGNATION BOOTSTRAPPED

A New York Administrative Law Judge (“ALJ”) recently asserted that the “convenience of the employer” rule is the result of “a substantial body of case law developed over several decades. . . .”⁶²

⁵⁸*Id.*

⁵⁹Under the interpretation adopted by Delaware, all of a nonresident’s income from a Delaware employer is allocated to Delaware, except to the extent it can be allocated to another state under the quoted rule. *Id.*

⁶⁰Del. Tax Rptr. (CCH) ¶ 200-197 (1968).

⁶¹*Id.* See also *Gow v. Director of Rev.*, 556 A.2d 190, 197 (Del. 1989) (personal services attributable to employment in Delaware “constructively performed” in Delaware if the employer did not require performance outside Delaware).

Perhaps it would be more accurate to say it results from numerous repetitions over decades – as if repetition can validate any proposition.

The history of New York’s wage-income allocation rules actually starts 40 years before the “convenience of the employer” rule’s initial utterance. In 1919 the New York Attorney General ruled that income to be taxed is associated with the work done, not the person paying, resulting in a “place of performance” locus as the source of the resulting income.⁶³ That statement was, and remains, consistent with generally accepted rules of jurisdiction and taxation, even in New York.⁶⁴ It was also expressly relied on by the Appellate Division in a decision concerning the “source” of commissions paid to a nonresident executor, handed down over a decade after the “convenience of the employer” rule was first uttered.⁶⁵

The “convenience of the employer” rule was first mentioned in a court opinion about 50 years ago. A reasonable decision, consistent with the 1919 Attorney General’s ruling was used to reach a desired result in subjectively deserving, but readily distinguishable, cases. The results were rationalized by an unsupported conclusion in the form of a general rule. The rationalization became precedent, easier to apply than examine – then a “line of decisions” to be defended, not reversed. Isolated from serious examination, a reflexive response to less-than-credible taxpayers has been elevated to venerable precedent.

The precursor was the Appellate Division’s 1950 decision in *Carpenter v. Chapman*,⁶⁶ involving the 1939 income taxes of Carpenter, a New York licensed attorney. His proprietorship’s only office was in New York but sometimes (he claimed) he worked at his New Jersey home or his Vermont farm. The Appellate Division concluded that he could not allocate income to those other states because all the business income was earned in New York; the activities outside New York were merely “incidental,” and produced a result (income) only in New York.⁶⁷ *Carpenter* is consistent with generally accepted rules (including today’s New York rules⁶⁸ and the 1919 Attorney General’s ruling) as applied to proprietorship income; it did not involve wage or salary income.

⁶²In re Dalsass, DTA No. 818932, N.Y. TAX RPTR. (CCH) ¶ 404-600 (Sm. Cl., ALJ, 2003).

⁶³1919 Rept. of Atty. Gen. 301, *cited in* Speno v. Gallman, 35 N.Y.2d 256, 258-59, 319 N.E.2d 180, 181 (1974).

⁶⁴*See, e.g.*, N.Y. TAX CODE § 631(b) (Consol. 2004), N.Y. CODE, R. & REGS., tit. 20, §§ 132.2, 132.4(b), 132.18, 132.22 (2004).

⁶⁵*Oxnard v. Murphy*, 19 A.D.2d 138, 140, 241 N.Y.S.2d 333, 335 (3d Dept. 1964), *aff’d* 15 N.Y.2d 593, 203 N.E.2d 648 (1964) (App. Div. opinion adopted). See discussion at note , et seq., *infra*.

⁶⁶276 A.D. 634, 97 N.Y.S.2d 311 (3d Dept. 1950).

⁶⁷*Id.*, 267 A.D. at 636, 97 N.Y.S.2d at 313. The court expressly relied on *Shaffer v. Carter*, 252 U.S. 37 (1920) (see discussion at note , *infra*) in which the U.S. Supreme Court held that a state could tax the income of a nonresident “carrying on a profession” in the state. *Id.*, 276 A.D. at 636, 97 N.Y.S.2d at 314.

⁶⁸N.Y. CODE, R. & REGS., tit. 20, §§132.2, 132.13 (2004)

In 1960, ten years after *Carpenter*, the Appellate Division decided two cases. In *Burke v. Bragalini*,⁶⁹ Burke controlled at least 76% of the stock of, and was president of, a family corporation with a New York City office. He lived in New Jersey. Burke allocated 40 days of salary income to working at home and 45 to work in “various cities”.⁷⁰ Burke argued that his work at home was especially productive, to the benefit of his controlled-corporation employer. One can easily infer that the Appellate Division did not really believe the story. There was nothing special about Burke’s home workspace.⁷¹ Most significantly, the Appellate Division stated:

The personal convenience of an employee is not the test. It is understandable that many people--living within and out of the State--may on occasions find it more advantageous to work at home, either during the regular working hours or extra ‘home work’ after hours. Such a person living in the State is not entitled to special tax benefits and, intriguing as it may be, the commuter from outside the State is entitled to no such special benefits. . . . Any allowance claimed for work outside the State must be for those purposes that of necessity--as distinguished from convenience--obligate the employee to out of State duties in the service of his employer.⁷²

No authority (statute, regulation, or court decision) is cite, no explanation is given.

In *Burke*, the Appellate Division put a nonresident’s wage income paid by an in-state business in the same basket as an in-state business’ income. From the perspective of the average voter, there may little economic difference between a sole proprietor and a majority shareholder/president of a corporation. The Appellate Division did not expressly base its decision on that similarity. It used terms applicable to all employees, not just to employee-owners of incorporated businesses. The sole logic was that the employer’s New York office had adequate workspace.

Morehouse v. Murphy,⁷³ involved a vice president of a large holding company. Morehouse lived in New Jersey and commuted to the corporation’s New York City offices. Morehouse allocated income to New Jersey based on the time allegedly spent working on the commuter train and at home, contending that the work was beneficial to his health, his performance, and therefore to his employer.⁷⁴ The Appellate Division decided Morehouse could have done the work at his office; working elsewhere was merely convenient and did not justify allocation outside New York, referencing *Burke*.⁷⁵ The opinion

⁶⁹10 A.D.2d 654, 196 N.Y.S.2d 391 (3d Dept. 1960).

⁷⁰*Id.*, 10 A.D.2d at 654, 196 N.Y.S.2d at 391.

⁷¹*Id.*

⁷²*Id.*

⁷³10 A.D.2d 764, 197 N.Y.S.2d 763 (3d Dept.), *appeal dismissed* 8 N.Y.2d 932, 168 N.E.2d 840 (1960).

⁷⁴*Id.*, 10 A.D.2d at 765, 197 N.Y.S.2d at 764.

⁷⁵*Id.*, 10 A.D.2d at 765, 197 N.Y.S.2d at 765.

expressly equated *Morehouse* and *Carpenter v. Chapman*, acknowledging no distinction between nonresident employees and nonresident proprietors.⁷⁶

Morehouse and *Burke* were decided less than 30 days apart by the same panel of judges. It is easy to sympathize with the Appellate Division for seeing no practical difference between a controlling shareholder/president of a corporation (*Burke*) and a sole proprietor (*Carpenter*).⁷⁷ And, perhaps *Morehouse*'s contentions strained credibility.

Carpenter, *Burke*, and *Morehouse* do have similarities. Each taxpayer attempted to allocate income to another state based on alleged work location. It was not unreasonable to doubt the bona fide nature of the alleged work. If successful, the taxpayers would pay no state income tax on the non-New York income.⁷⁸ Despite the similarities, *Burke* and *Morehouse* are not analogous, in law, with *Carpenter*. The Appellate Division disregarded fundamental jurisdictional limitations and the distinctions between a business' income and an employee's. As recognized in New York regulations, how and where an employee earns income is not analogous to how and where a business generates income.⁷⁹ A carpenter driving nails generates personal income at the head of the nail, not his at employer's principal office. In these decisions, most obviously in *Burke*, the Appellate Division did not recognize any legal distinction between residents and nonresidents. It created the unitary class of "taxpayers," then created a "rule" to prevent a perceived potential "tax benefit" to part of that artificial group that could not be enjoyed by all.⁸⁰ Playground equity demanded equality between New York-based salarymen and their New Jersey-based coworkers; serious legal analysis was avoided. The Appellate Division apparently gave no thought to the possibility that New York might be constitutionally required to treat nonresidents differently from residents.

The predecessor to the now-Department of Taxation & Finance (hereafter "the Department") apparently liked those decisions' results and enshrined language from *Burke* in official regulations as the "convenience of the employer" rule, possibly in 1967.⁸¹ In 1971, the Appellate Division quoted the regulation but really relied on the cases discussed above.⁸²

⁷⁶*Id.*, 10 A.D.2d at 765, 197 N.Y.S.2d at 764 - 65. Perhaps the operative equation was between a lawyer who said he produced income while at his gentleman's farm and a corporate vice president who said he produced income on a commuter train.

⁷⁷In *Burke v. Murphy*, 33 A.D.2d 581, 304 N.Y.S.2d 354 (3d Dept. 1969), the facts were essentially identical to *Carpenter v. Chapman*, *supra* note (New York law practice, nonresident taxpayer), except that this taxpayer *Burke* was an employee. Denying his allocation of income to Connecticut, the Appellate Division directly relied on *Morehouse* and *Burke v. Bragalini*, with only a "cf." citation to *Carpenter*. The parallel treatment of employees and entrepreneurs could not be demonstrated more directly or obviously.

⁷⁸It is obvious that the Appellate Division was aware that allocating income to the other states effectively exempted that income from state tax because those states had no income tax at that time.

⁷⁹Compare N.Y. CODE, R. & REGS., tit. 20, §§ 132.13, 132.14, 132.15 (business income), with §§ 132.4(b), 132.18 (wage income).

⁸⁰*Burke*, *supra* note , 196 N.Y.S.2d at 393.

⁸¹See *Zelinsky (TAT)*, *supra* note . The Tax Appeals Tribunal noted that the predecessor to the current rule, using identical terms, appeared in the [TAX COMMISSION] MANUAL 67 (1967).

In 1973, the Appellate Division handed down a 3 - 2 decision in *Speno v. Gallman*.⁸³ The split resulted from how the facts were viewed – “the spin” for the politically inclined. Speno was president of a corporation that carried his name, but not a hands-on president. Instead, he was the promotions and “P.R.” man – making telephone calls, traveling, shaking hands, etc. – spending very little time at the corporation’s offices. His 1960 return allocated 236 work days to non-New York locations, including 106 to New Jersey where he resided. In 1961 Speno allocated 174 work days to New Jersey.⁸⁴ The majority did not mention the total number of work days claimed in either year. After reviewing selected facts, the majority stated:

The fact that Mr. Speno, an officer of a corporation with two offices in New York State, chose to live in New Jersey in order to make it more convenient for him to perform his promotional duties is not sufficient to entitle him to an allocation for days worked outside of New York for those days worked at his home in New Jersey.⁸⁵

The majority recited that the out-of-state work location must be of necessity, not convenience, to allow allocation, citing *Churchill, Morehouse, and Burke*.⁸⁶ For the majority, the citations were sufficient to decide the case. The majority did not question Speno’s allocation of work days to non-New York locations other than his New Jersey residence, but the days Speno allocated to his residence were reallocated to New York.⁸⁷

The two-justice dissent took a more holistic look at Mr. Speno’s allocation, mentioning (giving numbers) that the vast majority of his work days were outside New York.⁸⁸ The dissent also mentioned that Speno had no personal office at any New York location and his work required no New-York-located services, concluding:

Exactly when the Department put the rule in regulatory form is unclear. A 1969 Appellate Division decision did not mention any regulation when it held that a heavy workload was not a sufficient reason to allocate income to the employee-taxpayer’s home state, summarily citing the cases discussed above. *See Burke v. Murphy*, 33 A.D.2d 581, 304 N.Y.S.2d 354 (3d Dept. 1969) (continuing the Appellate Division’s reliance on *Carpenter v. Chapman*).

⁸²*Churchill v. Gallman*, 38 A.D.2d 631, 326 N.Y.S.2d 917 (3d Dept. 1971), *quoting* then-regulation § 131.16 (work at home to avoid office exacerbation of emphysema held to be for employee’s convenience, not necessity).

⁸³42 A.D.2d 627, 344 N.Y.S.2d 288 (3d Dept. 1973), *aff’d* 35 N.Y.2d 256, 319 N.E.2d 180 (1974). Mr. Speno died nine years after filing the last-challenged return, which was two years before his case was decided by the Appellate Division.

⁸⁴*Id.*, 42 A.D.2d at 628, 344 N.Y.S.2d at 290.

⁸⁵*Id.*

⁸⁶*Id.* No Department regulation was cited.

⁸⁷Treating the New Jersey days as producing New York-source income increased the “New York” portion of Speno’s income in 1960 from 20.3% to 56.1%, and in 1961 from 14.6% to 73.6%. The tax revenue gained by New York was impressive.

⁸⁸*Speno, (AD), supra note* , 42 A.D.2d at 629, 344 N.Y.S.2d at 291 (Kane, J., dissenting).

The mere fact that during the period of two years he voluntarily visited the home office on three occasions should not distinguish the case from the *Linsley* case [worked entirely outside New York]. Only in cases where the employee is based or is required to work in New York, and works outside [New York] during a tax year, should we apply the ‘convenience or necessity test’ of [the regulation].⁸⁹

The dissent suggested that the pivotal factor in deciding when the “convenience of the employer” rule applies should not be a fortuitous work day in New York but, instead, it should be applied only when a New York office is the taxpayer’s assigned principal work location.⁹⁰ That suggestion has never been seriously considered in a later decision.

On review, the New York Court of Appeals unanimously favored the Appellate Division majority decision.⁹¹ The Court of Appeals mentioned Mr. Speno’s allocation in essentially the same terms as the Appellate Division’s majority, emphasizing the less business-like nature of his activities in New Jersey.⁹²

To set up its *Speno* decision, the Court of Appeals recapitulated the “convenience of the employer” rule’s development in three steps. First, it acknowledged that New York’s source rule was originally based on place of performance, following the 1919 Attorney General’s “interpretation.”⁹³ Second: “In view of the large number of nonresidents who avail themselves of employment within New York State, the place of performance doctrine was *refined* by virtue of the ‘convenience of the employer’ test.”⁹⁴ Finally, the Court of Appeals stated that the “refinement” had been consistently applied by New York courts, again mentioning *Burke*, *Morehouse*, and *Churchill*, all decided before the related regulation was adopted. In defense of this so-called refinement, the Court of Appeals stated:

The policy justification for the ‘convenience of the employer’ test lies in the fact that since a New York State resident would not be entitled to special tax benefits for work done at home, neither should a nonresident who performs services or maintains an office in New York State.⁹⁵

The Court of Appeals made no attempt to provide a legal or theoretical basis for the “refinement” of the place of performance rule. Neither did it appear to notice the inconsistency between the stated rule and

⁸⁹*Id.*

⁹⁰*Id.* Given the “convenience of the employer” rule’s starting point, an in-state business operation case, the dissent’s suggestion would align the rule much more closely to its roots than the majority’s position. A few in-state acts by an out-of-state business operation does not trigger tax liability for all the business’ income, even if the in-state acts were paid for by a New York based person or entity.

⁹¹*Speno v. Gallman*, 35 N.Y.2d 256, 319 N.E.2d 180 (1974).

⁹²*Id.*, 35 N.Y.2d at 258, 319 N.E.2d at 181.

⁹³*Id.*

⁹⁴*Id.*, 35 N.Y.2d at 259, 319 N.E.2d at 181 (emphasis added). Labeling a 180-degree reversal of the 1919 A.G. opinion a “refine[ment]” is an outstanding example of judicial “spin”.

⁹⁵*Id.*, 35 N.Y.2d at 259, 319 N.E.2d at 182. Note that the Court of Appeals continued to equate a nonresident entrepreneur’s business income and a nonresident employee’s salary income.

the court's implicit limitation to employees who work at their out-of-state residence. Instead, its opinion is a "Reader's Digest" of preceding Appellate Division decisions. The Court of Appeals gave its stamp of approval to the Appellate Division's playground equity.

The *Speno* decision became, and remains, the touchstone for "convenience of the employer" rule cases. Among the situations in which the taxpayer's allocation of work days to his or her state of residence has been found to be for "personal convenience":

- ! An employee-creative writer who worked at a home office because his employer did not provide in-office space or materials to any of its creative writers.⁹⁶
- ! A free lance commercial announcer whose only work space and equipment was at his Connecticut home where he practiced and made demos; he went to occasional New York employers' locations to record the commercials.⁹⁷
- ! A New Jersey resident employed by a New York consulting firm that preferred (perhaps required) him to work at home for more efficient use of time.⁹⁸
- ! A nonresident employee who was instructed to work at home on a confidential assignment and to not visit the New York office unless specifically required, and whose office and staff were assigned to another employee.⁹⁹
- ! A New Jersey-resident television critic who was required to work 18 or more hours per day simultaneously watching numerous television channels and consulting family members, whose employer's office was not suitably equipped.¹⁰⁰

⁹⁶Page v. State Tax Comm'n, 46 A.D.2d 341, 362 N.Y.S.2d 599 (3d Dept. 1975). The Appellate Division said the employer could have provided the necessary space and services at its New York offices. The fact that the employer had business reasons for not providing space to any of its writers was treated as irrelevant.

⁹⁷Simms v. Procaccino, 47 A.D.2d 149, 365 N.Y.S.2d 73 (3d Dept. 1975). It is very unclear why this person was treated as an employee rather than an independent contractor. The Appellate Division held that the necessary equipment and materials could have been made available at one of the taxpayer's many irregular New York "employers". *Id.*, 47 A.D.2d at 151, 365 N.Y.S.2d at 75. Why any business would supply work space to a less-than-part-time employee is not revealed.

⁹⁸Gross v. State Tax Comm'n, 62 A.D.2d 1117, 1117-18, 404 N.Y.S.2d 437, 439 (3d Dept. 1978). The Appellate Division held that *employers'* decisions on work efficiency are irrelevant to the "convenience of the employer" rule. *See also* Brody v. Chu, 141 A.D.2d 907, 529 N.Y.S.2d 223 (3d Dept. 1988) (professor not provided adequate or secure office space, New Jersey home was only available space to prepare lectures and other job-required tasks); Wheeler v. State Tax Comm'n, 72 A.D.2d 878, 421 N.Y.S.2d 942 (1979) (employee held not required to work at New Jersey home on weekends even though the New York office was "generally unavailable" due to burglar alarm and lack of mail support); Colleary v. Tully, 69 A.D.2d 922, 415 N.Y.S.2d 266 (3d Dept. 1979) (two jobs combined by the Appellate Division into one job to support conclusion that taxpayer "could have" worked in employer's New York office because he did when doing part of the court-created unitary position).

⁹⁹Evans v. Tax Comm'n, 82 A.D.2d 1040, 442 N.Y.S.2d 174 (3d Dept. 1981).

- ! A Pennsylvania resident employed as a bond salesman, required by his employer to be available to worldwide clients 24 hours per day, whose New York employer supplied the employee's office-at-residence with computers, information systems, fax machine, and 25 telephone lines, and referred to the employee's home office as its Pennsylvania branch.¹⁰¹
- ! A New Jersey employee who for the last part of the year was fired from her supervisory position (but not her writing position), locked out of her employer's office, her work space given to other persons, and could thereafter work only at her home.¹⁰² With respect to the period after she was booted out of the employer's office, the Tax Appeals Tribunal acknowledged that the taxpayer never worked in New York, but it refused to analogize her situation to prior cases where the employee had a job-description change and no longer came to New York.¹⁰³ The fact that the taxpayer continued doing one of her two prior jobs was sufficient to prevent her from being treated as no longer working in New York, despite objective reality.¹⁰⁴

¹⁰⁰*Kitman v. State Tax Comm'n*, 92 A.D.2d 1018, 461 N.Y.S.2d 448 (3d Dept. 1983). In this decision it appears that the Appellate Division makes no distinction between imaginable possibility and practical reality – a hypothesis proven in *Phillips*, next.

¹⁰¹*Phillips v. Dept. of Tax'n & Fin.*, 267 A.D.2d 927, 700 N.Y.S.2d 566 (3d Dept. 1999). From the Appellate Division's opinion it appears that the pivotal evidence was that the taxpayer had worked in the New York office all or part of 41.66% of the working days during the period in questions. *Id.*, 267 A.D.2d at 929, 700 N.Y.S.2d at 568. The "necessary" logic was that since the taxpayer could perform his job at the New York office during part of the time, he must be able to perform it there all the time.

Compare *Phillips* with *Lopez Edwards Frank & Co, LLP*, TSB-A-99(4)(l), N.Y. TAX RPTR. (CCH) ¶ 403-429 (Comm'r of Tax'n Advisory Op. 1999), which concerned an employee stockbroker who intended to relocate to Wyoming, but remain an employee of the New York firm. The Commissioner's advice was that the employee would not have New York source income, based on the assumption that once the employee left New York, he would never return.

¹⁰²*In re Unterweiser*, DTA No. 818462, N.Y. TAX RPTR. (CCH) ¶ 404-617 (Tax App. Trib. 2003). The affirmed ALJ decision states, "Despite her claims to the contrary, it appears that with a bit of effort and ingenuity petitioner's concern for her personal property could have been addressed and the need for storage and office space satisfied." *Id.*, N.Y. TAX RPTR. (CCH) ¶ 404-213 (ALJ 2002).

¹⁰³Compare *Linsley v. Gallman*, 38 A.D.2d 367, 329 N.Y.S.2d 486 (3d Dept.), *aff'd w/o op.*, 33 N.Y.2d 836, 307 N.E.2d 257 (1972), discussed at note , *infra*.

¹⁰⁴*Id.* The employee's still having one of the prior jobs gave the Tax Appeals Tribunal an easy exit from a difficult situation. The ALJ's decision recited established dogma. Therefore, the Tribunal could not reverse as to the latter part of the year and preserve dogmatic continuity. The Tribunal could have reached a reasonable result similar to *Lopez Edwards Frank & Co.*, *supra* note . However, the cited precedent cases for that all involve a change in job description. Apparently the Tribunal felt that maintaining doctrinal purity required the employee to take a totally new position, despite the Commissioner's friendly opinion in *Lopez Edwards Frank & Co.*, *supra* note . Since the taxpayer continued to do a job that had been done part of the year in New York, for the Tribunal's purposes, the conclusion was that the job could have been done

2. *BUT ON THE OTHER HAND . . .*

Taxpayers have not lost every time. In *Fass v. State Tax Commission*,¹⁰⁵ the taxpayer's job required unusual, specialized facilities, none of which were, or could be made, available at the employer's New York City location. The Appellate Division found work at those facilities was not for the employee's convenience even though they were located at the taxpayer's New Jersey residence or farm. The strong one-justice dissent emphasized the fact that the taxpayer was the majority shareholder and executive officer of the employer-corporations and was therefore free to determine where the necessary facilities were obtained or built, concluding that the New Jersey location was actually chosen by the taxpayer, in his role as employer, for his personal convenience as employee.¹⁰⁶ In response to the dissent and the Tax Commission's position, the majority held that the precedent only required proof concerning the employer's location, not every possible New York location¹⁰⁷

Many have tried to liken their situations to *Fass*, without success. A partial taxpayer win was recorded by another New Jersey resident in *Fischer v. State Tax Commission*.¹⁰⁸ The taxpayer was the principal of a New York based firm providing engineering services to New Jersey school districts and municipalities. Fischer allocated 128 working days to New Jersey, broken down into 13 days solely at worksites or clients' offices, 64 days solely in his residence office, and 51 days divided between construction sites and his residence office.¹⁰⁹ The Tax Commission allocated to New Jersey only the 13 days spent entirely at clients' locations. The Appellate Division sustained the Tax Commission with respect to the days allocated solely to working at the residence-office, holding that there was no evidence connecting the work done to New Jersey clients.¹¹⁰ But, in a rare example of understanding logistic reality, the Appellate Division disagreed concerning the days split between construction sites and the residence-office:

Petitioner testified that his use of the office at his home on the days he visited construction sites was a matter of practicality; there was insufficient time to travel all the way into the New York City office and complete work that could not be completed at the job site but usually was

there all year. That made possible the conclusion that working outside the New York office was solely for the employee's convenience. Obviously a very special definition of "convenience" is used – and dogma triumphs over reality.

¹⁰⁵68 A.D.2d 977, 414 N.Y.S.2d 780 (3d Dept.), *aff'd w/o op.* 50 N.Y.2d 932, 409 N.E.2d 998 (1979).

¹⁰⁶*Id.*, 68 A.D.2d at 978-79, 414 N.Y.S.2d at 782-83, Main, J., dissenting. The dissent labeled the claimed allocation to New Jersey an "exemption from taxation". *Id.* 68 A.D.2d at 978, 414 N.Y.S.2d at 782.

¹⁰⁷*Id.* 68 A.D.2d at 977-78, 414 N.Y.S.2d at 781-82. As the dissent points out, the prior Court of Appeals decision spoke in terms of tasks not performable in New York, not tasks not performable at the employer's facilities. *Id.* 68 A.D.2d at 979, 414 N.Y.S.2d at 783, Main, J., dissenting (*citing* *Speno v. Gallman*, *supra* note).

¹⁰⁸107 A.D.2d 918, 484 N.Y.S.2d 345 (3d Dept. 1985).

.....¹⁰⁹*Id.*, 107 A.D.2d at 918-19, 484 N.Y.S.2d at 346.

¹¹⁰*Id.*, 107 A.D.2d at 919 - 20, 484 N.Y.S.2d at 347. Logical deductions from proven facts again were found insufficient to support the taxpayer's heavy burden of proof.

required at the job site the next morning. In addition, he often needed to consult with people from the job site while completing this work and they would not travel into New York City.¹¹¹

3. . . .AND NEVER COME BACK!

A few decisions declined application of the “convenience of the employer” rule if the employee continued working for the New York employer but never performed the same job as he previously did in New York.

In 1963, the Appellate Division decided *Oxnard v. Murphy*.¹¹² Oxnard was paid by a New York-administered decedent’s estate for services as its executor, but he lived in New Mexico and never visited New York. The Tax Commission decided that Oxnard’s income was taxable in New York.¹¹³ The sole issue was the meaning of the statutory phrase “gross income from sources within the state.”¹¹⁴ The Appellate Division was quite perplexed that the Tax Commission did not contend that Oxnard was engaged in a New York business or that Oxnard rendered services in New York as an employee. Those were the only definitions of “New York source income” in the then-existing regulations. The Appellate Division concluded that the Commission thought Oxnard’s income was New York-source income solely because it was paid from New York.¹¹⁵ Rejecting that definition of “source”, the Appellate Division expressly relied on the 1919 Attorney General’s ruling that “the work done, rather than the person paying for it, should be regarded as the ‘source’ of income.”¹¹⁶ The Tax Commission’s regulations (quoted in the opinion) were consistent with the Attorney General’s opinion, not its contentions in the case.¹¹⁷ Since none of Oxnard’s services were physically performed in New York, the Appellate Division held that he received no New York-taxable income.¹¹⁸ The fact that taxpayer Oxnard had never been in New York

¹¹¹*Id.*

¹¹²19 A.D.2d 138, 241 N.Y.S.2d 333 (3d Dept. 1963), *aff’d* 19 N.Y.2d 593, 208 N.E.2d 648 (1964) (Appellate Division’s opinion adopted, without more, subject to a dissent contending that “source” means who pays).

¹¹³*Id.*, 19 A.D.2d at 139, 241 N.Y.S.2d at 334.

¹¹⁴*Id.*, referring to N.Y. TAX LAW § 359, subd. 3 (year unstated).

¹¹⁵*Id.*, 19 A.D.2d at 140, 241 N.Y.S.2d at 335.

¹¹⁶*Id.* quoting 1919 RPT. OF ATTY. GEN. 301. The authority of the 1919 Opinion was seriously qualified eleven years later in *Speno v. Gallman*, *supra* note , but *Oxnard* continued as precedent for similar cases

¹¹⁷*Id.*, quoting N.Y. CODES, R. & REGS., tit. 20, § 261.2, p. 514 (date not given). The Appellate Division also relied on the same construction of “source” for federal tax purposes in *Perkins v. Comm’r*, 40 T.C. No. 40 (1963). The operative part of the nonresident employee regulation quoted by the Appellate Division is also in the current principal regulation concerning nonresidents, verbatim. See N.Y. CODES, R. & REGS., tit. 20, § 132.4(b) (2004) (first sentence).

¹¹⁸*Id.* On appeal, the Appellate Division opinion was adopted by the majority, but the one-justice dissent argued that the “source” of the income was obviously the New York payor and no “construction” was needed. *Oxnard v. Murphy*, 15 N.Y.2d 593, 203 N.E.2d 648 (1964), Dye, J.,

was the pivotal factor. Many later decisions have tried to explain away *Oxnard* and the 1919 Attorney General's opinion while attempting to justify of the "convenience of the employer" rule.

In 1972, the Appellate Division decided *Linsley v. Gallman*,¹¹⁹ in which the taxpayer took an early retirement and moved to Connecticut during the tax year. The income in question was for post-retirement consulting services under a written agreement that did not require Linsley to travel to the employer's New York office. Specifically relying on *Oxnard* (thus indirectly and without acknowledgment on the 1919 Attorney General opinion), the Appellate Division held that the location of the person while working was determinative, not the location of the person paying.¹²⁰

Oxnard and *Linsley* establish that a nonresident who does no work in New York has no New York source income, even if the employer is a New York resident or business operation. In contrast to the "convenience of the employer" rule cases, *Oxnard* and *Linsley* are based on stated reasoning and sound authority.¹²¹ The Department has apparently conceded the issue. However, both the Department and subsequent decisions adamantly limit application of *Oxnard* and *Linsley* strictly to their facts.¹²²

4. DICHOTOMY UNEXPLAINED

Since 1972 at the latest, New York has had two distinct rules with the dividing factor being whether the taxpayer was paid for any time she or he was in physically New York during the relevant period. In the *Oxnard-Linsley* line, the taxpayer did no work in the state during the entire year, or during the latter part of the tax year after a change in job description and the facts were interpreted as predicting that the

dissenting. Characteristically, no authority was cited. Subsequent decisions have not mentioned this dissent, even when they reach the same result, worded slightly differently.

¹¹⁹38 A.D.2d 367, 329 N.Y.S.2d 486 (3d Dept. 1972), *aff'd w/o op.*, 33 N.Y.2d 863, 307 N.E.2d 257 (1973).

¹²⁰*Id.*, 38 A.D.2d at 370, 329 N.Y.S.2d at 489.

¹²¹*See also* *Gleason v. State Tax Comm'n*, 76 A.D.2d 1035, 429 N.Y.S.2d 314 (3d Dept. 1980) (taxpayer was an officer and shareholder in a family corporation that had two business locations, both in New York City, job consisted solely accounting and administrative duties performed only at his New Jersey residence), *Hayes v. State Tax Comm'n*, 61 A.D.2d 62, 401 N.Y.S.2d 87 (3d Dept. 1978) (taxpayer resigned and performed consulting contract solely from Connecticut home). *But see* *Lopez Edwards & Frank Co.*, *supra* note (taxpayer-requested opinion on effect of proposed domicile change to Wyoming, while continuing same work for same New York employer, no distinction based on change of job description).

¹²²*But see* *Unterweiser*, *supra* n. , in which the Tax Appeals Tribunal held that *Hayes* did not apply because the taxpayer continued to do one of her two previous jobs after the break point. While that is a factual distinction, a drastic job change is not necessary under the *Hayes* rationale or the subsequent opinion in *Lopez Edwards Frank*. In *Unterweiser*, there was an extremely remote possibility that the employer might change his mind and invite the taxpayer back to the New York office to continue doing the same job. That is not what one would call a significant distinction between *Hayes* and *Unterweiser*, but that is the only distinction available. At the time of the hearing, the facts showed that the employer did not invite the employee back during the tax year, making *Unterweiser* substantively identical to *Linsley*.

taxpayer would not work in New York in the future.¹²³ In that line, all income is sourced to the physical work location, regardless of employer's New York location or why the taxpayer worked at an out-of-state location.

In the "convenience of the employer" line of cases, the taxpayer worked in New York for some time (however short) during the tax year. There, income is sourced to New York unless *the job* required the work be done in the other state.

The differing result is was made possible by applying *Carpenter's* source-of-business-operations-income rule to employees. Despite that, there is no administrative or judicial decision stating that employees are entrepreneurs whose place of business is their employers' place of business. Instead, the decisions merely cite prior decisions in that line of cases, without examining the merits of those prior decisions. The only rationalization for ignoring the fundamental difference between business income and wage-earner income has been the one about not giving nonresident commuters a "benefit" that residents could not get because when they stay at home to work, they are still in New York. Department regulations have continuously placed entrepreneurs and employees in separate categories with differing rules, apparently not noticing the fact that the separation is inconsistent with the "convenience of the employer" rule.

When one attempts to ascertain the substantive distinction between the two lines of cases, nothing that withstands scrutiny is found.

C. *The Taxpayer's Burden*

In addition to applying the "convenience of the employer" rule to as many home-working taxpayers as possible, New York also imposes a special "procedural" burden of proof requirement that even Atlas would find taxing.

Almost every decision involving New York's "convenience of the employer" rule states that the taxpayer failed to provide sufficient proof, which is a "finding of fact" and therefore subject to less rigorous review. Tax law in general imposes on the taxpayer the burden of proving the tax agency's decision is wrong. In New York, taxpayer must prove the Department is wrong by "clear and convincing" evidence¹²⁴ (similar to the burden in fraud actions). On appeal to the courts, the taxpayer must demonstrate the challenged administrative determination is not merely wrong, but is without a rational basis,¹²⁵ or is not supported by more than a mere scintilla of evidence.¹²⁶ No actual rational basis is required because mere issuance of a deficiency assessment creates a vigorous presumption that the Department has a rational basis – even if it has to be discovered *nunc pro tunc*. As stated by an ALJ:

¹²³If there were a possibility, however unlikely, that the taxpayer could possibly return to New York doing the same job, all the other factors were ignored and the "convenience of the employer" rule applied. See *Unterweiser*, *supra* note .

¹²⁴See, e.g., *Phillips*, *supra* note , *Bello v. Tax App. Trib.*, 213 A.D.2d 754, 623 N.Y.S.2d (3d Dept. 1995).

¹²⁵*Id.* See also *Fischer v. State Tax Comm'n*, *supra* note . However, it is said that the Department's determination receives no special consideration when there is no issue of fact and the only issue is the correctness of the Department's legal interpretation of a specific court decision. See also *Montmerie v. Tax App. Trib.*, 291 A.D.2d 129, 740 N.Y.S.2d 141 (3d Dept. 2002).

¹²⁶*Donahue v. Chu*, 104 A.D.2d 523, 479 N.Y.S.2d 889 (3d Dept. 1984). "Substantial evidence [also] does not rise from surmise, conjecture or speculation." *Id.*, 104 A.D.2d at 526, 479 N.Y.S.2d at 892. (citation omitted).

Although every notice of deficiency must have a rational basis in order to be sustained on review, the presumption of correctness raised by the issuance of the assessment, in itself, provides the rational basis in the absence of evidence challenging the basis or correctness of the assessment.¹²⁷

If the taxpayer presents no clear and convincing evidence, the Department's determination is sustained, even if, objectively, it has no rational basis.¹²⁸

If bootstrapping notices are not enough, an even higher burden is imposed in "convenience of the employer" rule cases. In *Kitman v. State Tax Commission*,¹²⁹ the Appellate Division approvingly stated:

Because of the obvious potential for abuse where the home is the workplace in question, the [Tax C]ommission has generally applied a strict standard of employer necessity in these cases, which, with rare exception, has been upheld by the courts.¹³⁰

A review of the cases cited in *Kitman* reveals what the court meant by "a strict standard of employer necessity." At many administrative hearings, taxpayers have presented documents, such as letters from their employers, to prove the employer desired or required that the taxpayer work at a non-New York location. Without exception, the evidence is rejected as insufficient to prove the employer's position, or as irrelevant to the "real" issue of necessity. Court and administrative decisions have consistently held that practical realities, such as commuting time and distance, security measures, required work hours, special equipment requirements, and even employer lock-outs, are irrelevant.¹³¹

Thus the taxpayer must prove, by "clear and convincing," "strictly construed" evidence, that it was literally impossible to perform the particular job functions at an employer's New York location. The choice of where the work done must be conclusively proven to be totally beyond the employee's *and the employer's* control.

The economic reality resulting from the evidentiary burden undoubtedly crushes most taxpayers' desire to challenge administrative fiat. Perhaps the administrative position is more a choice of tactic than a matter of conviction. But, the income from taxpayers who cannot afford to fight no doubt more than

¹²⁷In re Rosenthal, N.Y. TAX RPTR. (CCH) ¶ 403-639 (ALJ 1999).

¹²⁸*See* *Suburban Carting Corp. v. Tax App. Trib.*, 263 A.D.2d 793, 694 N.Y.S.2d 211 (3d Dept. 1999), *Leogrande v. Tax App. Trib.*, 187 A.D.2d 768, 589 N.Y.S.2d 383 (3d Dept. 1992).

¹²⁹*Kitman*, *supra* note .

¹³⁰*Id.* 92 A.D.2d at 1019 (citations omitted). Why working at home unequally creates that potential for abuse is not stated.

¹³¹The underlying bias shines through. The obvious presumption is that any and all evidence, facts and circumstances that tend to make working outside New York rational results from perjury or special arrangements made for the sole purpose of employees' evading New York income tax. No amount of evidence demonstrating the employer's economic decision to have an employee work at home has ever been allowed to overcome that presumption. The implicit belief in the over-reaching importance that saving a few tax dollars plays in taxpayers' lives is more a matter of ego than logic. Appendix A demonstrates the small savings for which taxpayers and employers are presumed to be willing to commit criminal acts.

offsets the cost of defending the few challenges. In this litigation roulette the odds are more stacked than in any casino, legitimate or not.

D. THE REAL STORY: “CONVENIENCE OF THE EMPLOYER” AS APPLIED

.....I. THE PRACTICE

U.S. Supreme Court decisions consistently state that state tax rules must be judged on practical effect, not formal phraseology.¹³² New York’s “convenience of the employer” rule is an object lesson. To refresh recollection, the operative portion of the “convenience of the employer” rule, as stated in the regulation, is:

[A]ny allowance [to a nonresident, individual taxpayer] claimed for days *worked outside New York State* must be based upon the performance of *services which of necessity*, as distinguished from convenience, obligate the employee *to out-of-state duties* in the service of his employer.¹³³

Note the regulation’s express terms: (1) “Employer” is not qualified; the rule is not limited, expressly or by implication, to New York-based employers. (2) The phrases “outside New York State” and “out-of-state duties” are not limited, expressly or by implication, to any particular non-New York work environment or location. (3) The characteristics of the work performed is the sole factor for determining the income to which the rule is applied. Administrative and judicial pronouncements, particularly the former, habitually use the same terms.

The rule’s “real world” application is definitely disconnected. Obviously inconsistently with its inclusive terms, application of the rule is limited to situations in which: (1) the employer has a New York operation that is a location with which the employee is, in some way, associated,¹³⁴ (2) enforcement is limited to nonresident employees who earn income while working at her or his non-New York residence, and (3) the character of the location where the income was earned is the sole factor for determining the income to which the rule is applied. All of the decisions found to date involve that pattern.¹³⁵

The key to the difference between the rule’s terms and its application can be found in the asserted justifications for the “convenience of the employer” rule. All of those rationalizations require that the taxpayer be a New York employer’s nonresident employee working at home. The rationalizations are totally meaningless if the employee is working at some out-of-state location that is not his or her residence, or does not generally work in New York alongside New York residents. The rationalizations are also meaningless if a nonresident employee of a nonresident employer works both within and without

¹³²See, e.g., *Complete Auto*, *supra* note .

¹³³N.Y. COMP. CODE, R. & REGS., tit. 20, § 132.18(a) (2004) (emphasis added).

¹³⁴In contested cases, the employee principally worked at, and was assigned to, the employer’s New York location. Though it has never been expressly stated as a factor or requirement, the involved employees appear to have been paid out of a particular New York office of their employers. However, payment from a New York location is assumed in the New York courts’ constitutional discussions.

¹³⁵In cases “won” by the taxpayer, he worked at his residence so that clients could confer at a location convenient to the client (see *Fischer*, *supra* note) or his work activities required physical facilities structures and spaces not available at the employer’s New York location, but available at, and outside of, the employee’s dwelling. See *Fass*, *supra* note .

New York, or if a nonresident employee of a New York employer voluntarily works in a state other than her residence state. The “convenience of the employer” rule, as written, includes both situations.¹³⁶

The as-applied rule is so different from the adopted rule that pure logic would not derive the applied rule from the written rule. Even if, as written, the “convenience of the employer” rule met constitutional requirements, which it does not, the applied rule must also withstand constitutional scrutiny.

2. *NONRESIDENTS – LIMITED INFORMATION REQUIRED*

The selective application of the rule begins with the nonresident employee-taxpayer’s initial interaction with the tax-payment and enforcement process – tax return forms and instructions. There, taxpayers are told the rules of the game. Average taxpayers, not unreasonably, believe the forms and instructions embody, or are at least consistent with, the tax law. With respect to the “convenience of the employer” rule, New York nonresident individual tax return forms and instructions have changed in interesting ways.¹³⁷ Prior to 1985, New York courts had pronounced judgment in, *inter alia*, *Speno* (1974),¹³⁸ *Colleary* (1979),¹³⁹ and *Kitman* (1983),¹⁴⁰ all discussed in Part II, B, *supra*, and the regulations had included the “convenience of the employer” rule for 15 to 20 years. Since 1985 (the earliest year for which forms are available online), there has been no significant change in the regulatory language or results in adjudicated cases. One would, therefore, expect little change in how the rule is reflected in forms and instructions over the same period. Reality differs.

From at least 1985, nonresidents allocating wage income between New York and another state have been required to provide supporting details on Form IT-203-ATT, Sch. A.¹⁴¹ (See Attachment B-1) On the 1985 form, the taxpayer starts with total work days in the year, then subtracts “out-of-state” work days to fix the number of days (thus the percent of income) to be allocated to New York. The 1985 Sch. A has a small box below the calculation lines where the number of days “worked at home” is to be entered. There is no other reference to that box or its number and it is not part of the allocation calculation. The 1985 Instructions concerning “working at home” are less than enlightening. The most likely understanding would be that “days working at home” are not “working days”.¹⁴² Neither the form nor the Instructions say anything about “convenience” or “necessity” of the taxpayer, her employer, or the job.

¹³⁶For the latter situation, see Attachment A, “Betty” column (New Jersey resident).

¹³⁷Post-1984 New York forms can be found at <http://www.tax.state.ny.us>.

¹³⁸*Speno*, *supra* note .

¹³⁹*Colleary*, *supra* note .

¹⁴⁰*Kitman*, *supra* note .

¹⁴¹Form IT-203-ATT (1985), http://www.tax.state.ny.us/pdf/1985/inc/IT203ATT_1985.pdf.

.....¹⁴²The 1985 Form IT-203 instructions for Form IT-203-ATT, Sch. A, state:

Working days are days on which you have to perform the usual duties of your job. This does not ordinarily include duties performed at your home. Nonworking days are holidays, sick leave, vacations, Saturdays, Sundays, etc.

IT-203-I, 1985 INSTRUCTIONS FOR FORM IT-203, p. 7, col. 2, http://www.tax.state.ny.us/pdf/1985/inc/IT203I_1985.pdf. If work done at home is not “usual duties of [the taxpayer’s] job”, the instruction states, those days are not to be included in “total working days”. The result is an income allocation based on fewer than the actual number of work days and income is allocated

The 1986 Sch. A is the same as 1985's, except there is no box for days "worked at home." The "worked at home" box reappeared substantively unchanged in 1987.¹⁴³ From then through 1994, the form remained essentially unchanged. The Instructions show semantic changes, but continue to make it most likely they will be understood as instructing that days worked at home are to be excluded from the total number of work days.

The 1995 Sch. A (see Attachment B-2) has a revised format. At first glance, the "worked at home" box appears to have become part of the allocation calculation, but it is really still just a box off to the side. The format change is not substantive, but probably increased confusion by appearing to include the "worked at home" number in the calculation when it was not. The Instructions did not change.

In 1996, the Instructions for Sch. A, changed, but the form did not (see Attachment B-3). The new Instructions include the "convenience of the employer" language from a then-35-year-old court decision, albeit somewhat paraphrased.¹⁴⁴ The Instructions make the rule's application appear to depend on the employer's decision about where the employee must work, explaining why taxpayers continued to provide evidence of their employers' opinions and work arrangements. The 1996 Instructions about "working at home" apparently require that "normal work days" spent working at home be included in "days worked in New York" (a calculated line, not a data entry line), and require "not normal work days" spent working at home be counted as non-working days.¹⁴⁵ If one follows what the Instructions say, there would either (a) never be a number entered in the "days worked at home" box, or (b) the number in the "days worked at home" box would also be included in the number entered in one or more of the other boxes.

There were no further notable changes in forms or Instructions until 2002. That year's Sch. A (see Attachment B-3), for the first time, inserts the "days worked at home" box's entry into the calculation process. But the Instructions did not change. The changed form is more confusing and likely to cause

based solely on non-at-home work days. If all of a taxpayer's out-of-state work was at home, all income is allocated to New York, regardless of how much work was done in New York (the intended result). If the taxpayer worked at other non-New York locations, the income earned while working at home would be allocated, pro rata, between New York and the other non-resident, non-New York, locations (not the intended result).

¹⁴³It would be interesting to learn why the box was not on one year's form. Perhaps it was merely an oversight. That seems unlikely, given the number of reviews that form changes should go through before publication.

¹⁴⁴The revised Instructions state, in relevant part: "Any allowance for days worked outside New York State must be based upon the performance of services which, because of necessity (not convenience) of the employer, obligate the employee to out-of-state duties in the service of his employer. Such duties are those which, by their very nature, cannot be performed at the employer's place of business." IT-203-I, INSTRUCTIONS FOR 1996 FORM IT-203, p. 11, col. 2, http://www.tax.satte.ny.us/pdf/1996/inc/IT203I_1996.pdf. The first sentence is an almost-verbatim copy of the Appellate Division's 1960 decision in *Burke v. Bragalini*, *supra* note . The second sentence may look like a rewording of the first, but it is not. The first sentence speaks of the "obligat[ion] of the employee" to work out of state for his employer. The second sentence severely limits the reasons why the employee may be so obligated.

¹⁴⁵The revised instructions state, in part: "Applying the above principles [see preceding footnote] to the allocation formula, normal work days spent at home are considered days worked in New York, and days spent at home that are not normal work days are considered to be non-working days." *Id.*

error than prior forms, partly because the Instructions say nothing about the change. A person trying to follow both the form and the Instructions would most likely allocate the number of days worked at home to New York twice.¹⁴⁶

Other information prepared for taxpayers by the Department does not lessen the confusion. The “General Tax Information” publication for nonresidents says that nonresidents must pay New York income tax on all “New York source income.”¹⁴⁷ The publication’s multi-page itemization of “New York source income” does not mention anything about the “convenience of the employer” rule or special treatment for income earned while working at home.¹⁴⁸

The conclusion that can be drawn? From 1985 (or before) through 1995 a taxpayer relying on forms and Instructions would have no idea that the “worked at home” number had any special significance, except (if the Instructions were read) that those days are not counted as working days. Taxpayers were no doubt surprised when they received from the Department a cryptic recalculation that resulted from adding the “days worked at home” number to the “days worked in New York” number.¹⁴⁹ Perhaps more significantly, the forms give the Department no information about whether the taxpayer had excluded the “days worked at home” entirely, or had allocated them to one of the states.

The 1996 Instructions change informed the taxpayer exactly where the “worked at home” days should be allocated (to New York) but the recently changed placement of the “worked at home” line on the form became even more ambiguous. The 2002 form change (inserting the “worked at home” number into the calculation sequence) may have clarified the form while, at the same time, making the Instructions more confusing and adding the probability of allocating the number of days “worked at home” to New York twice.

¹⁴⁶If the Instructions are followed, the number of “days worked at home” are not included in the “days worked outside New York” line which effectively allocates those days to New York. The very next line asks for the number of days worked at home that are included in the “days worked outside New York” line. The answer should always be “0”. However, most persons who are not tax professions would probably also enter the number of days worked at home on the “days worked at home” line, which causes that number of days to be subtracted from the “days worked outside New York” line for a second time. A taxpayer who works only at the New York office or at her residence would end up with a number of days allocated to New York exceeding the total number of working days, with the excess equal to the number of days worked at her residence.

¹⁴⁷DEPT. OF TAX’N & FIN., GENERAL TAX INFORMATION FOR NEW YORK STATE NONRESIDENTS AND PART-YEAR RESIDENTS, Pub. 88, p. 8 (Nov. 2003), http://www.tax.state.us/pdf/publications/income/Pub88_1103.pdf.

¹⁴⁸*Id.* at p. 9 - 12.

¹⁴⁹It would be interesting (and no doubt impossible) to learn what percent of taxpayers receiving such notices just accepted the resulting decrease in refund (or paid the bill) without questioning what the Department had done or why. *Cf.* In re Friedman, Div. of Tax App. No. 818271, N.Y. TAX RPTR. ¶ 404-224 (ALJ 2002) (the taxpayer rolled over after the Department communicated its version of the rules).

On the other hand, it has been clear throughout this 20-year period that the Department has been only interested in whether the nonresident taxpayer “worked at home.”¹⁵⁰ Neither forms nor instructions require any information concerning, or mention anything about, the nature of the work done outside New York, at the taxpayer’s home or elsewhere. From the required information, the Department would have no factual basis for questioning, based on the “convenience of the employer” rule as written, any non-New York allocation. It would, however, have a taxpayer-provided number for “adjusting” the return allocation based on “days worked at home” – if the taxpayer did not follow Instructions and put some number on the “worked at home” line.

All of the litigation involving the “convenience of the employer” rule demonstrates the same focus solely on work at the taxpayer’s home.

What can be concluded? Only that the sole purpose and use of the “convenience of the employer” rule has been, and is, to force nonresidents to treat all home-office-earned income as New York-source income. The general language used in the regulation veils actual intent and practice. Even if the generalized regulatory language is constitutional, as-applied reality is not.

3. *RATIONALIZATION IS NOT REALITY*

With respect to the “convenience of the employer” rule, the Department’s only effort in its forms and form instructions is to tax nonresidents on income earned while working at their residence. Consistently, one searches in vain for a reported adjudication in which the Department has challenged a nonresident’s allocation related to an out-of-state location other than her or his home. There is a similar absence of cases concerning the resident credit.

The New York courts focus on the same select group of nonresidents as the Department. The courts have consistently rationalized the “convenience of the employer” rule by saying it creates equal treatment of residents and nonresidents who work at home, that it eliminates the potential for fraudulently claiming to work at home rather than at the office, and that it protects the allocation scheme. *See* Part II.B, *supra*.

The rationalizations are rational if it is assumed that the “convenience of the employer” rule applies only to nonresidents working at their residences. Unfortunately, that assumption is inconsistent with the rule’s express terms. The rule does not include the term “home,” or “residence,” or “abode,” or “dwelling,” or any related term. Under the rationalizations, the nature of work done at any location is irrelevant, even though that is the operant factor in the written rule. If either the Department or the courts had to justify applying the “convenience of the employer” rule to an employee working at some non-New

¹⁵⁰A recent Advisory Opinion demonstrates the continuing significance of work “at home.” In TSB-A-04(2)I (Apr. 27, 2004) (http://www.tax.state.ny.us/pdf/Advisory_Opinions/Income/A04_1i.pdf) the taxpayer worked in and outside New York. One year he was a Connecticut resident working for a Connecticut company (which also had a New York office). The next year he changed to a New York employer but everything else was the same. The third year, he became a statutory resident (in New York more than 183 days) but everything else was the same as the year before. In each year the taxpayer was, in theory, subject to the “convenience of the employer” rule, the first two as a nonresident, the last as a resident. The Advisory Opinion discusses the application of Reg. § 132.18, which includes the “convenience of the employer” rule, but *nowhere* is there any mention of that rule or its applicability. But for the Department’s “working at home” blinders, each of the scenarios would have produced some consideration of the “convenience of the employer” rule. The most logical, if not only, explanation is that none of the supplied scenarios said the taxpayer did any work at his residence. Therefore the Department considered the “convenience of the employer” rule irrelevant.

York location other than his or her residence, which the rule unquestionably encompasses, totally new rationalizations would have to be developed.¹⁵¹

E. Legal & Constitutional Challenges

The vast majority of reported “convenience of the employer” cases are treated as presenting solely factual issues, with taxpayers attempting to prove: (a) they were really working, to the benefit of the employer, in the out-of-state location,¹⁵² or (b) their situation was essentially the same as in *Fass* (clear job necessity), or (c) that their situation was essentially the same as in *Linsley* (no work in New York). Evidently seeing the futility of basing their cases on facts and standard definitions, some taxpayers challenged the legal validity of the “convenience of the employer” rule, as applied and on its face. Since the rule is stated in both regularly adopted regulations and precedent, legal challenges are effectively limited to constitutional issues.

In 1979, the taxpayer in *Colleary v. Tully*¹⁵³ argued that the “convenience of the employer” rule violated various clauses of the U.S. Constitution. The contentions were summarily dismissed. The argument that applying the test resulted in unfair apportionment, thereby violating Equal Protection rights, was said to be without merit because:

The “convenience of the employer” test merely serves to protect the integrity of the apportionment scheme by including income as taxable where it results from services substantially connected with New York but performed outside New York to effect a subterfuge.¹⁵⁴

To say this rationale does not respond to the issue and is based on unsupported assumptions would be an understatement.

The taxpayer in *Colleary* also contended that the rule’s application violated the Due Process and Equal Protection clauses because it results in nonresident self-employed persons receiving more favorable treatment than nonresident persons employed by others.¹⁵⁵ The Appellate Division responded:

¹⁵¹The only rationalization stated to date that might apply is the one about state services to the employer justifying taxes on its employees’ out-of-state-earned income. That applies because it encompasses all employees of New York-based employers, wherever in the world they happen to work or live.

¹⁵²This is most frequent in earlier cases, before it became obvious that doing beneficial work with the employer’s approval was irrelevant. Given the language used, particularly the “convenience of the employer” label, this is a very rational and relevant contention. However, the longer the rule has been applied, the more its application has become divorced from ordinary understanding.

¹⁵³69 A.D.2d 922, 415 N.Y.S.2d 266 (3d Dept. 1979).

¹⁵⁴*Id.*, 69 A.D.2d at 923, 415 N.Y.S.2d at 268. The Appellate Division went on to justify the test’s constitutionality by stating that it had “met with approval” by the New York Court of Appeals in *Speno*, *supra* note . Since *Speno* never mentioned constitutional issues, the Appellate Division’s reference is, at best, cryptic. Perhaps the rationale was that since the state’s highest court did not *sua sponte* declare the rule unconstitutional, it must be constitutional. Interesting, but not convincing.

The argument is without merit. There is a rational distinction between the two. The income of an out of State self-employed person is taxable only through his intrastate activities since these activities are the connection with the State, whereas, *the source of an out of State employee's income is the employer within the State*. Thus, the employment relationship is important in establishing the necessary connection with the State.¹⁵⁶

The Appellate Division, understandably, did not cite any supporting authority.¹⁵⁷ Nor did it explain how being paid by a New York client is substantially different from being paid by a New York employer.

Colleary's blithe treatment of constitutional issues apparently cowed taxpayers. It was over 20 years later, in 2000 - 01, when the next cases presenting constitutional arguments appeared.

In *In re Zelinsky*, an ALJ decision adverse to the taxpayer was before the Tax Appeals Tribunal.¹⁵⁸ The taxpayer, a professor at a law school in New York, allocated a significant portion of his work time (and therefore income) to Connecticut, where he resided. The stipulated facts showed that he generally worked at his residence office on the two weekdays he was not lecturing. He also worked there essentially full-time during the semester he was on sabbatical. At his Connecticut office, Zelinsky prepared for lectures, graded exams and papers, and did research and writing for professional publications. The only evidence submitted at the ALJ hearing was a stipulation of facts, which the ALJ incorporated as findings of fact.¹⁵⁹ The ALJ's findings of fact were adopted by the Tax Appeals Tribunal. Those findings provide no details concerning Zelinsky's employment contract or any understood expectations concerning where or on what Zelinsky was to work. The lack of evidence in the stipulation was held against the taxpayer:

We take the strongest possible negative inference from petitioner's failure to present evidence that would demonstrate where and when petitioner discharged his duties [for his employer]. . . . We conclude that petitioner did not produce such evidence because it would not have contradicted the presumption that his services were performed in New York.

¹⁵⁵*Id.* Though not elaborated in the opinion, the taxpayer probably pointed out that a self-employed nonresident would be subject to New York income tax only for hours physically worked in New York, without regard to reasons the choice of work location, while an employee doing similar work in similar locations for similar reasons would be taxed on income earned while working outside New York if the employee could not provide incontrovertible proof that job requirements that necessitated working outside New York — not an illogical argument.

¹⁵⁶*Id.*, 69 A.D.2d at 923, 415 N.Y.S.2d at 268 (emphasis added). In other words the source of income for tax purposes is the physical location of the payor. The statement is contrary even to New York regulations.

¹⁵⁷The Appellate Division, for some reason did not cite the Court of Appeals dissent in *Oxnard*, *supra* note , stating that the “source” of an employee's income is the employer and no “construction” of the word “source” is needed.

¹⁵⁸*Zelinsky (TAT)*, *supra* note , *aff'g* *In re Zelinsky*, N.Y. TAX RPTR. (CCH) ¶ 403-791 (ALJ 2000).

¹⁵⁹*Zelinsky (ALJ)*, *supra* note .

* * * * Petitioner's interpretation of his job duties, the weight he attributed to each of them and the place of their performance was chosen by him for his personal gain and convenience.¹⁶⁰

The Tax Appeals Tribunal ignored the fact that the Department had agreed to the stipulated facts. Instead, it treated its own subjective conjecture, based on its "strongest possible negative inference". The Tribunal's decision does not even pretend to be objective.

After many pages of facts and contentions, the Tax Appeals Tribunal held that the taxpayer failed to satisfy the burden of proof requirement because, it said, the evidence did not support a conclusion that any of the taxpayer's out-of-state activities were part of the "job" for which he was paid.¹⁶¹ Instead, the Tribunal concluded, it was the taxpayer's arbitrary, self-serving allocation of work time to Connecticut that caused the problem, not the "convenience of the employer" test.

We believe it was just this type of arbitrary allocation the rule was meant to prohibit. This conclusion is strengthened by the fact that the policy consideration set forth in *Speno* is still present and petitioner's allocation [would have allowed him, if it were to succeed,] to enjoy a benefit not available to his New York counterparts.¹⁶²

Having fully disposed of the case on the facts, the Tribunal nevertheless expressed its opinion of the taxpayer's constitutional arguments.

While the Tribunal's discussion is of no precedential value (dicta, administrative decision, etc.), it is the first "convenience of the employer" decision even noticing that potentially relevant U.S. Supreme Court decisions exist. Setting a pattern, the Tribunal first acknowledges that the movement of persons across state lines is a "form of commerce," then denies that any "interstate interest or activity [is] impacted by the 'convenience of the employer' test."¹⁶³

..... It would serve no useful purpose to examine in detail the Tribunal's mix-and-match trundle among partial quotes lifted without context from selected U.S. Supreme Court decisions. The Tribunal managed to make it appear (so long as one does not think much about what is said) that those decisions support New York's fairness-to-resident-taxpayer rationalizations.

On appeal the Appellate Division summarized the stipulated facts in an interesting manner, totally consistent with the actual stipulations set out in the administrative decision. The Appellate Division stated:

¹⁶⁰*Zelinsky (TAT)*, *supra* note .

¹⁶¹*Id.*

¹⁶²*Id.* The Tax Appeals Tribunal did not identify the alleged tax benefit, but the common innuendo is that the taxpayer pays no state tax on income allocated to another state, which is incorrect, as was known to the Tribunal. Connecticut's income tax is somewhat over two-thirds of New York's.

¹⁶³*Id.* Near the end of its decision, the Tribunal came up with an interesting basis for not finding the "convenience of the employer test" invalid due to double taxation. The Tribunal states that it is Connecticut's tax that creates the threat of double taxation! This, it states, is because the New York test existed "as early as" 1967 – 24 years before Connecticut enacted its income tax. According to the Tribunal, given the time priority, Connecticut must have been aware of New York's tax rules and, therefore, should have conformed its own laws to New York's version of reality. *Id.* Apparently the theory is that double taxation is a first-in-time, first-in-right proposition.

[Zelinsky's] duties included teaching classes, meeting with students, preparing and grading examinations, writing recommendations for students and conducting scholarly research and writing. . . . [Zelinsky] spent three days each week in New York City teaching classes and meeting with students. He remained in Connecticut two each week *performing the balance of his duties*.¹⁶⁴

Obviously, the Appellate Division understood that the taxpayer performed significant portions of his employment duties outside New York.

Based on the parties' contentions, the legal issue was limited to whether the "convenience of the employer" test survived the "fair apportionment prong of the four-part test" of *Complete Auto Transit v. Brady*.¹⁶⁵ The Appellate Division referred to excerpts from Supreme Court cases stating generalities related to the "external consistency" factor of *Complete Auto*'s "fair apportionment" "prong." The emphasis is on excerpts indicating that a state must have some economic justification for imposing the subject tax. The Appellate Division's opinion does not include statements indicating the court had considered anything beyond conclusory rule statements.¹⁶⁶ So fortified, the Appellate Division held that New York's tax on the employee's income from out-of-state work is justified (*i.e.* satisfies the "external consistency" test) because it is paid by a New York based employer.¹⁶⁷

Based on the conclusion that the employer's in-state presence is the significant factor, the Appellate Division held that the "value being taxed . . . is not subject to easy apportionment . . ." ¹⁶⁸ It identifies the "value being taxed" as the "host of tangible and intangible protections, benefits and value" provided by New York to the taxpayer's employer.¹⁶⁹ To bolster its difficulty-of-apportionment position, the Appellate Division reiterates the venerable mantra that the employee-working-in-another-state-situation "implicate[s]" potential for abuse.¹⁷⁰ How that justifies no apportionment is left for speculation.

¹⁶⁴*Zelinsky v. Tax App. Trib.*, 301 A.D.2d 42, 43, 753 N.Y.S.2d 144, 145 (2002) (hereafter *Zelinsky (AD)*).

¹⁶⁵*Id.*, 301 A.D.2d at 45, 753 N.Y.S.2d at 146-47, *citing* *Complete Auto Transit v. Brady*, 430 U.S. 274, 279 (1977) (discussed at note et seq., *infra*).

¹⁶⁶*Id.*, 301 A.D.2d at 45-46, 753 N.Y.S.2d at 147, *citing* *Oklahoma Tax Comm'n v. Jefferson Lines*, 514 U.S. 175, 185 (1995) (a sales tax case, discussed at note , et seq., *infra*).

¹⁶⁷*Id.*, 301 A.D.2d at 46, 753 N.E.2d at 147.

¹⁶⁸*Id.* (referring, as an opposite example, to *Central Greyhound Lines Co. v. Mealey*, 334 U.S. 653 (1949) discussed *infra* at notes , et seq.).

¹⁶⁹*Id.* Not finding a quantifiable relationship between benefits to the employer and income earned by the employee should have given the Appellate Division a clue that it had missed a signpost somewhere. The "value being taxed" by a personal income tax is the taxpayer's income – nothing else. Every person who has ever completed a tax return is aware of that fact.

¹⁷⁰*Id.* Apparently the Appellate Division's argument here is that apportionment is not simple (by reference to days worked) because the employee might lie about days worked outside the state. Of course that could be said about any item included on any tax return.

The Appellate Division concludes its apportionment discussion with a conclusion of fact, *i.e.* that the taxpayer “failed to demonstrate by clear and cogent evidence” that the tax exacted was disproportionate to the taxpayer’s business in New York.¹⁷¹

The Appellate Division gave even shorter shrift to the taxpayers’ Due Process argument. It summarily held that the fact that the taxpayers’ income comes from a New York employer is “ample foundation” to tax all of that income.¹⁷² This is the same reason given for meeting the “external consistency” test.

In 2003, the New York Court of Appeals affirmed.¹⁷³ The Court of Appeals’ opinion does not differ substantively from the lower court’s, though it avoids citing some of the cases that are most obviously inconsistent with the result. But the Court of Appeals reverts to the more dogmatic “fact”-based approach of the Tax Appeals Tribunal. The court emphasized the connection between the taxpayer’s work and his employer’s New York location, stating that he was paid for teaching classes in New York and not “reading in his study in Connecticut.”¹⁷⁴ The court relies almost exclusively on the conclusion unsupported that employer’s connection with the state establishes the state’s right to tax the nonresident employee’s income, *e.g.*:

The work [the taxpayer] chooses to do at home is . . . inextricably intertwined with the business of his New York law school, and cannot convert his employer’s New York business into an interstate one when Cardozo [Law School] did not employ him to carry out any of the school’s business activities in Connecticut.¹⁷⁵

The Court of Appeals holds that the taxpayer’s working in two states does not involve interstate commerce because he was not required to work outside New York and what he actually did outside the state was not the task for which he was paid.¹⁷⁶ On that basis, the court falls back to the old reliables, *i.e.* that the “convenience of the employer” rule merely eliminates the potential for discrimination against New York residents and prevents fraud.

The court gives a more-detailed statement of how fraud became involved than any prior court or administrative decision (remember this is over 50 years after the “convenience of the employer” rule was revealed):

¹⁷¹*Id.*, 301 A.D.2d at 46, 753 N.E.2d at 148. Perhaps the Appellate Division did not notice that it had changed the operative factor (“value being taxed”) between the reasons stated and the conclusion based thereon.

¹⁷²*Id.*, 301 A.D.2d at 47, 753 N.E.2d at 148.

¹⁷³*Zelinsky v. Tax App. Trib.*, 1 N.Y.3d 85, 801 N.E.2d 840 (2003).

¹⁷⁴*Id.*, 1 N.Y.3d at 93, 801 N.E.2d at 840.

¹⁷⁵*Id.*, 1 N.Y.3d at 92, 801 N.E.2d at 846. Later, the court states: “[A]ll of petitioner’s teaching is accomplished in New York and his voluntary choice to bring auxiliary work home to Connecticut cannot transform him into an interstate actor.” *Id.*, 1 N.Y.3d at 93, 801 N.E.2d at 847. That is obviously inconsistent with the Appellate Division’s fact recitation. The Court of Appeals obviously made its own conclusions of fact, including some key ones not obviously supported by the stipulated facts.

¹⁷⁶*Id.*, 1 N.Y.3d at 92, 801 N.E.2d at 846. There is no indication that the stipulation filed with the Appellate Division (that the work done in Connecticut was part of the taxpayer’s job) was withdrawn before the Court of Appeals. If it had not been withdrawn, the Court of Appeals based its decision, in part at least, on “facts” contrary to the record.

The convenience [of the employer] test was originally adopted to prevent abuses arising from commuters who spent an hour working at home every Saturday and Sunday and then claimed that two-sevenths of their work days were non-New York days and that two-sevenths of their income was thus not New York income, and either free of tax . . . or subject to tax at a lower rate than New York's.¹⁷⁷

The court cites no source for this “fact” and no other discovered case mentions those “facts.” Use of the term “adopted” implies the rule first came into being as a statute or regulation, which is inconsistent with the rule’s history laid out above. The language, at this point and elsewhere in the opinion, smacks of righteous indignation, declaring all nonresident commuters (or at least Professor Zelinsky) to be tax evaders.

The Court of Appeals’ discussion of the taxpayer’s constitutional arguments follows the pattern set below, *i.e.* numerous short quotations, or summaries, of phrases from Supreme Court decisions without consideration of the facts or analysis in those decisions. The Court of Appeals focus is continuously on the two themes: (1) the taxpayer is paid solely for teaching, which he does solely in New York, and (2) that his employer receives numerous invaluable services from New York that indirectly trickle down to the taxpayer. Also as in the decisions below, the Court of Appeals states that any threat of “double taxation” is caused by the taxpayer’s attempt to avoid rightful New York taxes and Connecticut law, not New York law.¹⁷⁸

In *In re Thomas L. Huckaby*¹⁷⁹ (hereafter “*Huckaby*”) the taxpayer lived and worked in Nashville, Tennessee, long before he became employed by “NOITU,” a New York-based organization. Huckaby’s employer assigned him to work with NOITU from the employer’s Nashville offices. When the Nashville employer “reorganized,” Huckaby’s employment ended. But NOITU then needed someone with Huckaby’s skill and expertise, so it hired him directly. The contract was probably almost identical to the one with Huckaby’s former employer. It provided that Huckaby would continue to work in Nashville, communicating with NOITU electronically. The agreement also required him to go to New York if necessary. NOITU provided most of the equipment needed for Huckaby’s Nashville office, which was, incidentally, at his residence. The new arrangement functionally changed nothing except the Nashville address at which Huckaby generally worked.

On his New York return, Huckaby allocated income between Tennessee and New York based on days physically worked in each state. The Department applied the “convenience of the employer” test and allocated all income to New York. That determination was sustained by the ALJ. The only “fact”

¹⁷⁷*Id.* The court added in a footnote: “Of course, in the absence of the convenience test, opportunities for fraud are great and administrative difficulties in verifying whether an employee has actually performed a full day’s work while at home are readily apparent.” *Id.*, at n.4. This is a non-issue in light of the New York regulations that any portion of a day spent in New York (working or otherwise) is treated as a full day. The rules do not allow either partial days or splitting days. Similar rules exist in Connecticut and probably every other state and country. There would never be a need for tax administrators to determine how many hours or minutes were worked during any day.

¹⁷⁸*Id.*, 1 N.Y.3d at 95-96, 801 N.E.2d at 848-49.

¹⁷⁹Div. of Tax Appeals No. 817284, N.Y. TAX RPTR. (CCH) ¶ 403-859 (ALJ 2001), *aff’d*, N.Y. TAX RPTR. (CCH) ¶ 404-188 (Tax App. Trib. 2002), *aff’d*, 6 A.D.3d 988, 776 N.Y.S.2d 125 (3rd Dept. 2004).

treated as relevant was that the job could be, and sometimes was, performed in NOITU's New York office.¹⁸⁰

In addition to factual arguments, Huckaby contended that the application of the “convenience of the employer” rule was unconstitutional because it allocated income to New York “out of all proportion to his contacts and benefits from New York State.”¹⁸¹ The ALJ dismissed that contention based on *Colleary*, *i.e.* that the state's relationship with NOITU was the only connection necessary for New York to tax all income Huckaby received from NOITU.¹⁸²

Huckaby also contended that the “convenience of the employer” test violates the Equal Protection Clause by using an irrational standard to distinguish between nonresidents.¹⁸³ The ALJ's response is remarkable:

First, contrary to petitioner's argument, the test is not whether an employee is required to work out of state by his employer. Rather, the test asks whether it is necessary to perform services out of state in the service of the employer [citing *Speno*]. Second, as previously noted, the rational basis for the rule is that the test protects the integrity of the apportionment scheme by including as taxable income receipts from services which are substantially connected to New York but which are performed outside of New York to effect a reduction in New York State taxes [citing *Colleary*].¹⁸⁴

The ALJ's “First” response makes one go back and read the two “test” statements many times. To the extent there may be substance to the semantics, it is that even an employer's *requirement* that the employee work outside New York does not satisfy the “convenience of the employer” rule. Thus, so long as either the employer or the employee has even the slightest choice of physical work location, taxpayer fraud is presumed and the rule allocates all of the employee's income to New York.

The Tax Appeals Tribunal affirmed the ALJ decision, doing little more than reciting the ALJ's reasons and conclusions.¹⁸⁵

Before its decision in *Huckaby*,¹⁸⁶ the Appellate Division had the benefit of the Court of Appeals' *Zelinsky* decision. Thus, not much effort was required. The Appellate Division's opinion is principally selected generalities from prior New York and U.S. Supreme Court decisions, followed by equally

¹⁸⁰*Id.*

¹⁸¹*Id.*

¹⁸²*Id.* Only *Colleary*, *supra* note , was cited for this conclusion.

¹⁸³*Id.*

¹⁸⁴*Id.* “Protecting the integrity of the apportionment scheme” is confirmed as merely a higher-level-language version of the stock irrefutable presumption of fraud rationalization. The facts recited in the ALJ decision unequivocally prove clear and convincing, non-tax reasons why Huckaby worked in Tennessee. Those were deemed irrelevant. In an earlier statement of the same “reason”, the ALJ continued to assert the traditional “policy” basis for the test, *i.e.* that it provides fair taxation of residents by preventing nonresidents from gaining a “tax benefit” by working at home. *Id.* That fairness argument was stated to be “particularly important” in *Huckaby* – without explanation.

¹⁸⁵*Huckaby (TAT)*, *supra* note

¹⁸⁶*Huckaby (A.D.)*, *supra* note .

general conclusions. The most-repeated rationalization in support of the decision is the refrain that state services to the employer validates New York's taxing of all an employee's income. "The 'convenience of the employer test [is] a valid means of capturing income derived from work performed for New York employers"¹⁸⁷

To summarize the New York decisions concerning the "convenience of the employer" rule, the New York administrative and judicial authorities are of the opinion that:

- » The "convenience of the employer" does not discriminate against nonresidents because its application promotes a valid policy of denying a "tax benefit" to nonresidents that is not available to residents. In other words, if the rule were not applied, nonresidents would not pay New York tax on income earned at home but residents would.
- » The "convenience of the employer" rule does not offend Due Process principles because its application prevents tax evasion by nonresidents (see preceding point).
- » The "convenience of the employer" rule results in fair apportionment [Commerce Clause] and is justified [Due Process] because it only results in taxing income of nonresidents who (a) work for New York-based employers (which receive incalculable valuable benefits from their in-state location), and (b) have a personal connection with New York because during the year they physically perform some part of their work duties in New York
- » The "convenience of the employer" rule does not discriminate against nonresidents because residents are subject to the same rule with respect to credit for taxes paid to other states.

If in reality, as in the realm of fairies and small children, saying something three times makes it true, then all the above are true many times over. If, on the other hand, a conclusion becomes true after only one iteration based on objective, reasoned facts and logic that fairly supports the conclusion, the above statements have not yet become true.

Regardless of the New York courts' belief system or their rationalizations, New York's "convenience of the employer" rule is inconsistent with more than one federal constitutional principle.

III. "CONVENIENCE OF THE EMPLOYER" AND THE CONSTITUTION

A. *Fundamental Principles*

The fundamental question considered in this article is simple: Does a state have the power to enforce a law, such as New York's "convenience of the employer" rule, that taxes the income of nonresidents earned while working in another state?

The first step is to recognize the fundamental, and frequently unstated, principle that a state can impose any legal rule it chooses, unless some superior rule requires otherwise.¹⁸⁸ If U.S. states were sovereign countries, that basic principle would end the inquiry; the only possible limitations would be whatever "international law" rules the state chose to recognize.¹⁸⁹ Because U.S. states are subject to the U.S. Constitution and laws enacted thereunder, the issue becomes whether one or more superior rules

¹⁸⁷*Id.*, 6 A.D.3d at 990, 776 N.Y.S.2d at 128 (citing *Speno*, *supra* note , and *Kitman*, *supra* note).

¹⁸⁸This article assumes that the enacting state did not, and will not, violate internal laws while making or enforcing the rule under examination. In other words, the rule was enacted or adopted in accordance with the internal rules empowering and regulating the acting body(ies) or agency(ies), and does not conflict with some other internal rule that has precedence.

¹⁸⁹Of course, even sovereign states are forced, in some degree, to comply with international custom. Any internal law that relies on enforcement in some foreign state will be effective only to the extent the foreign state(s) recognizes the law's validity.

preclude a particular state action. So far as the author is aware, there is no federal statute or regulation that restricts states on the issue here discussed. Thus, there is “only” the problem of determining if one or more provisions of the U.S. Constitution are violated by a state’s “convenience of the employer” rule, on its face or as applied.

New York’s “convenience of the employer” rule necessarily involves cross-border events. It applies only to nonresident individuals’ actions while they are engaged in activities in some state other than the enacting, enforcing state. Thus, there are a number of constitutional rules and principles that might limit a state’s actions, including the 14th Amendment’s Due Process and Equal Protection clauses, Article IV, § 2’s Privileges & Immunities Clause, and the inherent limitations of the Commerce Clause, Art. I, § 8. Those are distinct clauses, each with a particular focus, but there are substantial overlaps when taxation of nonresidents is at issue.

Overlaps occur partly because many constitutional clauses, in whole or part, function to establish or enforce the “federal” nature of the United States. States are not independent sovereigns, but are subject to a larger sovereignty, and are constituent parts of the national polity, society, and economy. Maintaining the nation requires that individual states not hinder activities necessary or appropriate to the continued existence, or the smooth functioning, of the whole. Clauses relevant to this discussion play pivotal roles.

There are many U.S. Supreme Court decisions dealing with state taxation of events that cross or transcend state boundaries. Like all other state law, state tax law is subject to the Due Process, Equal Protection, Privileges and Immunities, and Commerce Clauses of the U.S. Constitution. In the state taxation context, the clauses have differing spheres of influence, or differing principal applications, even in the areas of apparent overlap.

The Due Process clause, *inter alia*, precludes states from imposing their laws on persons and events beyond the states’ jurisdiction — due process principles are violated when a state attempts to impose its rules with respect to situations or persons over which it has no legitimate authority.¹⁹⁰ The Equal Protection Clause prevents states from imposing rules that distinguish between persons (and taxpayers) based on unacceptable, irrelevant, or irrational distinctions.¹⁹¹ The Commerce Clause, principally through the “dormant commerce clause” construct, precludes states from discriminating against, or unduly burdening, interstate commerce.¹⁹² The Privileges & Immunities Clause precludes states from discriminating against citizens and residents of other states.¹⁹³ The latter three clauses, in whole or part,

¹⁹⁰*See, e.g., Quill Corp. v. North Dakota*, 504 U.S. 298, 306-07 (1992), *Moorman Mfg. Co., v. Blair*, 437 U.S. 267, 273 (1978), *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 342 (1954).

¹⁹¹In cases involving state taxation of persons or events that cross state boundaries, issues based on discrimination may be discussed in the context of the Commerce Clause or the Privileges and Immunities Clause. For that reason, there is no separate discussion in this article concerning Equal Protection.

¹⁹²*See, e.g., Quill, supra note .*

¹⁹³*See, e.g., Austin v. New Hampshire*, 420 U.S. 656 (1975), *Toomer v. Witsell*, 334 U.S. 385 (1948), *City of New York v. New York*, 94 N.Y.2d 577, 730 N.E.2d 920 (2000). In making arguments based on Commerce Clause and Equal Protection or Privileges & Immunities principles, taxpayers frequently implicitly concede the Due Process issue. Arguments made under those clauses assume that the state has the authority to impose its laws to the situation and person but the manner in which those laws are being imposed violates other constitutional limitations. If a state attempts to impose rules beyond the scope of its jurisdiction, the attempt is invalid (violates Due Process) without regard to whether it violates one of the other clauses.

restrict states' authority to distinguish between persons based on citizenship or residence. The Due Process Clause, on the other hand, requires some distinctions based on citizenship and residence.

B. Due Process

The primary objection to New York's "convenience of the employer" rule results from the most fundamental limitation on governmental power. For at least 350 years imaginary lines have been placed across the Earth establishing politico-geographic boundaries. Inside its boundaries a government's sovereign power and authority is theoretically absolute. But at the boundary, government power stops – absolutely. The resulting constraint on government extraction of funds through taxation has been recognized from the beginning of the nation. In *McCulloch v. Maryland*,¹⁹⁴ Chief Justice John Marshall wrote:

[T]he power of taxing the people and their property, is essential to the very existence of government, and may be legitimately exercised on the objects to which it is applicable, to the utmost extent to which the government may choose to carry it.

* * * *

It may be objected . . . that the power of taxation is not confined to the people and property of a state. It may be exercised upon every object brought within its [physical] jurisdiction. This is true. But to what source do we trace this right? It is obvious, that it is an incident of sovereignty, and is co-extensive with that to which it is an incident. All subjects over which the sovereign power of a state extends, are objects of taxation; but those over which it does not extend, are, upon the soundest principles, exempt from taxation. This proposition may almost be pronounced self-evident.¹⁹⁵

Fundamental principles both authorize and limit government power to tax to: (a) persons sufficiently associated with the jurisdiction to be treated as a "subject" of the jurisdiction's government (*i.e.* its citizens, nationals, residents, domiciliaries, the name varies); and (b) activities, events, persons, and things within a government's recognized politico-geographic boundaries.¹⁹⁶

The first category (authority over subjects) is somewhat theoretical. A natural or legal person is deemed to "consent" to a government's authority by becoming associated with it in a recognized manner, which can be voluntary or by implication from birth or long-term presence within the government's territory.¹⁹⁷ Persons can change the government to which they are subject. Sometimes changes happen

¹⁹⁴17 U.S. (4 Wheat.) 316 (1819).

¹⁹⁵*Id.* at 428 - 29.

¹⁹⁶1 RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 402(1)(a), (b) (1987) (hereafter "REST. (3D) FOREIGN REL."). Rest. (3d) Foreign Rel. § 402, and U.S. Due Process principles, recognize a state's power to exercise jurisdiction over an out-of-state actor who takes some action with the intent that it have an effect in the acting state. *Id.*, § 402(c). New York courts have never made any claim remotely like the so-called "effects principle" – and there is no rational basis for making such a claim – concerning the "convenience of the employer" rule.

¹⁹⁷*Id.*, comment *e.*

without the person's participation.¹⁹⁸ Nevertheless, so long as it exists, the relationship connection between subject and government does not stop at geographic boundaries. A United States citizen Montreal or Mongolia is still a United States citizen subject to U.S. law.

..... The second category (control within boundaries) should be obvious. Sovereignty includes the power to act within the sovereign's boundaries — otherwise it would be meaningless. The power to legitimately employ force and violence enables geographic jurisdiction. This category of power necessarily ends at the boundary. While a government may appear to act in some instances beyond its boundaries, those acts normally result from cooperation between governments – or acts of war.

In United States constitutional cases, these two categories of jurisdiction are often termed “general jurisdiction” (citizen) and “special jurisdiction” (physical location). For general jurisdiction, the question is whether the person or thing is sufficiently closely connected with a particular government's geographic area to have become a “subject” of that government. “Continuous” and “systematic” activities within a state will eventually satisfy the requirements for general jurisdiction.¹⁹⁹ Concluding that a person is “domiciled” in, or a “resident” of, a particular area is another way of saying that area's government has general jurisdiction over that person.²⁰⁰

..... “Special jurisdiction” is a government's limited power with respect to a thing or person that made limited contact with the governed area, but not enough to establish general jurisdiction. Current United States legal theory on states' special jurisdiction is traceable to *International Shoe Co. v. Washington*,²⁰¹ a tax case. There, the Supreme Court held that it is sufficient for *in personam* jurisdiction if a person (or corporation) has “certain minimum contacts with [the state] such that the maintenance of suit does not offend ‘traditional notions of fair play and substantial justice.’ ”²⁰² Nevertheless, *special jurisdiction is limited to the activities or things that occur or exist within the government's geographic boundaries.*²⁰³ Special jurisdiction is the basis for both state “long arm” statutes, and those statutes' restriction to matters arising from the person's or entity's “contacts” with the state. It is not always necessary that the acting party be physically within the jurisdiction. But, “it is essential . . . that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within . . . the State”²⁰⁴

¹⁹⁸Since different governments have differing laws concerning how persons or entities become subjects, it is possible for a person, or legal entity, to be treated as a subject under the laws of more than one country at a particular time. Normally, however, becoming subject to a new government terminates that status vis-a-vis the old government. It is usually easier to become a subject of a government than to terminate that status. *See generally, id.*, “Introductory Note” preceding § 402, at 236.

¹⁹⁹*See Helicopteros Nacionales de Columbia, S.A. v. Hall*, 466 U.S. 408 (1984), *Perkins v. Benguet Consol. Min. Co.*, 342 U.S. 437 (1952).

²⁰⁰*See, e.g., Tamagni v. Tax Appeals Trib.*, 91 N.Y.2d 530, 695 N.E.2d 1125, *cert. denied* 525 U.S. 931 (1998).

²⁰¹326 U.S. 310 (1945).

.....²⁰²*Id.* at 316 (quoting *Milliken v. Meyer*, 311 U.S. 457, 463 (1940)).

²⁰³*Id.*

²⁰⁴*Burger King Corp. v. Rudzewicz*, 471 U.S. 462, 475 (1985). *See also* REST. (3d) FOREIGN REL., *supra* note , § 402(1)(b), (c), comments *c, d*. Reporter's note 5 to § 402 states:

In the context of taxation, principles of prescriptive jurisdiction and Due Process principles, “require[] some definite link between the state and the person, property or transaction it seeks to tax,”²⁰⁵ **and** that the thing or used to determine the tax amount be associated with that link.²⁰⁶ Laws that attempt to impose tax on, or measure tax obligations by, property, persons, or events that are not within the attempting government’s jurisdiction are, simply, void.²⁰⁷

The Due Process limitations expressed in *International Shoe* and progeny are the same fundamental rules expressed in *McCulloch v. Maryland*: (1) Governments can tax their residents (citizens, domiciliaries) on all income, wherever earned, based on general jurisdiction; (2) With respect to other persons (non-citizens, nonresidents, etc.), a government can impose a tax only with respect to events or properties within that government’s geographic jurisdiction.²⁰⁸

Those principles have been applied to state income taxes essentially from their beginning. In 1920, the U.S. Supreme Court held, concerning Oklahoma’s income tax adopted in 1915:

[J]ust as a state may impose general income taxes upon its own citizens and residents whose persons are subject to its control, it may, as a necessary consequence, levy a duty of like character, and no more onerous in its effect, upon income accruing to nonresidents from their property or business within the state, or their occupations carried on therein. . . .²⁰⁹

State and federal income taxes are imposed on increases in wealth. Even though it may be taxed at some other time, “income” results as of the moment the earning person has a property or contract right to that value.²¹⁰ No one could seriously argue that an individual working for hourly wages or a periodic salary does not earn income as she, moment by moment, does the tasks required by her employment agreement. The proposition is self-evident. An hourly worker gains the contract right to receive income hourly, even though actual receipt of payment of the accumulating amount may occur later. The time of payment does not control when the income is earned; the right to receive income does not go from zero to full pay when “pay day” rolls around. The truth of that statement can be attested to by anyone who has been dismissed, or who has dismissed an employee, before the end of a “pay period.” The dismissed person must be paid the amount earned in the hours and days prior to dismissal. That aspect of earning income is codified in New York’s Tax Law. If a resident decides to leave New York to take up residence elsewhere, she or he is required to treat and report all income earned during the

“[E]xercise of jurisdiction to prescribe by States [of the United States] is governed by the same principles whether the exercise of jurisdiction has international or inter-State implications.”

²⁰⁵ *Miller Bros. Co. v. Maryland*, 347 U.S. 340, 344 - 45 (1954).

.....²⁰⁶ *Quill*, *supra* note , *Moorman*, *supra* note . See also REST. (3d) FOREIGN REL., *supra* note , § 411 (“*Jurisdiction to Tax: The Basic Rule.*”)

²⁰⁷ *Id.*

²⁰⁸ *McCulloch v. Maryland*, *supra*, note .

²⁰⁹ *Shaffer v. Carter*, 252 U.S. 37, 52 (1920). On the same day, the U.S. Supreme Court held a portion of New York’s 1919-adopted income tax, as applied to nonresidents, invalid under the Privilege and Immunities clause because it discriminated against nonresidents in favor of residents. *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920).

²¹⁰ See *Helvering v. Horst*, 311 U.S. 112 (1940).

resident period as New York-resident income, regardless of when payment is received.²¹¹ The related regulation has an example that expressly includes wage income earned before, but payable after, the change of residence.²¹² Similar accrual is allowed to persons becoming New York residents.²¹³

The combination of the fact of when wage or salary income is earned and the inherent limitations on state sovereignty precludes imposition of a “convenience of the employer” rule. That rule intentionally and solely applies to income earned by nonresident individuals while working outside the state. The acts fixing the right to receive income, and the persons doing those acts are not within the New York’s physical boundaries. Neither the income producing act nor the person acting are subject to the distant state’s legal jurisdiction. Any acts taken to collect the extra legal tax violate the income-earner’s Due Process rights, even if the collection actions take place within the acting states boundaries, such as forcing the employer to withhold money from the employee’s pay. None of the rationalizations attempted by New York tax authorities or courts are sufficient to overcome this lack of jurisdiction — most are not even marginally relevant.

New York courts have repeatedly tried to justify the “convenience of the employer” rule by declaring that it creates equality between residents and nonresidents by denying a “benefit” to nonresidents that is not available to residents.²¹⁴ Even if that were true, it is irrelevant; residents and nonresidents are not in the same category with respect to jurisdiction.²¹⁵ That distinction has been recognized in New York at least since the Court of Appeal’s 1921 decision in *People ex rel. Stafford v. Travis*.²¹⁶ The reason New York residents do not “benefit” when they work at some location other than their employer’s is because they are taxable, and taxed, on all income, wherever earned.²¹⁷ The so-called “benefit” to nonresidents exists *because Due Process limits the state’s power*. New York’s attempt to eliminate the “benefit” is a refusal to recognize that Due Process limitation. In this context, it is not only appropriate to distinguish between residents and nonresidents, it is absolutely necessary. A desire to benefit residents can not override either Due Process or inherent sovereignty limitations.²¹⁸

New York authorities have attempted to circumvent Due Process limitations by stating that the *employer’s* New York location establishes jurisdiction to tax a nonresident employee’s out-of-state-

²¹¹N.Y. TAX LAW § 639(a) (Consol. 2004).

²¹²N.Y. CODE R. & REGS., tit. 20, § 154.10 (2004).

²¹³N.Y. TAX LAW § 639(b) (Consol. 2004), N.Y. CODE R. & REGS., tit. 20, § 154.10 (2004).

²¹⁴See Part II, *supra*.

²¹⁵McCulloch, *supra* note , Shaffer, *supra* note .

²¹⁶231 N.Y. 339, 132 N.E. 109 (1921). *Stafford* involved a New York-based business operated by a Connecticut resident. The Court of Appeals acknowledged that state taxing jurisdiction is constitutionally limited to business income earned by in-state operations. The Court of Appeals also recognized the parallel limitation with respect to income from occupations (*i.e.* wages) “carried on” within the state through its quotation from *Shaffer*. *Id.*, 231 N.Y. at 348, 132 N.E. at 112, *citing Shaffer*, *supra* note , 252 U.S. at 52.

²¹⁷See N.Y. TAX LAW § 601, 612 (Consol. 2004).

²¹⁸Similarly motivated state actions have been held to also violate Commerce Clause and Privileges & Immunities clause principles. See Part III.D. and E, *infra*.

earned income.²¹⁹ This conclusion is dependent on what can only be a voluntary obfuscation of the term “source.” When the proper definition of “source” is used, the courts’ conclusion is illogical.²²⁰

If the definitional problems are overlooked, the argument proves too much. If the employer’s location were a sufficient basis for taxing its employees’ income, then the state would tax all persons receiving income from New York payors.²²¹ New York does not attempt to do that; it expressly does not tax income of nonresidents who work only outside the state for New York-based employers.²²² The employer’s in-state location may justify a wages-paid tax on the employer, but that would be a tax entirely different from the state tax on nonresident individuals’ income.²²³

A generally-accepted maxim of tax law, as stated by no less a jurist than Judge Learned Hand of the Second Circuit (which includes New York), is that one “is not bound to choose the pattern which will best pay the Treasury; there is not even a patriotic duty to increase [or not legally decrease] one’s taxes.”²²⁴ Apparently New York authorities believe that principle does not apply to nonresidents who have New York-based employers.

New York tax authorities and courts also assert that the potential for taxpayer fraud allows it to exercise jurisdiction over nonresidents’ out-of-state actions via the “convenience of the employer” rule. If a person who works outside the state cannot satisfy the exceptionally high burden proof requirement, New York tax authorities and courts presume that the person’s allocation of income to another state is

²¹⁹See, e.g., *Zelinsky (A.D.)*, *supra* note , *Huckaby*, *supra*, note , *Speno*, *supra*, note .

²²⁰REST. (3d) FOREIGN REL., *supra* note § 412, rptr. note 6, states: “A state is generally considered to be the “source” of income if the property or *activity that gives rise to the income* is located in the state.”

²²¹If the employer-based argument were valid, there is no logical reason to restrict it to employers’ payments to employees. Any payment by a New York person or organization could be used as a basis for taxing the payee’s resulting income. Given legislators’ preference for taxing persons who cannot vote them out of office, if the argument were valid New York would be trying to collect tax from all who receive income from New York payors, regardless of the reason for the payment. The fact that New York does not do that is not a result of legislators’ largess.

²²²N.Y. Code R. & Regs., tit. 20, § 132.4(b) (2004), states in part:

Compensation for personal services rendered by a nonresident individual wholly without New York State are not included in his New York adjusted gross income *regardless of the fact that payment may be made from a point within New York State or that the employer is a [New York] resident or corporation.*

(emphasis added). See also, *Gleason v. State Tax Comm’n*, *supra* note , *Hayes v. State Tax Comm’n*, *supra* note , *Linsley v. Gallman*, *supra* note , *Oxnard v. Murphy*, *supra*, note , *Lopez Edwards Frank Co.*, *supra* note .

²²³If New York were serious about “taxing the value” of nonresident employees’ wages, it could easily impose a tax on wages paid, with a deduction equal to the amount of wages paid to individuals subject to New York individual income tax. The most probable reason New York has not adopted such a tax is political — the taxpayer would be the resident employer. Residents can vote in the next election, nonresidents cannot.

²²⁴*Helvering v. Gregory*, 69 F.2d 809, 810 (2d Cir. 1934).

fraudulent. As discussed earlier, the fraud presumption is effectively absolute; it has been applied in numerous cases where all the evidence clearly proved the employee's (and often the employer's) legitimate, non-tax reason for not working in New York. The presumed fraud theory divides all nonresidents who allocate wage income between New York and another state into two, and only two, categories: (1) those working on tasks that can only be done outside the state, and (2) those engaged in tax fraud.²²⁵ That dichotomy is obviously absurd. One example should suffice:

A California resident works for a New York City-based employer. He has never worked at a New York office and, for many years, has not visited New York for any purpose. One year, he accompanies his wife while she attends a professional convention at an upstate New York resort. While his wife attends meetings, the person connects his laptop computer, via Internet, to his California home office and writes a few memos and emails to his employer and others.²²⁶ Under the "convenience of the employer" rule, *ALL of that person's income for the entire year* would be New York source income, based on the presumption that he lived and worked in California for the sole purpose of defrauding New York.

The presumed fraud theory also proves too much. In *Huckaby*, the administrative law judge admitted that the "convenience of the employer" rule applied to persons who work in New York just one day, but not to persons who work no day in New York during the year.²²⁷ If it is reasonable to conclude that the one-day-in-New-York worker works elsewhere all other days solely to defraud the state, there is no logical reason for concluding that a person who works one less day in the state has no fraudulent intent. If the presumed fraud rationalization is legally sufficient, there is no constitutional limitation on New York's using it to justify taxing all persons who work everywhere in the world except New York – because they are presumptively defrauding the state. The assumed fraud argument does not require that the employer have some connection with the state.²²⁸

If the presumed fraud theory works for tax purposes, there is no reason to limit it to taxation. Under the "logic" explained by the ALJ any presence in New York is sufficient to grant jurisdiction over a nonresident with respect to anything that might have, but did not, happen in New York. Thus, New York could exercise jurisdiction in a negligence action by a resident plaintiff concerning an accident that occurred in Connecticut because the defendant would be assumed to have fraudulently arranged his affairs to avoid driving in New York. Research has not revealed any case holding that the *possibility* that a person *could have* done something in a particular state is sufficient to allow that state to impose its laws

²²⁵The presumption and its application gathers into one category persons who knowingly report having worked outside the state when they did not and persons who actually did work outside the state for non-tax-related reasons that made good economic sense to themselves and their employers.

²²⁶See N.Y. CODE, R. & REGS., tit. 20, § 105.2(e) (2004) ("any part of a day" counted as a full day).

²²⁷See *Huckaby* (ALJ), *supra* note

²²⁸As the nature of the work that can be done electronically expands, an increasing portion of the work force will be able to accomplish tasks almost anywhere in the world. The presumed fraud rationalization would support taxing those persons' income just as well as it supports taxing a nonresident commuter who works at a chosen out-of-state location a few days per week, month or year.

on that person or for that state's courts to exercise jurisdiction over that person. That, however, is the substance of the "convenience of the employer" rule.

Judged against the "minimum contacts" necessary to allow a state to impose its laws on or exercise jurisdiction over a nonresident, the "convenience of the employer" rule fails.²²⁹ In *International Shoe v. Washington*,²³⁰ the U.S. Supreme Court considered contentions that both the imposition of Washington's tax and the exercise of personal jurisdiction by Washington courts violated Due Process principles. The Court addressed the *in personam* jurisdiction question, only incidentally mentioning the tax question. But it is clear that the Court did not ignore the issue; it said more than once that the tax involved in the case was measured by International Shoe's activities within the state.²³¹ The important point for this discussion is not the type or extent of activity necessary to establish minimum contacts. Instead, the significant point is the *scope* of jurisdiction constitutionally exercisable after the minimum level has been reached. Due Process principles limit jurisdiction to matters resulting from a party's contacts with the state. As the Court states in *International Shoe*:

[T]o the extent that a corporation [or person] exercises the privilege of conducting activities within a state . . . [t]he exercise of that privilege may give rise to obligations; and, *so far as those obligations arise out of or are connected with the activities within the state*, a procedure which requires the corporation to respond to a suit brought to enforce them can, in most instances, hardly be said to be undue.²³²

The "convenience of the employer" rule is applied in New York when the nonresident individual works, for any amount of time during the tax year, within the state for an in-state employer. The nonresident's in-state activities do support taxation of the nonresident's income arising from in-state activities. But that is all. The state's jurisdiction is limited by the in-state activities. It is therefore necessary to determine precisely what the state is attempting to tax when it applies the "convenience of the employer" rule.

Unlike the tax in *International Shoe*, the "convenience of the employer" rule is specifically and exclusively intended to impose tax obligations with respect to activities *not carried on within the state*. Had the state of Washington attempted to collect its tax measured by International Shoe's activities in other states, it is clear that the Supreme Court would have held the attempt unconstitutional. The attempt is no less unconstitutional when made with respect to nonresident's income earned outside the state.

Overall, New York's Tax Law and related regulations conform to Due Process requirements. New York does not tax nonresidents who never physically work in New York. New York taxes interstate business operations only on a portion of their income, determined by activities, events and property within the state.²³³ Indeed, New York tax statutes and principal tax regulations relating to nonresident employees who work inside and outside the state expressly limit New York's tax to income "derived

²²⁹To date, no case has been found where a New York court has consciously applied this standard to the "convenience of the employer" rule.

²³⁰See *International Shoe*, *supra* note .

²³¹See, e.g., *id.* at 319.

²³²*Id.*

²³³See N.Y. CODE R. & REGS. tit. 20, § 132.15 (2004). This regulation includes income for services rendered in New York; it does not include income from a New York customer for services performed in other states.

from” New York.²³⁴ New York violates Due Process principles only when it attempts to define “working days employed in New York State” to include days worked in other states.

The distinction between the rule “as written” and the rule “as applied” has little or no impact on the Due Process analysis. The class disadvantaged by the rule “as applied” is a constituent part of the class disadvantaged by the rule “as written.” The restricted enforcement of the “convenience of the employer” rule makes New York’s position more arbitrary but no more, or less, beyond the state’s jurisdiction.

In sum, New York has Due Process jurisdiction sufficient to tax income actually earned through a nonresident’s activities inside New York’s boundaries – nothing less, nothing more. The “convenience of the employer” rule attempts to tax income earned beyond even the New York Department of Taxation and Finance’s long arm.

C. *Commerce Clause*

I. *APPLICABILITY*

The New York “convenience of the employer” rule has been challenged as violating Commerce Clause principles, both on its face and as applied. In response, the New York courts have selected a few generalized quotes, followed by even more general conclusions, with no significant intervening analysis, appearing concerned only with justifying prior decisions.

In *Huckaby*, *Zelinsky*, and many other cases,²³⁵ the New York courts have held that a specific individual who works in New York but lives in another state is not engaging in interstate commerce, therefore Commerce Clause restrictions are irrelevant to New York’s taxation of nonresidents’ income. Perhaps that explains the superficial analysis of Commerce Clause principles.

In its *Zelinsky* opinion, the Court of Appeals considered the applicability of the Commerce Clause based only on the taxpayer’s activities in Connecticut.²³⁶ Since, the Court of Appeals said, the taxpayer was not, while working in Connecticut, engaging in interstate commerce personally, or for his employer, the Commerce Clause was a non-issue. That sounds like the Commerce Clause of 75-plus years ago.²³⁷ Under modern principles, activities are not atomized and a person’s individual, local, actions can implicate the Commerce Clause, particularly when hypothetically combined with others similarly situated.²³⁸ The Court of Appeals’ statements in *Zelinsky* are inconsistent with its own decision in *City of*

²³⁴N.Y. TAX LAW § 631(c) (Consol. 2004), N.Y. CODE R. & REGS. tit. 20, § 132.18(a) (2004). The first sentence of Reg. § 132.18(a) states:

If a nonresident employee . . . performs services for his employer both within and without New York State, his income derived from New York State sources includes that proportion of his total compensation for services rendered as an employee which the total number of working days employed within New York State bears to the total number of working days employed both within and without New York State.

²³⁵See Part II, *supra*.

²³⁶*Zelinsky (CA)*, *supra* note , 1 N.Y.3d at 92, 801 N.E.2d at 846.

²³⁷See *Hammer v. Dagenhart*, 247 U.S. 251 (1918).

²³⁸See, e.g., *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964), *Wickard v. Filmore*, 317 U.S. 111 (1942).

New York v. State of New York,²³⁹ which states: “It has long been recognized . . . that the movement of persons across State lines is a form of commerce.”²⁴⁰

The New York courts’ position is inconsistent with established law. The U.S. Supreme Court has held that a tax’s indirect effect on transborder journeys of individuals for the purpose of engaging in otherwise-local activities is subject to Commerce Clause scrutiny.²⁴¹ Even in *Zelinsky*, the New York Court of Appeals implicitly admitted (no doubt inadvertently) that transborder commuting has the potential for a substantial impact across state lines.²⁴²

The “convenience of the employer” rule and its application necessarily involve more than what each isolated taxpayer does at her residence. The rule only applies if a nonresident crosses state boundaries at least twice and New York employers importing labor services from other states. New York’s “convenience of the employer” clause is subject to Commerce Clause scrutiny.

In addition to precluding conflicts between state and federal laws, Commerce Clause principles restrict state regulations that “discriminate against” or “unduly burden” interstate commerce. With respect to taxation, if a state, even indirectly, imposes a tax on an out-of-state person or entity solely because it is not a local resident, the tax is discriminatory and invalid.²⁴³ Similarly, a state tax that imposes a heavier burden on persons or entities involved in interstate commerce than on local persons or entities is invalid.²⁴⁴

²³⁹94 N.Y.2d 577, 730 N.E.2d 920 (2000).

²⁴⁰*Id.*, 94 N.Y.2d at 597, 730 N.E.2d at 930. In *Zelinsky*, The Court of Appeals attempts to distinguish *N.Y.C. v. N.Y.* on the basis that the tax in the latter case “was imposed on the act of commuting, not on the individual commuter.” *Zelinsky (CA)*, *supra* note , 1 N.Y.3d at 93, 801 N.E.2d at 846. Since that tax was measured by individual commuters’ net income, and the commuters were personally liable for its payment, those commuters would have been very surprised to learn that the tax was not imposed on them. For all practical purposes the invalid “Commuter Tax” was nothing more or less than an additional New York income tax on nonresidents – economically identical to the “convenience of the employer” rule.

Compare *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241 (1964). It is highly likely that employers and employment agencies in New York City actively recruit potential employees in other states, particularly Connecticut and New Jersey. Such solicitation would not be significantly different from a motel’s solicitation of guests from other states.

²⁴¹*Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997).

²⁴²The court there stated: “The State need not subsidize such personal convenience [(nonresidents working at their residence)], while at the same time discouraging commuting into New York City and facilitating erosion of the tax base.” *Zelinsky (C.A.)*, *supra* note , 1 N.Y.3d at 94, 801 N.E.2d at 847. That is as close as any New York court or administrator has come to admitting that of the “convenience of the employer” rule expands the state’s tax base and revenue.

²⁴³*See Camps Newfound*, *supra* note , *ARMCO Inc. v. Hardesty*, 467 U.S. 638 (1984), *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983).

²⁴⁴*Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996). *See also*, *City of New York v. New York*, *supra* note .

Not many cases discuss Commerce Clause principles in the context of individual workers' transborder wage income.²⁴⁵ There can be little question that the daily flow of workers across state borders and back, together with all the transportation and other supporting services, affect interstate commerce – even if one considers only the New York City metropolitan area. In a case from metropolitan Chicago, another city with significant transborder commuting, the Seventh Circuit Court of Appeals had little problem in determining that Commerce Clause principles applied. In *W.C.M. Window Co., Inc. v. Bernardi*,²⁴⁶ the Seventh Circuit held that a state law discouraging the employment of nonresident construction workers violated the Commerce Clause and was therefore invalid.²⁴⁷ A state law that results in higher tax burdens on nonresident employees is not substantively different.

2. PLUCKING OTHERS' GEESE

The modern touchstone for testing a tax against Commerce Clause principles is the Supreme Court's 1977 decision in *Complete Auto Transit, Inc. v. Brady*²⁴⁸ (hereafter "*Complete Auto*"). Almost from the nation's beginning, there was a bright-line distinction between *interstate* and *intrastate* commerce, with the federal government exclusively regulating the former and state governments exclusively regulating the latter.²⁴⁹ Any state attempt to tax property and activities that were on the far side of the bright line was unconstitutional.²⁵⁰ Over time and many court decisions, determining where the bright line lay in state tax cases degenerated into determining which formal words were used to label the tax.²⁵¹ By the time *Complete Auto* was decided, that formalism in general Commerce Clause cases had been shunted aside by Supreme Court decisions considering practical realities above form. In place of the prior formalism, *Complete Auto* held:

²⁴⁵This dearth of cases no doubt results from the fact that the states have uniform rules and no conflict arises. Other states may have rules like New York's, but New York applies its rule in a singular manner, and with a passion.

²⁴⁶730 F.2d 486 (7th Cir. 1984).

²⁴⁷*Id.* Most cases discussing state or local laws that limit hiring to local residents are decided based on the Privileges & Immunities clause. *See, e.g.,* United Bldg. & Constr. Trades Council v. Mayor & City Council of Camden, 465 U.S. 208, *Hicklin v. Orbeck*, 437 U.S. 518 (1978) ("Alaska Hire" law), 1st Westco Corp. v. School Dist. of Philadelphia, 811 F. Supp. 204 (E.D. Pa. 1993). However, in *Hicklin v. Orbeck*, the U.S. Supreme Court noted the "mutually reinforcing relationship" between the Privileges & Immunities clause and the Commerce Clause, and used cases concerning the latter to support its holding concerning the former. *Hicklin v. Orbeck, supra*, 437 U.S. at 531-33. Reverse application should also be possible – a law that discriminates against nonresidents would have a negative impact on interstate commerce.

²⁴⁸430 U.S. 274 (1977).

²⁴⁹*See, e.g.,* *Veazie v. Moor*, 55 U.S. (14 How.) 568 (1852), *Cooley v. Board of Wardens*, 53 U.S. (12 How.) 299 (1851), *Mayor of N.Y. v. Miln*, 36 U.S. (11 Pet.) 102 (1837), *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1 (1824). *Compare* *Wickard v. Filburn*, 317 U.S. 111 (1942).

²⁵⁰*See, e.g.,* *Spector Motors Svc. v. O'Conner*, 340 U.S. 602 (1951), *Freeman v. Hewitt*, 329 U.S. 249 (1941), *State Tax on Ry. Gross Receipts*, 15 Wall. (82 U.S.) 284 (1873).

²⁵¹*See Complete Auto, supra* note , 430 U.S. at 281-87.

A tax [will be sustained] against Commerce Clause [challenge] when the tax [1] is applied to an activity with a substantial nexus with the taxing State, [2] is fairly apportioned, [3] does not discriminate against interstate commerce, and [4] is fairly related to the services provided by the State.²⁵²

The inserted numbers identify what has come to be known as the “four prongs” of the *Complete Auto* “test.” A tax that fails any one of the four prongs is unenforceable.

Zelinsky and *Huckaby* are the only New York cases in which the “convenience of the employer” rule has been subjected to even a cursory examination based on constitutional principles.²⁵³ The Appellate Division’s *Zelinsky* opinion indicates that it is applying the *Complete Auto* four-prong test, but limits its remarks to the “external consistency” aspect of *Complete Auto*’s second (“fair apportionment”) prong, apparently based on the parties’ contentions.²⁵⁴ Unfortunately that is the broadest and most vague prong in *Complete Auto*, seeming to lap over into considerations covered by all the other prongs, except perhaps the “internal consistency” half of the same prong.²⁵⁵ The Appellate Division quotes from both *Jefferson Lines*²⁵⁶ and *Goldberg v. Sweet*²⁵⁷ for general statements of the external consistency test.²⁵⁸ The quotes do not mention the principal external consistency factor, which is, as stated in *Goldberg v. Sweet*:

²⁵²*Id.*, 430 U.S. at 279.

²⁵³*Zelinsky (A.D.)*, *supra* n. , 301 A.D.2d at 43, 753 N.Y.S.2d at 145. The Appellate Division did mention constitutional issues in *Colleary v. Tully*, *supra* note , but made no effort to analyze the issues. The Appellate Division “resolved” the issues by reciting traditional stock rationalizations without reference to authority.

²⁵⁴*Zelinsky (A.D.)*, *supra* note , 301 A.D.2d at 45, 753 N.Y.S.2d at 146 - 47. As read by the Appellate Division, the parties’ stipulation of facts stated that the taxpayer performed job functions in Connecticut, his home state. However, either that stipulation did not carry over to the Court of Appeals, or that court choose to read it differently, because most of that court’s rationalization of its decision was based on the “fact” conclusion that the taxpayer’s work outside the state was not the work for which he was paid. *Zelinsky (C.A.)*, *supra* note , 1 N.Y.3d at 92-95, 801 N.E.2d at 845-49. The Court of Appeals’ discussion appears to be substantially informed by the U.S. Tax Court’s rejected “focal point test” relating to the federal home office deduction. *See* *Commissioner v. Soliman*, 506 U.S. 163 (1993) (rejecting the “focal point” test as too narrowly focused on one of many income-producing factors).

²⁵⁵It is possible for a tax to violate the “external consistency” aspect while satisfying the other *Complete Auto* criteria. One example is found in *Norfolk & Western Ry. Co. v. Missouri State Tax Comm’n*, 390 U.S. 317 (1968). In that case, the state’s property tax valuation formula resulted, the Court held, in an allocation of value to the taxing state unreasonably disproportionate to the value of property actually in the state. *Id.* at 326-27. As *Norfolk & Western* demonstrates, in-state taxable value may be enhanced by related out-of-state factors, but only the instate factors are subject to the state’s tax. The out-of-state factor itself is not subject to the state’s tax. *Id.*

²⁵⁶*Oklahoma Tax Comm’n v. Jefferson Lines, Inc.*, 514 U.S. 175 (1995).

²⁵⁷*Goldberg v. Sweet*, 488 U.S. 252 (1989).

[W]hether the State has taxed only that portion of the revenues from the interstate activity *which reasonably reflects the in-state component of the activity being taxed* We thus examine *the in-state business activity* which triggers the taxable event and the practical or economic effect of the tax on that interstate activity.²⁵⁹

The Appellate Division avoided considering the relevant rules by declaring that since all the taxpayer's income was paid out by a New York-based employer, there was no need to apportion any part of it to the actual work location. The Appellate Division's Commerce Clause discussion is based on the assumption that attributes of the income-payer can be properly used to measure the extent of the income-payee's in-state activities.²⁶⁰ Naturally, the Appellate Division did not cite any authority for that proposition.²⁶¹ New York's income tax is measured by the receipt of income, not the payment of expenses. That bit of reality has been established at least since 1901 when Lord Macnaghten of the U.K. House of Lords stated, in the traditional manner of that institution: "Income tax, if I may be pardoned for saying so, is a tax on income."²⁶²

..... Paraphrasing *Goldberg v. Sweet*'s statement of the external consistency test to fit the "convenience of the employer" test results in:

The external consistency test asks whether New York has taxed only that portion of a nonresident individual's wage income which reasonably reflects the in-state component of the individual's wage-earning activities.

When the external consistency standard is properly stated, it is obvious that the "convenience of the employer" rule fails. The sole purpose of that rule is to tax income produced by out-of-state wage-earning activities.²⁶³ Application of the rule necessarily creates the *risk* of multiple taxation. The creation of that risk, even if it may never be realized, causes a tax to fail the external consistency test.²⁶⁴ In *Goldberg*, Illinois eliminated the slight risk of double taxation by allowing a credit for parallel taxes paid to another state, thereby saving the tax from invalidation. Instead of recognizing and eliminating the high

²⁵⁸*Zelinsky (A.D.)*, *supra* n. , 301 A.D.2d at 45 - 46, 753 N.Y.S.2d at 147.

²⁵⁹*Goldberg v. Sweet*, *supra* note , 488 U.S. at 262. (emphasis added). *See also* *Allied-Signal Inc. v. Director*, 504 U.S. 768 (1992).

²⁶⁰*Zelinsky (A.D.)*, *supra* note , 301 A.D.2d at 46, 753 N.Y.S.2d at 147.

.....²⁶¹That conclusion is directly contrary to the U.S. Supreme Court's decision in *Commonwealth Edison*, *supra* note , 453 U.S. at 619.

.....²⁶²*London County Council v Attorney General*, 4 T.C. 265, 293, [1901] A.C. 26.

²⁶³It is possible that the Court of Appeals was actually concerned about the Commerce Clause limitation of taxation to in-state activities. Its opinion goes to great lengths (and heights of righteousness) to justify its conclusion of fact that none of the taxpayer's out-of-state activities had any relationship to the tasks for which he was paid. *Zelinsky (C.A.)*, *supra* note , 1 A.D.3d at 92-96, 801 N.E.2d 846-48. Even if that were a valid factual conclusion, it does not insulate the rule from Commerce Clause scrutiny.

²⁶⁴*Goldberg*, *supra* note , *Allied-Signal*, *supra* note .

risk inherent in the “convenience of the employer” rule, New York casts blame on other states, saying that it is those states’ responsibility to prevent realization of the risk New York creates.²⁶⁵ A rule that creates a recognizable risk of double taxation does not pass the external consistency test and is therefore void under Commerce Clause principles.

3. THE FORM EFFECT

Even though purporting to address *Complete Auto*’s second prong, the New York courts’ Commerce Clause discussions in *Zelinsky* and *Huckaby* more directly relate to *Complete Auto*’s fourth “prong,” viz. whether the tax is “fairly related to the services provided.” That fourth prong is more significant to the “convenience of the employer” test than the second and third prongs.²⁶⁶ Demonstrating that requires some background.

While *Complete Auto* counsels that the practical economic application and effect of a tax is the central consideration, a degree of *form-alism* is necessary. That is particularly true in when an item or activity exists or continues across time and jurisdictional boundaries. One example:

Super-Maker, Inc. manufactures, then sells and delivers a \$100,000 super-computer to End User, LLC., all in State Central. End User transports the computer to, installs it in, its factory in State Yonder.

State Central imposes a 2% gross receipts tax on manufacturers and a 5% sales tax on personal property sold and delivered in the state. State Yonder imposes a 7% use tax on items first used in the state, and an annual 0.5% personal property tax on factory equipment in the state. All four taxes are (directly or by proxy) *measured by* the sale price of the computer.

For State Central’s gross receipts tax, the taxable event is receiving gross income and its incidence is on the manufacturer, Super Maker. For State Central’s sales tax, the taxable event is a sale transaction and its incidence is on the buyer, End User, LLC.

For State Yonder’s use tax, the taxable event is first use of property in the state and its incidence is on End User, LLC. State Yonder allows a credit against its use tax for sales tax paid to another state. End User therefore pays a net 2% of the computer’s value as use tax. That does not insulate it from State Yonder’s personal property tax because, for that, the taxable event is the existence of property in the state on tax day and its incidence is on the owner, End User. As a practical, economic matter, after End User pays the personal property tax, in one year, 9.5% of the computer’s value has been paid in various taxes, and the full burden is on End User. The total will increase each time State Yonder’s personal property tax day rolls around.

If the Commerce Clause required total disregard of form, only one of the hypothetical taxes would be valid, probably the first one imposed, without regard to the rate. But under *Commonwealth Edison Co. v. Montana*,²⁶⁷ all of the taxes are valid. A decision that those taxes were invalid “double taxation” would raise havoc with state tax revenues.

²⁶⁵ See, e.g., *Zelinsky (CA)*, *supra* note , 1 N.Y.3d at 96, 801 N.E.2d at 849.

²⁶⁶ On the surface there appears to be an almost 100% overlap between *Complete Auto*’s second and fourth prongs. However, the basic considerations differ even if their general statements are similar. The second prong’s “external consistency” test focuses on the possibility of multiple taxation by different states. See *Goldberg*, *supra* note . The fourth prong focuses on factors internal to the taxing state, specifically the proportionality of the state’s tax to the taxpayer’s local presence. Of course a tax that is not appropriately proportional will create the possibility of multiple taxation.

²⁶⁷ 453 U.S. 609 (1981). See also *Container Corp. v. Franchise Tax Bd.*, 463 U.S. 159 (1983), *Moorman*, *supra* note .

The continued importance of precise identification of the form and attributes of a particular tax for Commerce Clause purposes is demonstrated in *Jefferson Lines* and *Commonwealth Edison*, both of which applied the *Complete Auto* formula.

In *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*²⁶⁸ Oklahoma's sales tax on autobus tickets was center stage. The bus operator (obligated to collect and remit) contended that the tax was invalid because it is measured by the full sales price, even though the transportation services were partly performed in other states. It was argued that apportionment was required under *Central Greyhound*²⁶⁹ decided nearly 50 years earlier. The Supreme Court chose to discuss the apportionment issue under the "external consistency" heading, probably because the pivotal question was whether the gross income tax in *Central Greyhound* was conceptually equivalent to Oklahoma's sales tax. Based on the historical (and logical) treatment of sales taxes as being imposed on the singular, discrete event of a completed sale transaction, the Court found that a sales tax is both internally and externally consistent, *i.e.*, does not create a risk of double taxation.²⁷⁰

[T]he Commerce Clause does not forbid the actual assessment of a succession of taxes by different States on distinct events as the same tangible object flows along. Thus, it is a truism that a sales tax to the buyer does not preclude a tax to the seller upon the income earned from a sale, and there is no constitutional trouble inherent in the imposition of a sales tax in the State of delivery to the customer, even though the State of origin of the thing sold may have assessed a property or severance tax on it.²⁷¹

Oklahoma was not required to apportion the bus ticket tax because the taxable event was singular and could only happen in one state.²⁷² That the *measure* of the tax, its value/sales price, might be used for different taxes imposed by different states, or paid by different taxpayers, is irrelevant.

Oklahoma's bus ticket tax's taxable event and incidence is easily distinguished from the taxable event and tax incidence in *Central Greyhound*. There, the taxable event was earning gross income, which was accomplished by transporting passengers over routes going through different states. Some portion of that event necessarily happened in, and could legitimately be taxed by, those other states. By measuring its tax on total gross receipts, New York was taxing gross-income-earning activity occurring beyond its borders. To prevent that, apportionment was required. Since the taxable event in *Central Greyhound*

²⁶⁸*Jefferson Lines, supra* note .

²⁶⁹*Central Greyhound, supra* note .

²⁷⁰*Jefferson Lines, supra* note , 514 U.S. at 186-88.

²⁷¹*Id.* at 187 - 88 (citations omitted). However, a use tax must preclude the risk of double taxation by providing a credit for sales taxes paid. This is because the two taxes effectively apply to a single transaction.

²⁷²*Id.* at 190. In *Jefferson Lines*, the Court stated the obvious: "[N]othing in our case law supports the view that when delivery is made by services provided over time and through space [that] a separate sale occurs at each moment of delivery, or when each State's segment of transportation State by State is complete. The analysis should not loose touch with the common understanding of a sale. . . ." *Id.* at 191 (citation omitted). This is distinctly different from the manner in which gross income, or wages, are earned.

happened equally over each mile (or inch) of the route traveled, apportioning the resulting income based on the miles traveled within each state was reasonable.²⁷³

The importance of precision is further demonstrated in *Commonwealth Edison*. In that case, the tax under scrutiny was Montana’s coal severance tax, triggered by the severance of coal from the earth, imposed on coal producers and measured by the sale price of the coal.²⁷⁴ Because of the parties’ contentions, the decisive issue concerned *Complete Auto*’s fourth prong, *i.e.* whether the tax is fairly related to services provided by the state.²⁷⁵ The appellants (coal producers and their customers) argued that the fourth prong is tested by comparing the amount of tax paid with the state’s cost for services to the taxpayer. Not so, the Court said, the fourth prong is related to the first prong, which is a “threshold” test that requires a sufficient nexus between the state and taxpayer to allow the state to impose *any* tax.²⁷⁶

[T]he fourth prong of *Complete Auto Transit* test imposes the additional limitation that the *measure* of the tax must be reasonably related to the extent of the [taxpayer’s] contact [with the state], since it is the activities or presence of the taxpayer in the State that may properly be made to bear a “just share of the state tax burden”. . . .²⁷⁷

Based on the correct understanding of fourth prong considerations, the Court had no difficulty finding Montana’s severance tax acceptable. The “operating incidence” of the tax (a/k/a “taxable event”) was the production of coal within the state, which was precisely the activity that satisfied the first prong’s taxpayer-state nexus requirement. The measure of tax was the amount of coal produced, which exactly quantified the extent of the appellants’ relevant contact with the state.²⁷⁸ The Court concluded: “When a tax is assessed *in proportion to a taxpayer’s activities or presence in a State*, the taxpayer is shouldering its fair share of supporting the State’s provision of police and fire protection, the benefit of a trained work

²⁷³Apportionment based on mileage was reasonable because it was administratively feasible for New York to determine the number of miles in any particular route in New York.

New York apparently did not, in *Central Greyhound*, argue that the taxpayer purposefully chose its routes so that the fewest possible miles were in New York, or that the taxpayer must be assumed to have submitted tax returns identifying short New York routes when its buses actually took different, much longer, New York routes. Those arguments, absurd as they might sound, are essentially identical to the justifications used to support the “convenience of the employer” rule.

²⁷⁴*Commonwealth Edison, supra n. ,* 453 U.S. at 613. The tax rate varied depending on the quality of coal severed.

²⁷⁵*Id.* at 625. The producers could not argue that the severance tax had to be apportioned between states because only coal severed in Montana was taxed. With respect to taxable event, a severance tax is more like a sales tax than a gross receipts tax.

²⁷⁶*Id.* at 626.

²⁷⁷*Id.*, quoting *Western Live Stock v. Bureau of Rev.*, 303 U.S. 250, 254 (1938) (emphasis in original).

²⁷⁸*Id.*

force, and ‘the advantages of a civilized society.’ ”²⁷⁹ A tax which is not proportionate to the taxpayer’s in-state presence or activity does not satisfy *Complete Auto*’s fourth prong.

With these principles in mind, return to New York’s income tax on nonresidents and its “convenience of the employer” rule. An income tax on individuals’ wage or salary income does not, of itself, present apportionment difficulties. A salaried or wage-earning employee earns income by doing the tasks required by her or his employment contract. The earned income is paid periodically, but it accrues as the individual performs the requisite tasks.²⁸⁰ The relevant event is the activity that creates the right to receive payment. The measure is the amount received.

New York’s Appellate Division and Court of Appeals premise their application of *Complete Auto* factors on a commingling of the “source” of income (in the sense of the pocket from which it comes) with the “source” of income (in the sense the geographic locale of the taxable event).²⁸¹ By mixing the two meanings of “source”, both courts were able to say that the source (as in “who pays”) of all the nonresident’s income is the in-state employer, then concluding that the source of income (using the other meaning of “source”) was New York. This allows facile rationalizations, such as the Appellate Division’s statement: “When a New York employer who is the source of the income requires an employee to be in another state, New York *permits* a nonresident employee to apportion income.”²⁸² In other words, as mischaracterized by the court, all of a nonresident’s income from a New York employer is “New York source” income but, by legislative grace, nonresidents are allowed to exclude income earned in other states if their job assignment absolutely requires doing the work in that particular other state. The homogenized definition of “source” is pivotal in the Appellate Division’s rationalization. “Initially, we note that the value being taxed herein is not subject to easy apportionment as in *Central*

²⁷⁹*Id.* at 627, quoting *Exxon Corp. v. Wisconsin Dep’t of Rev.*, 447 U.S. 207, 228 (1980), quoting *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434, 445 (1979) (emphasis added).

²⁸⁰There are a number of income tax rules that support the moment-by-moment earning of income. The fact that individuals usually account on the “cash basis,” treating the income as if earned when the funds are available to the taxpayer is irrelevant to determine what the taxable event is. Most businesses and some individuals use the “accrual basis” under which the time of receipt of payment is totally irrelevant. That is more consistent with the tax definition of “income.”

New York has consistently recognized the accrual nature of individual income in its treatment of individuals who change residence status. Before leaving the state, those persons are required to calculate all of the income they have earned but have not received payment and, before departure, pay New York resident income tax on those earnings. See N.Y. TAX LAW § 639 (Consol. 2004), N.Y. CODE R. & REGS., tit. 20, § 154.10 (2004), N.Y. DEP’T OF TAX’N & FIN., PUB. 88, *General Tax Information for New York State Nonresidents and Part-Year Residents*, at *Special Accruals*, pp. 12 - 14 (2002) (available at http://www.tax.state.ny.us/pdf/publications/Income/Pub88_1102.pdf).

²⁸¹In common tax parlance, “[a] state is generally considered to be the ‘source’ of income if the property or activity that gives rise to the income is located in that state.” REST. (3d) FOREIGN REL., *supra* note , § 412, rptr. note 6. This common understanding of “source” may be why the Court of Appeals in *Zelinsky* went to absurd lengths to conclude that the taxpayer-professor was paid solely for his in-class activities.

²⁸²*Zelinsky (A.D.)*, *supra* note , 301 A.D.2d at 46, 753 N.Y.S.2d at 147 (emphasis added).

*Greyhound.*²⁸³ Based on the actual taxable event, the statement is incredible. But the Appellate Division reveals what it considers the “value being taxed”:

Here, New York provides a host of tangible and intangible protections, benefits and value *to the source of petitioner’s income* [not to the petitioner/taxpayer] . . . and *such attributes* [employer-received tangible and intangible benefits] *are not susceptible to easy apportionment*. Moreover, the facts in *Central Greyhound* did not implicate the potential for abuse and accompanying administrative difficulties that could flow from the position urged by the petitioners [*i.e.* allocating tax based on physical work location].²⁸⁴

For the actual measure of the tax (individual taxpayer’s earned income), the Appellate Division substitutes the so-called benefits provided to the income-payor. Apportioning employees’ salary income based on state-provided benefits to the employer is naturally difficult because there is no relationship between the basis for apportionment and the amount to be apportioned.

The Court of Appeals avoids this particular semantic dilemma by its findings of fact concerning taxpayer Zelinsky’s employment contract.²⁸⁵ By concluding that Zelinsky’s sole employment obligation was to give lectures three days per week, all other work, including time spent preparing for lectures, research, and all work during a one-semester sabbatical, becomes irrelevant to apportionment. Based on the “fact” finding that “all” the taxpayer’s work was done in New York, there is no need to apportion.²⁸⁶ While the Court of Appeals semantically avoids equating the measure of the employee’s tax with the benefits to the employer, the result is the same.

If the New York courts’ commingled definition of “source” were correct, perhaps their rationalization would be too. Unfortunately, the commingling is inconsistent with standard tax definitions, most of the New York Tax Law, and the U.S. Constitution. If the tax-source of wage-earners’ income is the employer’s geographic location, New York could, and undoubtedly would, impose its income tax on all individuals who work for an employer with a New York location, regardless of the individual’s residence or work location.²⁸⁷ New York does not do that.

The New York regulations expressly provide that income paid by a New York employer to a nonresident who never works within New York is not “New York source” income.²⁸⁸ Similarly, a number of New York court decisions state that income earned by nonresidents who never work in New

²⁸³*Zelinsky (AD)*, *supra* note , 301 A.D.2d at 46, 753 N.Y.S.2d at 147.

²⁸⁴*Id* (emphasis added).

²⁸⁵The source of the evidence from which the Court of Appeals derived those factual conclusions is not apparent from the opinion. Some of the conclusions are inconsistent with the stipulation of facts upon which the case proceeded.

²⁸⁶*See Zelinsky (C.A.)*, *supra* note , 1 N.Y.3d at 94-95, 801 N.E.2d at 847-48.

²⁸⁷The N.Y. Court of Appeals, as justification for taxing 100% of Zelinsky’s income emphasizes the *indirect* benefits he received as a result of the direct benefits to his New York-based employer. *Id.*, 1 N.Y.3d at 95, 97, 801 N.E.2d at 848, 849. The same could be said for every employee of a business that has a New-York-located facility, even if that is not the employer’s principal location or one where the employee worked.

²⁸⁸N.Y. CODE, R. & REGS. § 132.4(b) (2004).

York is not subject to the “convenience of the employer” rule.²⁸⁹ There is a very abrupt, and unexplained, switch here. For nonresidents who never work in New York, income is sourced to their work location. But, if a nonresident works even part of one day in New York, income is sourced to his or her employer’s location. The most rational explanation for this distinction is that New York recognizes Due Process limitations (“minimum contacts”) on its taxing power but not Commerce Clause limitations.

That New York does not tax income earned by all nonresidents working in other states is not a matter of legislative grace, it is a matter of jurisdiction. Under the Due Process clause and the first prong of the *Complete Auto* test, a minimum nexus must exist between the state and the taxpayer before *any* tax can be imposed.²⁹⁰ If the nonresident employee never engages in income-earning activity in New York, those requirements are not satisfied. A nonresident employee with some income-earning activity in New York may create nexus sufficient to satisfy *Complete Auto*’s first-prong nexus requirement.²⁹¹ However, that does not mean the fourth-prong requirement (measure of tax proportionate to in-state activity) is automatically satisfied²⁹² – if it were there would be one “prong” not two.

None of the rationalizations intended to justify the “convenience of the employer” rule given in the *Huckaby* and *Zelinsky* decisions satisfies the *Complete Auto* test.

The New York decisions and regulations conform, coincidentally, to *Complete Auto*’s first-prong nexus requirement by requiring that an employee do at least some work in the state before applying the “convenience of the employer” rule. Under the New York formulation for employees, once the first prong nexus requirement is satisfied by a taxpayer’s momentary work in the state, the fourth prong’s nexus requirement is *measured by the taxpayer’s employer’s contact* with the state. That is inconsistent with the Supreme Court’s explanation in *Commonwealth Edison*:

When a tax is assessed *in proportion to a taxpayer’s activities or presence in a State*, the taxpayer is shouldering its fair share of supporting the State’s provision of [benefits].

* * *

[W]hen the measure of a tax bears no relationship to the taxpayer’s presence or activities in a State, a court may properly conclude under the fourth prong of the *Complete Auto Transit* test that the State is imposing an undue burden on interstate commerce.²⁹³

In the terms used in *Commonwealth Edison*, the operating incidence/taxable event of New York’s individual income tax is earning income. Only in-state taxable events can be used to determine if the tax is properly apportioned. *A fortiori*, a tax *measured by* all wages paid by a New York employer – regardless of where the taxable event occurs – cannot be “in proper portion” to the benefits provided *to the taxpayer* by New York.²⁹⁴ While an employee works outside New York, a taxable event does not

²⁸⁹See discussion in Part II.B.2, 3 *supra*.

²⁹⁰The Due Process aspects of jurisdiction are discussed at Part III.B, *infra*.

²⁹¹See *Commonwealth Edison*, *supra* note , 453 U.S. at 626.

²⁹²*Id.*

²⁹³*Commonwealth Edison*, *supra* note , 453 U.S. at 629 (emphasis added).

²⁹⁴For the same reasons, the “convenience of the employer” rule also fails the “external consistency” test of *Complete Auto*’s second prong. Given the general acknowledgment (interstate and international) that first priority for extracting income tax from individuals goes to the state in which the individual physically engages in income-earning activity, New York’s

occur within the state and a tax on that out-of-state-earned income imposes an undue burden on interstate commerce

The “convenience of the employer” rule fails *Complete Auto*’s fourth prong because it intentionally extends the measure of the tax beyond the activities that satisfy the first prong. It also fails the external consistency factor of *Complete Auto*’s second (double taxation) prong.

D. Discrimination

The third prong of *Complete Auto* requires that the law not discriminate against interstate commerce. In this discussion’s context, that means a tax rule cannot discriminate against nonresidents who earn some or all of their taxable income in New York. The Privileges & Immunities Clause prohibits discrimination based on other-state citizenship or residence. If New York’s “convenience of the employer” rule discriminates against nonresidents, it is unconstitutional under both the Commerce Clause and the Privileges & Immunities Clause. The following discussion of discrimination should, therefore, be considered as applying to both.

I. LAW AND THEORY

The Privileges & Immunities Clause of the U.S. Constitution precludes states from treating citizens of other states less favorably than it treats its own citizens/residents.²⁹⁵ Nevertheless, a law that makes distinctions based on residence is not automatically void under either the Privileges & Immunities Clause or the Commerce Clause. The issue for this discussion is whether a “convenience of the employer” rule improperly treats nonresidents less favorably than residents.

Two 1920 U.S. Supreme Court decisions establish the principles for applying the Privileges & Immunities Clause to state income taxes. In *Shaffer v. Carter*,²⁹⁶ an Illinois resident contested the application of Oklahoma’s personal income tax to him and his Oklahoma-based oil and gas business. The Court held that Oklahoma could impose its income tax on nonresidents’ business operations in the state and, more to the present point, could limit nonresidents’ business-loss deductions to losses incurred in Oklahoma, even though Oklahoma residents were not equally limited.²⁹⁷ The differing treatment, the Court noted, was not due to legislative choice, but was inherent in the state’s jurisdiction with respect to the two classes of taxpayers. The “limitation” on the nonresidents’ loss deductions was a natural function of the fact that the state could not, and did not, tax nonresidents’ income from out-of-state business operations.²⁹⁸ In analyzing the issue, the Court stated:

[W]here the question is whether a state taxing law contravenes rights secured by [the U.S. Constitution], the decision must depend not upon any mere question of form, construction, or definition, but upon the practical operation and effect of the tax imposed.²⁹⁹

“convenience of the employer” rule creates the risk (*i.e.* effectively ensures) that nonresidents will be subject to double taxation.

²⁹⁵U.S. CONST. art. IV, § 2

²⁹⁶252 U.S. 37 (1920).

²⁹⁷*Id.* at p. 56.

²⁹⁸*Id.* at 57. Note that this decision came before states started using the “unitary business” theory and formula apportionment.

²⁹⁹*Id.* at 55 (citations omitted).

Despite the appearance of discrimination when only the loss-deduction rule was considered, none existed when Oklahoma's income tax law was considered as a whole. Oklahoma allowed both residents and nonresidents to deduct losses incurred in business operations whose incomes were constitutionally subject to Oklahoma tax.

Travis v. Yale & Towne Mfg. Co.,³⁰⁰ decided the same day as *Shaffer*, involved a discriminatory provision in New York's personal income tax law. That law allowed personal and dependent exemptions to resident individuals, but not to nonresidents.³⁰¹ The Court noted that the provisions affected many persons, to their competitive disadvantage, "it being a matter of common knowledge that from necessity, due to the geographical situation of [New York City], in close proximity to the neighboring states, many thousands of men and women, residents and citizens of those states, go daily from their homes to the city and earn their livelihood there."³⁰² The Court held that the personal exemption denial discriminated against nonresidents employed in New York and thus violated the Privileges & Immunities clause.³⁰³

In attempting to justify the discrimination, New York argued that nonresidents had income not taxed by New York at least equal to the residents' personal exemptions. The Court observed that the discriminatory provisions were not conditioned on the existence of residence-state income and there was no factual basis for the presumption that taxable nonresidents earned that amount of income. Categorical assumptions about nonresidents' financial affairs, the Court held, cannot justify the discrimination.³⁰⁴

In *Travis*, New York also argued that when the law was adopted, New York legislators anticipated that neighboring states would adopt income tax laws with provisions similar to New York's. When such laws were enacted, the argument went, there would be no discrimination because New York residents would be subject to identical treatment in other states. The Court responded: "New York has no authority to legislate for the adjoining states; and we must pass upon its statute with respect to its effect and operation in the existing situation."³⁰⁵ With respect to the anticipated reciprocal legislation, the Court held that "a discrimination by the state of New York against the citizens of adjoining states would not be cured were those states to establish like discrimination against the citizens of the state of New York. . . . [D]iscrimination [can not] be corrected by retaliation. . . ."³⁰⁶

New York having presented no acceptable explanation for how or why its facially discriminatory tax law provisions did not, in fact, discriminate against nonresidents, those provisions were held to violate the nonresidents' rights under the Privileges & Immunities clause.

Subsequent decisions have not changed or limited the principles enunciated in 1920.

Austin v. New Hampshire,³⁰⁷ decided in 1975, concerned the application of New Hampshire's "Commuters Income Tax."³⁰⁸ The state imposed on nonresidents' New Hampshire-source income a tax of

³⁰⁰252 U.S. 60 (1920). Mr. Justice Pitney authored both the *Shaffer* and *Travis* opinions.

³⁰¹*Id.* at 74, citing N.Y. INCOME TAX LAW § 362 (Ch. 627, Laws of 1919).

³⁰²*Id.* at 89.

³⁰³*Id.* at 80 - 81.

³⁰⁴*Id.* at 81.

³⁰⁵*Id.* at 82.

³⁰⁶*Id.*

³⁰⁷420 U.S. 656 (1975).

4%, or an amount equal to the nonresident's home-state tax on New Hampshire-source income, whichever was less.³⁰⁹

On the whole, one must admire New Hampshire's effort. The end result was that nonresident taxpayers paid the same total amount of state income taxes that they would have without that tax. The only difference was that a portion of the taxes was paid to New Hampshire's coffers rather than some other state's.

Having no choice but to admit that the rules applied solely to nonresidents, New Hampshire argued that, in effect, its Commuter Income Tax did not burden nonresident taxpayers.³¹⁰ The burden, if any, was on the other states' fisc. And, New Hampshire argued, those other states could eliminate that burden merely by repealing their credit for taxes paid to New Hampshire.³¹¹ The Court was not convinced:

“[W]e do not think the possibility that Maine could shield its residents from New Hampshire's tax cures the constitutional defect of the discrimination in that tax. In fact, it compounds it. For New Hampshire in effect invites appellants to induce their representatives, if they can, to retaliate.

* * * *

Nor, we may add, can the constitutionality of one State's statutes affecting nonresidents depend on the present configuration of the statutes of another State.³¹²

In 1998, *Lunding v. New York Tax Appeals Tribunal*³¹³ presented a situation, and state arguments, substantively identical to those in *Travis*. New York's Tax Law allowed a resident taxpayer to deduct alimony paid but denied a similar deduction to nonresidents. New York made a number of arguments concerning how the discriminatory provision was protected by prior court decisions, logic, and substantial equality. All of those were rejected by the Court, most frequently because New York's arguments were not logical when considered in context of the practical effect of the provisions. The Court noted that states can make special provisions concerning nonresidents if there is a substantial connection between the provision and the state's limited ability to tax nonresidents' income.³¹⁴ However:

³⁰⁸N.H. REV. STAT. ANN. § 77--B:2 (1971).

³⁰⁹*Id.* at § 77--B:2 II. The resident portion of the tax act had a similar result. Residents working in other states were obligated to pay a tax equal to 4% of their out-of-state income or an amount equal to the credit granted by those states with respect to residence-state income. *Id.* § 77--B:2 I. If the resident was exempt from out-of-state income tax, or the state where they worked had no income tax, the residents were exempt from the New Hampshire tax.

³¹⁰*Austin, supra note* , 420 U.S. at 665 - 66.

³¹¹*Id.* at 666.

³¹²*Id.* at 666 - 668. The Court made extensive reference to *Travis* (*supra note*) in support of its conclusion in this case. Particular reference was made to that portion of *Travis* relating to reliance on another state's laws to cure discrimination.

³¹³522 U.S. 287 (1998).

³¹⁴*Id.* at 298.

[W]hen confronted with a challenge under the Privileges and Immunities Clause to a law distinguishing between residents and nonresidents, a State may defend its position [only] by demonstrating that “(I) there is a substantial reason for the difference in treatment; and (ii) the discrimination practiced against nonresidents bears a substantial relationship to the State’s objective.”³¹⁵

New York’s alimony-deduction denial foundered on the first requirement. The Court obviously felt New York’s attempt at justification was hollow: “The State’s failure to provide more than a cursory justification for § 631(b)(6) smacks of an effort to ‘penaliz[e] the citizens of other States by subjecting them to heavier taxation merely because they are such citizens.’”³¹⁶

With these principles in mind, the “convenience of the employer” rule, and New York’s attempts to justify that rule, present interesting issues. The Privileges & Immunities Clause is necessarily implicated. The rule applies only to nonresidents, extracting tax payments based on income earned while working outside New York.

2. THE “CONVENIENCE OF THE EMPLOYER” RULE AS WRITTEN

.....a. Same Rules . . .

New York authorities and courts argue that the “convenience of the employer” rule does not discriminate because it applies equally to residents who work both in and outside New York. The equality is alleged to be found in the rules relating to the resident credit for out-of-state taxes paid.³¹⁷ By statute, the resident credit is allowed for other-state tax on income “derived from sources within” that other state.³¹⁸ To determine the income so derived, the regulations direct that the determination be made consistent with the source rules for nonresidents.³¹⁹ Appearance does not create reality.

b. . . . Different Result

In response to contentions that the “convenience of the employer” rule discriminates against nonresidents, New York courts and administrators have said the rule applies equally to residents. That response is disingenuous – or at least “spin”. The regulations do say that the resident credit “sourcing” of wage income be consistent with the “convenience of the employer” test for nonresidents.³²⁰ However, in application, the rule has absolutely no impact on residents’ taxes or credits, which the tax forms and instructions confirm. See Attachment A.

³¹⁵*Id.*, quoting Supreme Court of New Hampshire v. Piper, 470 U.S. 274, 284 (1985).

³¹⁶*Id.* at 315, quoting Toomer v. Witsell, 334 U.S. 385, 408 (1948).

³¹⁷See Part II, *supra*.

³¹⁸N.Y. TAX CODE § 620(a) (Consol. 2004), N.Y. CODE R. & REGS., tit. 20, § 120.1(a) (2004). *Cf.* In re Mallinckrodt, N.Y. Tax Rptr. (CCH) ¶ 400-369 (ALJ 1992) (applying New York source rules to determine if income was “derived from” another state).

³¹⁹N.Y. CODE R. & REGS., tit. 20, § 120.4(d) (2004).

³²⁰N.Y. CODE, R. & REGS., tit. 20, § 120.4(d) (2004).

In contrast to the nonresident forms, the New York forms and Instructions concerning the resident credit allocation, since at least 1985, have never required resident taxpayers to consider the “convenience of the employer” rule or to include any relevant information.³²¹

The resident tax credit is calculated on N.Y. Form IT-112-R, which, for all practical purposes, has not changed since 1985.³²² Both forms and Instructions require the taxpayer to enter total (worldwide) income and deductions in column “A” and enter in column “B” the portion that was taxed by another jurisdiction. There is no requirement that the taxpayer consider any state’s allocation rules. The taxpayer reports, and takes a credit against New York tax for, the amount of taxes actually paid to the other state. The only limitation is that the credit cannot exceed the New York tax on the amount subject to the other state’s tax. Regardless of the other state’s allocation rules, the New York resident receives full credit for the taxes paid to the other state. New York’s “convenience of the employer” rule has no role in the calculation, and no impact on either the resident credit or the cumulative state income taxes paid by a New York resident.³²³

The “convenience of the employer” rule guarantees double taxation when applied to nonresidents. To establish equality, the resident credit could create double taxation for residents or prevent double taxation of nonresidents. The resident credit does neither – its sole purpose is to prevent double taxation of residents. If the work-location state applies a “convenience of the employer” rule in the same manner as New York, the resident receives a credit for all of the taxes paid to the other state.³²⁴ If the other state does not apply a “convenience of the employer” rule, the resident credit is still equal to the amount of tax paid to the other state (unless that other state’s tax is higher than New York’s, which is highly unlikely).³²⁵ The resident credit has the intended effect. The resident always pays a total state income tax

³²¹Given the actual objective, it is obvious why the resident tax credit forms do not mention the “convenience of the employer” rule. As the Department and New York courts have said on many occasions, when a New York resident works at home, she is still in New York. If the Department were concerned that a resident might choose, for personal convenience, to work outside the state, it would require relevant information on the resident tax credit forms. The absence of such a requirement further demonstrates that the Department’s only interest is taxing nonresidents for income earned while working at their residences.

³²²*Compare* Form IT-112-R (2003), http://www.tax.state.ny.us/pdf/inc/it122r_2003.pdf with Form IT-112R (1985), http://www.tax.state.ny.us/pdf/1985/inc/IT122R_1985.pdf.

³²³The amount of the resident tax credit allowed is unaffected by the “convenience of the employer” rule because the resident taxpayer cannot receive a credit in excess of the amount actually paid to the other state. The application of a “convenience of the employer” rule by the other state could increase the tax collected by the other state, which would in turn *increase* the credit allowed by New York, lowering the amount paid to New York and not increasing total tax paid. See Attachment A.

³²⁴N.Y. CODE R. & REGS., tit. 20, §§ 120.1(a), 120.2 (2004).

³²⁵N.Y. CODE R. & REGS., tit. 20, § 120.2 (2004). All resident credits are limited to the amount of New York tax on the income subject to tax in the other state. N.Y. TAX CODE § 620(b) (Consol. 2004). Therefore if the other state’s net tax is more than New York’s (not likely), the taxpayer would not receive a credit equal to the other-state tax paid. That, however, is totally independent of the “convenience of the employer” rule and does not influence any decision concerning parity between residents and nonresidents under the latter rule.

equal to New York's tax on all income, regardless of the source rule applied by other state(s) in which a New York resident taxpayer works. Application of New York's "convenience of the employer" rule to the resident credit is not substantively equivalent to its application to nonresidents. The resident credit *decreases* the total tax residents would have to pay in its absence; the "convenience of the employer" rule *increases* the total tax nonresidents' would have to pay in its absence.

c. We Know You're Lying!

In almost every decision applying the "convenience of the employer" rule, statements are made about the "potential for abuse." Sometimes that is associated with statements concerning administrative difficulties, sometimes with statements about "protecting the integrity of the apportionment scheme." The only cited authorities are previous New York decisions making the same conclusory, unsupported statements. To what these assertions might apply in a *Complete Auto* Commerce Clause, or a Privileges & Immunities, analysis is problematic. The alleged "potential for abuse" has no relationship to any recognized basis for apportioning income. Nor does it have any relationship to what *Zelinsky* and *Huckaby* state is the appropriate apportionment basis, *i.e.*, the taxpayer's employer's receipt of state services.

Nevertheless, "potential for abuse" is stated as an independent justification for allocating to New York income earned while working in another state, *i.e.* applying the "convenience of the employer" rule. Exactly what the potential "abuse" is normally unspecified. The usual implication is that nonresident employees will fraudulently claim to have been working at home when in fact they were working in New York.³²⁶ Despite the fact that there is no reported case finding that a taxpayer lied about where he or she worked, New York courts apparently believe that nonresidents as a group are pathological liars.³²⁷ The alleged risk relates to an objective event, *i.e.* the where the employee actually works. There is nothing in administrative regulations or publications, or in any published court decision, to indicate that New York has ever tried to obtain, outside the adjudication process, employer or third-party verification of nonresident employees' physical work location or the nature of the work done outside New York.³²⁸ If third party evidence were obtained, the problem would be significantly reduced, if not alleviated completely.³²⁹

³²⁶If the Department suspects that a taxpayer is falsely reporting work done at any location, it can perform an audit and require information from third parties, just as it does with any other fact problem. New York has been told before about the impropriety of making blanket assumptions about non-resident taxpayers. See *Lunding, supra* note , *Travis, supra* note . Apparently the lesson has not yet been internalized.

³²⁷From the decisions, one gets the feeling that the deciding persons (ALJs, Tax Tribunal members, etc.) have a fundamental belief that no person would decline an opportunity to live and/or work in New York unless she or he had some nefarious purpose, specifically tax evasion. Some who have commuted to work in New York City, even for a "brief" two years, can not understand why anyone would decline an opportunity to live/work anywhere else.

³²⁸The Department's, and ALJ's, attitude is that there is no need to seek or have evidence to support its position. It can issue an assessment and rely on evidentiary presumptions and burden of proof requirements to force the taxpayer to disprove all possible unstated factors that might support the Department's position. See ALJ decision in *Rosenthal, supra* note .

³²⁹The Department may not seek such information because the Department is actually interested only the situation in which that type of evidence would be least reliable. The

If one assumes that lessening the potential for tax abuse is a legitimate state goal, the second question is whether the method chosen actually tends to achieve the goal. The method chosen is, of course, the “convenience of the employer” rule. That rule effectively presumes that work is done outside New York only for the purpose of defrauding New York out of tax revenue unless the taxpayer can clearly and convincingly prove that the Department had no rational basis for believing that the work could be accomplished in New York. The rule may tend to reduce tax fraud against New York. However, without some evidence that the very broad class of persons adversely affected (*i.e.* nonresidents) are somehow more likely to commit tax fraud than persons not affected (*i.e.* residents), the rule is unacceptably discriminatory. It is not functionally different than the similarly broad New York rules that have found unconstitutional in *Travis* and *Lunding*. Vaguely stated problems do not automatically justify sweeping rules.

If one accepts the “convenience of the employer” rule is intended to combat tax fraud, it still does not pass constitutional muster. Since the rule only applies to nonresidents, it facially discriminates against interstate commerce and is “all but *per se* invalid.”³³⁰ A state law that facially discriminates against interstate commerce can survive Commerce Clause strict scrutiny only if the law addresses a compelling state interest, directly promotes that interest and there are no reasonable nondiscriminatory alternatives.³³¹ Both state and federal income tax law contains many provisions that combat tax fraud. It is highly unlikely that any non-New York court would hold that there is no reasonable nondiscriminatory alternative to the “convenience of the employer” rule.

An attempt to prevent fraud must be based on some reason to believe fraud is taking place, or might be attempted. As rationalized by the Court of Appeals in *Zelinsky*, New York’s “convenience of the employer” rule is applied to prevent nonresident taxpayers from reporting that they worked at home, thereby avoiding paying New York income tax on part of their income.³³² How does the “convenience of the employer” rule approach this goal? By assuming that all nonresidents who report working at their residence are either lying about their work location or working at home solely to avoid New York income tax.

There is nothing in any of the court or administrative decision that even mentions anything like objective evidence that “nonresidents who report working at home” identifies a group particularly prone to submitting fraudulent returns. In fact, the rule as applied is similar to denying all charitable deductions for donations “in kind” because some persons might possibly inflate the number and value of items donated. The possibilities are obviously endless. Why not deny all deductions of any kind that are not verified by independent third-party documents delivered directly to the tax authorities? But, even that may not solve the hypothetical problem because some third parties might cooperate with taxpayers. So the only solution is to deny all deductions. That is equivalent to New York’s “convenience of the employer” rule.

By employing a large-gauge scattergun to hit a notional target, the “convenience of the employer” rule is more likely to bag honest taxpayers – and probably increases the temptation to file creative tax returns. An informed and determined tax evader can significantly lessen the possibility of Department

“potential abuse” theory is not applied to “nonresidents working outside New York” (the class established by the “convenience of the employer” rule). Instead, it is applied only to “nonresidents working at home.” If there is any real administrative difficulty, it results from the Department’s concentration on a small subset of the persons potentially affected by the rule.

³³⁰*Camps Newfound, supra note* , 520 U.S. at 581.

³³¹*See Oregon Waste Sys., Inc. v. Dept. of Environ. Qual.*, 511 U.S. 93 (1994), *Maine v. Taylor*, 477 U.S. 131 (1986).

³³²*Zelinsky (CA), supra note* , 1 N.Y.3d at 92, 801 N.E.2d at 846.

scrutiny by merely not putting any number in the tax form's "worked at home" box. Allocating work days to other states, in general, does not provide any factual basis for an automatic adverse response from the Department. No information about what is being done in that other state (at one's residence or elsewhere) is required.³³³ The evading taxpayer can justify putting no number in the "days worked at home" box based on the Instructions, which say those days should be included in different boxes.

Even if one assumes that New York's rationalizations of the rule are based on a substantial state interest (*i.e.*, potential fraud by nonresident taxpayers about working at home) the result has adverse effects far beyond the target group. In addition, in the vast majority of reported cases, the taxpayers within the target group proved legitimate, non-tax reasons for their work arrangements and the presumption of fraud was proven non-rational.

State rules supported only by blanket presumptions about all nonresidents do not withstand Privileges & Immunities scrutiny. The "prevention of fraud" rationalization has no more basis than the New York tax rules found unconstitutional in *Travis*³³⁴ and *Lunding*³³⁵. Administrative convenience is not a state goal that allows violation of constitutional limitations.³³⁶ Even if the presumption and the rule as written is somehow found constitutional, the basis for applying the rule only against a lesser group must withstand constitutional scrutiny. New York's "convenience of the employer" rule cannot withstand even minimal scrutiny.

d. Let's Level the Playground

New York administrators and courts have repeatedly asserted that the "convenience of the employer" rule merely prevents nonresidents from having a "tax benefit" not available to residents.³³⁷ In other words, the asserted underlying purpose is to "equalize" taxes paid by residents and nonresidents. In one sense, the rule tends to do that. New York residents are taxed on worldwide income; nonresidents are taxed only on New York-source income. Any rule that increases the portion of nonresidents' out-of-state-earned income that is subject to New York tax treats nonresidents more like residents.

On the other hand, discrimination against residents is not precluded, or even suggested, by the Privileges & Immunities Clause; it is a purely political consideration. That seems particularly evident when the cause of the perceived "discrimination" is beyond New York's control. New York law does not create the alleged "benefit," the U.S. Constitution and inherent limits on state power do. Those same authorities restrict what the state can do to "correct" the perceived problem. The resolution adopted by New York is the alternative most clearly beyond the state's jurisdiction.

If the existence-of-nonresident-benefit argument were valid, New York (and every other state) would tax all nonresidents' world-wide income, thereby actually taxing residents and nonresidents equally. Taxing anything less than world-wide income would, as New York says it views the situation, be

³³³Allocating work days to one's residence state may trigger an inquiry concerning work location and activities, but it would not have the same effect as expressly allocating income to "work at home".

³³⁴*Travis, supra note*

³³⁵*Lunding, supra note*

³³⁶*See, e.g., Toomer v. Witsell, 334 U.S. 385 (1948).*

³³⁷*See Part II, supra, starting with Burke v. Bragalini, supra note*

allowing a “tax benefit” to nonresidents. New York has not yet attempted to tax nonresidents to that extent, perhaps because it recognizes the unconstitutionality of such a tax.³³⁸

Assuming it has identified a legitimate state purpose (“no benefit for working at home”), New York has at least three possible means of eliminating the alleged inequality. First, it could tax all voluntarily-outside-New-York-earned income of residents and nonresidents who work for New York employers, which is what New York argues the “convenience of the employer” rule does. (Residents are already taxed on that income due to their status.) However, that applies to a much broader class than the asserted state interest, *viz* all out-of-New York work, regardless of the worker’s immediate surroundings or the location of the worker’s employer. The “convenience of the employer” rule promotes the asserted state interest only if it is assumed that all nonresidents who work outside New York work only at home. That assumption is patently ridiculous. It is exactly the kind of categorical assumption found wanting in *Travis* and *Lunding*.

A second potential method for eliminating the alleged inequality would be to exempt all New York residents’ earned-outside-the-state income. The resident credit effectively does that. But, as demonstrated in Part III.D.3, *infra*, that does not provide true equality. It merely changes the persons discriminated against – from resident to nonresident. Unlike the situation with residents, the Privileges & Immunities Clause does prohibit discrimination against nonresidents. Perhaps more practically, the fact that exempting residents’ out-of-state income lowers the state’s tax revenues makes that a much less likely choice.

It is equally probable, perhaps, that this method was not chosen for the second reason New York argues that the “convenience of the employer” rule is justified. Many decisions claim that the “convenience of the employer” rule prevents fraud, without identifying what type of fraud by whom. The Court of Appeals in *Zelinsky*³³⁹ gives some specifics, but that comes 50 years after the rationalization was first discovered and the opinion gives no hint of its source of information. *Zelinsky*’s statements concerning “fraud” obviously impugn nonresidents. Apparently one is expected to assume that the Court of Appeals had evidence that nonresidents as a category are more prone to fraud than residents, or evidence that a large portion of nonresidents actually do work at their out-of-state homes solely to avoid state income taxes. One is apparently also supposed to assume that the potential tax savings is sufficient to sorely tempt a significant majority of nonresident taxpayers.³⁴⁰

However, if there is any doubt that New York residents are significantly more truth-prone than residents of other states, perhaps New York authorities are actually concerned about the potential for fraud should residents be allowed a corresponding “benefit”. It is much more likely that a much larger portion of residents would claim to be working at home solely to take advantage of a home-work exemption. If they were exempt from New York tax on home-earned income, residents would pay no state income tax on that income. In contrast, nonresidents would only be exempt from New York state income taxes, not their home state’s income tax. Resident-nonresident equality would exist only if the nonresident’s home state did not impose personal income taxes. When the rule was first discovered, no adjacent state imposed an income tax, but now they all do. A generally applicable “working at home”

³³⁸See *Shaffer*, *supra* note .

³³⁹*Zelinsky* (C.A.), *supra* note .

³⁴⁰See Attachment A, demonstrating the weakness of that “logic”. If one eliminates the unconstitutional New York tax, the only difference between residents’ and nonresidents’ total state income tax would be the difference between their respective residence-state’s tax on that income. Any “benefit” to nonresidents results from New York’s higher tax rate. Without the “convenience of the employer” rule, New York residents (voters) would notice the difference and correctly place responsibility with New York legislators.

credit would benefit residents much more than nonresidents. See Attachment A. The greater the benefit, the greater the temptation.

It is highly unlikely that the U.S. Supreme Court would agree that imposing a detrimental, categorical rule on all nonresidents can be justified as a measure to prevent potential fraud by residents should a different equalizing rule be adopted. It is also unlikely that the Supreme Court would find a law constitutional when its potential negative impacts go far beyond the “problem” it is ostensibly intended to solve.

e. A Level Credit Is Better

New York’s resident credit could foster equality, without eliminating the “convenience of the employer” rule. That could be accomplished by allowing nonresidents the equivalent of a “resident credit” with respect to income that is deemed taxable under New York’s “convenience of the employer” rule, and is also taxed as local-source income in the residence state. That would produce the equality ostensibly intended by the “convenience of the employer” rule. Residents and nonresidents would be on equal footing with respect to income earned outside New York. The double taxation caused by the “convenience of the employer” rule would be avoided and the Privileges & Immunity Clause satisfied. The solution is so obvious, one is constrained to conclude that it has been considered and rejected.

4. DISCRIMINATION AMONG NONRESIDENTS

As the “convenience of the employer” rule is written (and assuming it applies to both residents and nonresidents), the factors that identify the class of persons to whom it applies are:

- (1) employee (wage or salary income),
- (2) work both inside and outside the state in which her or his employer is located, and
- (3) tasks done outside the employer’s state can only be accomplished outside that state.

As applied, the factors are:

- (1) employee (wage or salary income)
- (2) nonresident of New York,
- (3) work for a New York employer, and
- (4) work (I) for some minimal period inside New York, and
(ii) *at her or his residence* outside New York.³⁴¹

The differences are apparent. The Department does not attempt to gather information concerning task requirements (the key factor “as written”) from either residents or nonresidents. It does, however, require nonresidents to indicate the amount of time “worked at home” (*the* key factor “as applied”). Thus, from the class of all wage-earning taxpayers, the real-life “convenience of the employer” rule segregates out nonresident taxpayers who report working at their residence during the year.

A state can justify discriminatory treatment, and pass Privileges & Immunities Clause muster, if: “(I) there is a substantial reason for the difference in treatment, and (ii) the discrimination practiced against nonresidents bears a substantial relationship to the State’s objective.”³⁴² None of the rationalizations offered to support the “convenience of the employer” rule meets either of those requirements, either with respect to the distinction between nonresidents who work at home and

³⁴¹There is an exception for employees who can clearly and convincingly prove that it was literally impossible to accomplish job-required tasks at an employer’s New York location. However, that becomes a factor only after the taxpayer challenges a Department adjustment of her or his return. *The only information the Department has that might trigger such an action is the “days worked at home” box found exclusively on nonresident return forms.*

³⁴²*Lunding, supra note* , 522 U.S. at 294, *quoting* Supreme Court of N.H. v. Piper, 470 U.S. 274, 284 (1985).

nonresidents who work at some other non-New York location, or with respect to the resulting distinction between nonresident employees and nonresident entrepreneurs..

a. A Couple Hours in the City Can Be Expensive

New York's application of the "convenience of the employer" rule distinguishes between nonresident employees who never work at their New York employer's in-state location and nonresident employees who spend a few hours per year working there.³⁴³ The only rationalization for that distinction in a reported decision is non-rational. In *Huckaby*, the ALJ "explained" that the distinction is supported by the fact that employees who work for some period in New York might choose to work at home merely to avoid New York income tax, or fraudulently report that they work outside New York.³⁴⁴ Apparently the potential for fraud disappears entirely if an employee spends a few less hours working in New York. In the context of preventing tax fraud, the dividing line is not related to the alleged problem. The transformation is obviously arbitrary, perhaps even more so than the one that happens when a 17.997-year-old innocent, gullible child is transformed into to a seasoned and competent adult at 12 midnight plus one second on his 18th birthday.

The real reason for the distinction between employees who do and employees who do not work in New York relates to jurisdiction and Due Process. (See Part II.B., *supra*.) But for New York authorities to concede that would at the same time admit the lack of authority for taxing out-of-state-earned income of nonresidents who do some work in New York. This "reason" for applying distinct rules to artificial categories of nonresidents does not satisfy Privileges & Immunity requirements; there is no relationship between the as-applied distinction and New York's alleged interest in preventing fraud.

b. Employees and Independent Contractors

There are rational reasons for establishing differing rules for taxpayers engaged in business (entrepreneurs or independent contractors) and wage-earning taxpayers. State and federal income taxes are imposed on net income. The entrepreneur's business activities have a center of operations that may, or may not, be where the business' owner habitually works. In contrast, an employee does not have a separately identified business operation. That difference does not, however, provide an excuse for distinguishing between employees and business owners in every aspect related to income taxes.

As demonstrated in *Boston Stock Exchange*,³⁴⁵ the Privileges & Immunities Clause precludes states from discriminating between arbitrary classes of nonresidents. New York's application of its "convenience of the employer" rule does just that. New York singles out nonresidents who sometimes work at their residence for special treatment. Those persons are taxed on all or part of their out-of-state earned income. Taxpayers who are independent contractors, rather than employees, allocate their income based on where services were actually rendered, regardless of whether some of those services were rendered at home.³⁴⁶

³⁴³*Huckaby (ALJ), supra note .*

³⁴⁴*Id.*

³⁴⁵*Boston Stock Exch. v [N.Y.] State Tax Comm'n*, 429 U.S. 318 (1977). That case held that the same tax also violated the Commerce Clause by inhibiting residents from engaging in interstate commerce. *Id.*, 429 U.S. at 334 - 35.

³⁴⁶N.Y. CODE, R. & REGS., tit. 20, §§ 132.4, 132.15 (2004). *Colleary, supra note ,* 69 A.D.2d at 923, 415 N.Y.S.2d at 268-69 (1979), states: "The income of an out of state self-employed person is taxable only through his intrastate activities since those activities are the connection to the state, whereas, the source of an out of state employee's income is the employer within the

One example should suffice: The taxpayer in *Huckaby* could have provided NOITU (employer) with services as an independent contractor, just as his previous employer had. If he had done that, under New York rules applicable to entrepreneurs, he would be required to allocate income to New York only for the days physically present in New York.³⁴⁷ There is no state-tax-relevant economic distinction between Mr. Huckaby, as employee, and hypothetical Mr. Huckaby, as independent contractor.

To create a result for independent contractors parallel to the “convenience of the employer” rule, New York would have to require independent contractors to allocate to New York all receipts from New York-based clients whenever the independent contractor could have chosen to physically work in New York, but actually chose to work elsewhere.³⁴⁸ New York does not have such a rule. New York decisions have attempted justifying the employee-entrepreneur distinction on the basis that the employees have a New York employer, but self-employed persons do not.³⁴⁹ How that makes a substantive difference is left for speculation. Both receive their income from a New York payor. A New York payor that engages independent contractors, receives state benefits (which theoretically trickle down to benefit the persons it pays) identical to what it would receive if it engaged employees. Both employees and independent contractors might be in a position to choose to work in another state to avoid New York taxes. An entrepreneur is really more likely to make such a choice because she does not have to get her boss’ permission.

Under another part of New York’s theory, allowing nonresident employees to not pay New York income tax on income earned while working at home would give them an advantage over New York residents working at home.³⁵⁰ Nonresident entrepreneurs who work at home have the same advantage. Thus, this also fails to justify a distinction between employees and independent contractors.

The most likely reason for the differing treatment is that New York recognized that it had no jurisdiction to tax an out-of-state business’ out-of-state-earned income before it became politically expedient to tax nonresidents who receive income from in-state payors. Ironically, the court decision that was improperly used to create the “convenience of the employer” rule actually requires that New York not apply a similar rule to nonresident entrepreneurs with a non-New York business location.

5. STATE FREEDOM TO CREATE TAX POLICY

New York courts have also defended the “convenience of the employer” rule by arguing that the U.S. Constitution necessarily allows states considerable discretion in formulating tax policy and the “convenience of the employer” rule supports the state policy of promoting equality of taxation and prevention of fraud. In context, it is apparent that at least the Appellate Division is of the opinion that the “convenience of the employer” rule is subject only to “minimal scrutiny” (a/k/a the “rational basis test”).³⁵¹ *Nordlinger v. Hahn*,³⁵² cited in support of that conclusion, is not even slightly analogous.

State. Thus the employment relationship is important in establishing the necessary connection with the State.”

³⁴⁷N.Y. CODE, R. & REGS., tit. 20, §§ 132.4, 132.15 (2004).

³⁴⁸N.Y. CODE, R. & REGS. tit. 20, § 132.15 (2003) (requiring allocation based on separate accounting or a three-factor formula, no mention of necessity concerning work location).

³⁴⁹See *Colleary*, *supra* note , *Huckaby (TAT)*, *supra* note .

³⁵⁰*Id.*

³⁵¹*Id.*

³⁵²*Nordlinger v. Hahn*, 505 U.S. 1 (1992).

Nordlinger involved a California property tax distinction between different categories of resident homeowners based on when they purchased their home. The plaintiff contended that distinction should be subject to strict scrutiny because it implicated the “right to travel.” The Court found no such implication, nor any the involvement of any other fundamental or constitutional right, and therefore held that the distinction was subject only to minimal scrutiny.³⁵³ In contrast, New York’s application of its “convenience of the employer” rule implicates at least three fundamental constitutional protections: Due Process, discrimination against interstate commerce, and Privileges & Immunities, all three of which call for strict scrutiny. The U.S. Supreme Court has held that state actions are subject to “rigorous” review when challenged as violating the Privileges & Immunities Clause.³⁵⁴ The New York courts have not cited any authority that would allow a state to violate constitutional provisions in its quest to support state tax policy.

6. *THE RESULT OF DISCRIMINATION*

New York’s “convenience of the employer” rule, as written, cannot withstand even cursory scrutiny under the Privileges & Immunities Clause. The inequality ostensibly eliminated by the rule results from inherent limitations on the state’s jurisdiction over nonresidents. Evading constitutional limitations on state power cannot be considered a legitimate state objective. Even if that infirmity is set to one side, the reasons that New York authorities have given in support of the rule are logical only if one unquestionably accepts them as true. Under even slight scrutiny, the arguments fall apart. As written, New York’s “convenience of the employer” rule results in residents being taxed more favorably than nonresidents, which is contrary to the Privileges & Immunities Clause.

IV. **SUMMATION**

New York’s “convenience of the employer” rule is legally indefensible. Its sole purpose is to impose New York income tax on home-earned income of nonresidents who generally work for employers in New York alongside New York residents. The rule was revealed at a time when exaggerating the amount of time spent working in an adjacent state could significantly reduce a nonresident’s state tax costs, because adjacent states did not impose income taxes. It was also a time when the scope and quality of work that could be done at home by the average employee was significantly less than what could be done at the office. And, admittedly, there was a case or two where a taxpayer may not have been entirely credible. The decisions that spawned the rule are understandable in context, despite the fact that the rule was and is unconstitutional. The rule’s subsequent development and continued existence is less understandable.

Cases decided after the rule’s announcement took it as revealed truth and expanded its reach to the greatest extent possible. To do that, it was first necessary to deprive the employee of any choice, perhaps on the assumption that a taxpayer will create evidence – become a criminal – to save taxes. Then it was necessary to also deprive the employer of choice, apparently on the assumption that the employer (who had nothing to gain) would take similar risks to assist the employee. When the employer was a corporation controlled by the employee, perhaps that assumption was reasonable. But, once employer’s choice becomes irrelevant, the employer-employee relationship, the employer’s characteristics, and the employer’s rational economic choices become irrelevant.

Similarly, once it was established that an employee who normally worked in a New York office could not be trusted about working at home, there was no obvious basis for distinguishing one day in New Jersey and only one day not in New Jersey – the potential for taxpayer deception was equal. An employee who never worked in New York could not be put in the same category because New York did not have even the minimal nexus required to tax any of her income.

³⁵³*Id.*

³⁵⁴*Lunding*, supra note , 522 U.S. at 298. See also Supreme Court of New Hampshire v. Piper, 470 U.S. 274, 284 (1985).

The rule's expansion engendered a series of presumptions: (1) All taxpayer allocations based on work "at home" are fraudulent, and (2) Any employer statements that verify an employee-taxpayer's allocation is in aid of the employee, not truth, and (3) The burden of proof necessary to prove an exception to the rule must be extremely high because all of the witnesses concerning work requirements are predisposed to support the taxpayer. Making uncontrollable objective requirements of the employee's required tasks the sole basis for finding an exception eliminated any need to weigh evidence. The decision-maker could express a high level of sympathy with the taxpayer's position and still decide in favor of the Department. The presumptions made decisions easy, and produced ridiculous results. Logical employee and/or employer decisions based on economic reality, without regard to tax consequences, are conclusively presumed to be contemptible attempts at tax evasion.

The "convenience of the employer" rule's formal statement has always been in more abstract terms than its application. Its seminal 1960 proclamation in *Burke v. Bragalini*³⁵⁵ (employee-controlled employer corporation) abstracted a high-level rule statement considerably more encompassing than required for the case before the court.³⁵⁶ It remains considerably more encompassing than the situations in which the rule is actually applied.

Over the years that the "convenience of the employer" rule has been applied, administrators and adjudicators have apparently come to believe that unfounded presumptions create reality. When taxpayers began questioning the rule and its application, the adjudicators were apparently so convinced of the rule's validity that their response was to enshrine the rule, not examine it. The resulting published opinions are not significantly different from what one might expect in an advocacy memorandum written by a recent law school graduate newly hired by the Department.

When examined in light of established constitutional principles, New York's "convenience of the employer" rule comes up short on all counts. Its sole purpose is to collect tax measured by income earned by nonresidents outside the state. The mere statement of the rule's de facto purpose demonstrates its violation of Due Process principles. No state has jurisdiction over the person or acts of non-subjects acting beyond state boundaries. Laws reaching beyond the acting government's legal jurisdiction of the acting government violate the Due Process rights of all adversely affected persons. A rule required some evidence that the subject taxpayer had represented that he was working outside the state when he was really working inside the state may not be improper. But no proof is required in New York. In lieu of evidence, there are essentially irrefutable presumptions that all nonresidents claiming to have worked at his or her residence is lying or, if not lying, chose to work outside New York solely and exclusively to evade New York income tax. If jurisdiction could be based on such presumptions, every state and nation could legitimately exercise jurisdiction over every person and entity, regardless of location. Rather obviously, that would put somewhat of a strain on the federal character of the United States and the international system of independent states.

New York's "convenience of the employer" rule, as stated and applied, is also inconsistent with Commerce Clause principles. It does not satisfy the "external consistency" aspect of the "fair apportionment" prong of *Complete Auto*. The reason for that is the same as for the rule's failure to meet Due Process requirements. The rule's only effect is to tax income earned in another state. That obviously creates the risk, and the reality, of multiple taxation. Rather than doing something to resolve the problem, New York officials point fingers and say that the sole obligation to eliminate New York-caused double

³⁵⁵*Burke, supra* note .

³⁵⁶The Appellate Division pronounced: "Any allowance claimed for work outside the State must be for those purposes that of necessity--as distinguished from convenience--obligate the employee to out of State duties in the service of his employer." *Id.*, 10 A.D.2d at 654, 196 N.Y.S.2d at 393.

taxation lies with the states into which New York reaching. Similar contentions concerning other New York tax rules have been found unconstitutional by the U.S. Supreme Court.

In addition, New York's rationalization for taxing all nonresident wage-earner's income does not satisfy the proportionality requirement of *Complete Auto*'s fourth prong. That prong requires that the tax exacted be in reasonable proportion to the taxpayer's related in-state acts. Since the "convenience of the employer" rule is intentionally proportional to the taxpayer's out-of-state acts, New York courts assert that the proportionality must be judged not by the taxpayer's activities but by employer's in-state presence. If that were true, *Complete Auto*'s fourth prong would not exist.

A tax's failure to satisfy one part of the *Complete Auto* test requires the conclusion that the tax violates the Commerce Clause. When two parts are not satisfied, one failure does not offset the other.

New York's "convenience of the employer" rule, and its application, also discriminates against nonresidents in violation of constitutionally protected privileges and immunities of the nonresidents against whom it operates, and is inconsistent with *Complete Auto*'s third prong. New York's rule, both as written and as applied, creates nonrational distinctions:

- ! between nonresident employees and nonresident entrepreneurs,
- ! between nonresidents who never work in New York and residents who work one hour in New York,
- ! between nonresidents who allocate income to work done at their non-New York residence and nonresidents who allocate income to work done at non-New York, non-residence locations, and
- ! between residents and nonresidents.

Frustrating potential tax fraud is, perhaps, a valid state goal, assuming there is any evidence that fraud has been attempted. Having a valid goal is, of itself, insufficient to justify discrimination against nonresidents. The distinctions made must clearly advance the asserted goal. None of the rationalizations proposed for the "convenience of the employer" rule, or for its enforcement are based on objective reality. Instead, they are based on the same presumption that does not meet Due Process requirements, *i.e.* that all nonresidents who claim to have performed income-producing work at home are lying. The Appellate Division, at least, would contend that any tax-law distinction that might be true in some instances or under some circumstances is sufficient to satisfy Privileges & Immunities requirements. A significantly higher level of scrutiny is applied. Actually, though, the scrutiny level makes little difference because New York's "convenience of the employer" rule fails when any level of scrutiny higher than unquestioning acceptance is applied.

Given the constitutional problems, it is fair to ask why and how is New York's "convenience of the employer" rule still viable. As indicated earlier, the rule's genesis was cases in which its result was at least emotionally satisfying. From that point, it was in the interest of everyone involved, except individual nonresident wage-earning taxpayers, to perpetuate the rule.

Common law courts, which includes New York's, are supposed to rely on precedent. The *stare decisis* doctrine counsels against departing from established propositions, even in situations that would produce a different result when not viewed through the lens of prior decisions.³⁵⁷ The New York courts had precedent. No person or case sufficiently stirred the courts' interest to examine that precedent. No higher court has forced re-examination – and probably will not in the immediate future. On the scale of important national issues, the interests of a few tens of thousands of New York nonresident taxpayers is not sufficiently important to capture the U.S. Supreme Court's attention – at least not yet. If New York officials, elected or appointed, wanted to promote tax equality (and incidentally comply with constitutional mandates), they could easily so do. The resident credit prevents double taxation of residents' income from work done outside the state. If a similar credit is allowed to nonresidents for work performed outside the state, true equality would result. Since resident-nonresident equality is the state's

³⁵⁷This applies even to U.S. Supreme Court constitutional decisions. *See Quill, supra* note .

oft-repeated purpose, there is no reason to not adopt a “nonresident credit.” The reason none has been adopted must lie elsewhere.

The non-judicial branches of New York government are undoubtedly even less inclined to reconsider the “convenience of the employer” rule. Its existence increases state revenues. In a time of tight government budgets (which is always, if one listens to politicians), any diminution of revenue from one source must be replaced from other sources. In this instance, the replacement revenue would have to come from New York voters. The revenue produced by the “convenience of the employer” rule comes from nonresidents who cannot vote in New York. Few elected officials will risk benefitting nonvoters to the detriment of voters. Administrative officials dependent on elected officials for their jobs and salaries are not likely to take strong actions that might be contrary to those elected officials’ political interests.

Officials in New York’s Department of Taxation and Finance are in a well-protected position in continuing their support of elected officials. To disgruntled nonresidents ensnared by the rule, those officials can say: “We did not make the rule, the courts did. We are only enforcing the rule. We really have no choice. Go ask the courts to change the rule.” Even if those officials believe that the rule is really unconstitutional, fiscal and career considerations support its continued enforcement.

No doubt the majority of taxpayers against whom the rule is applied make a very rational economic decision to pay the additional tax rather than incur the time and expense of litigation. That is particularly true when a glance at existing decisions reveals that taxpayer success short of the U.S. Supreme Court is improbable, and that Court is not particularly interested in discussing the matter. The Department’s cost of defending against a few challenges is undoubtedly minuscule when compared to the revenues produced. Litigation roulette – the Department wins.

The ultimate conclusion is unpalatable but virtually inescapable. New York’s “convenience of the employer” rule is unconstitutional, but its continued enforcement is highly probable. Advice from the 17th Century is still good in the 21st Century – Go forth and pluck hiss-challenged geese!

A Wider Perspective

New York’s application of its “convenience of the employer” rule is an aberration – both because it intentionally reaches beyond its borders to capture tax revenues and because it renders employers’ and employees’ substantial non-tax considerations irrelevant. Despite that, on a global scale (or even a national scale) the impact is negligible, except to the individuals involved. However, if New York can create unique definitions of things like “source of income” to increase its tax revenues, then every other jurisdiction could create unique definitions for the same purpose. The result could be disastrous. Combining Humpty-Dumpty definitions with New York’s rationalizations, would allow every jurisdiction in the world could claim the right to tax the worldwide income of all individuals in the world. Even if New York’s “convenience of the employer” rule were not unconstitutional, it would be bad tax policy.

APPENDIX A

The Lubova triplets (Alice, Betty, Clair) all work for the same New York City employer. They have identical positions and each have \$100,000 taxable income, all from that employment. Alice lives in Connecticut, Betty lives in New Jersey, and Clair lives in New York. Their father is a widower and disabled. The sisters made arrangements with each other and their employer. Father Lubov lives in Alice's home. Medicare benefits pays for in-home care two days per week. Each of the sisters stays with Father Lubov one of the other three days each week. Their employer agreed to have the sisters "telework" from Alice's home on the days they were there, and provided all of the necessary computer and communications equipment and connections. Therefore, each of the sisters earns 20% of her income while working from Alice's Connecticut home.

In Table A-1, the "current" columns present the results based on New York having the "convenience of the employer" rule and the other states having the standard place-of-work allocation rule. For Betty, there are two "current" columns to demonstrate the difference between New York's rule as written and as applied. In the "as applied" column, New York's "convenience of the employer" rule is irrelevant because Betty is not working outside New York at her home.

The "New York idea" column illustrates what the other states would have to do if, as New York courts suggest, they are required to adopt their rules to counteract the double taxation resulting from New York's "convenience of the employer" rule.

Table A-1

<i>Assuming all states have 5% tax rate (to isolate the effect of the rule).</i>	ALICE (Conn. Resident)			BETTY (N.J. Resident)				CLAIR (N.Y. Resident)		
	<i>current</i>	<i>normal</i>	<i>N.Y. idea</i>	<i>current as written</i>	<i>current as applied</i>	<i>normal</i>	<i>N.Y. idea</i>	<i>current</i>	<i>normal</i>	<i>N.Y. idea</i>
New York Tax	\$5,000	\$4,000	\$5,000	\$5,000	\$4,000	\$ 4,000	\$ 5,000	\$5,000	\$ 5,000	\$5,000
New York Credit								(1,000)	(1,000)	(1,000)

New Jersey Tax				5,000	5,000	5,000	5,000			
New Jersey Credit				(5,000)	(5,000)	(5,000)	(5,000) ³			
Connecticut Tax	5,000	5,000	5,000	1,000	1,000	1,000	1,000	1,000	1,000	1,000
Connecticut Credit	<u>(4,000)</u>	<u>(4,000)</u>	<u>(5,000)</u> ¹				<u>(1,000)</u> ³			
Total State Tax	\$6,000	\$ 5,000	\$ 5,000	\$6,000	\$5,000	\$5,000	\$ 5,000	\$5,000	\$5,000	\$ 5,000

1. In the “N.Y. suggest” column for Alice, to eliminate the effect of New York’s “convenience of the employer” rule, Connecticut (residence state) would have to give a credit for 100% of its tax, effectively ignoring its own (standard) source rules.
2. In Betty’s “current as written” column, because Betty is voluntarily working in Connecticut, the written “convenience of the employer” rule does not allow her to allocate the Connecticut working day anywhere except New York. In that situation, it is not New Jersey rules that would have to change to eliminate double taxation, it is Connecticut’s rules concerning non-New York nonresidents that would have to change. To fully eliminate double taxation Connecticut would have to give a credit for all New York taxes paid by both residents and non-New York nonresidents. New York courts suggest that is a better solution than New York’s eliminating the “convenience of the employer” rule, even though New York’s rule is the one that creates the double taxation problem.
Under the rule *as applied*, the net result is be the same as in the “standard” column. Because Betty is not working at her home outside New York, New York tax forms (and practice) allows her to allocate 20% to “another state” and she properly would not enter anything in the “days worked at home” box.
- *3. In the “N.Y. suggests” column for Betty, it would make no difference to New York whether (i) New Jersey “refunded” Betty \$6,000 (more than its tax) or (ii) Connecticut refunded its \$1,000 nonresident tax.

Table A-2

<i>Using actual tax rates (there may be some discrepancy from actual due to other factors)</i>	ALICE			BETTY			CLAIR		
	current	normal	N.Y. idea	current	normal and as applied	N.Y. idea	current	normal	N.Y. idea
New York (6.453%)*	\$6,453	\$5,162	\$6,453	\$6,453	\$5,162	\$6,453	\$6,453	\$5,162	\$6,453
New York Credit							(960)	(960)	(960)
New Jersey (4.24375%)				4,244	4,244	4,244			
New Jersey Credit				(4,244)	(4,244)	(4,244) ²			
Connecticut (4.8%)	4,800	4,800	4,800	960	960	960	960	960	960
Connecticut Credit	<u>(3,840)</u>	<u>(3,840)</u>	<u>(4,800)</u> ¹			<u>(960)</u> ²			

Total State Tax	\$7,413	\$ 6,122	\$6,453	\$7,413	\$6,122	\$ 6,453	\$6,453	\$6,453	\$ 6,453
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See notes to Table A-1

Changing to the actual tax rates (Table A-2), the results are fundamentally the same.

The “foreigners” working in New York currently pay more than the New York resident, solely because of New York’s “convenience of the employer” rule. If New York used the same source rules as other states (*i.e.* not use the “convenience of the employer” rule) the resident sister would pay more, \$331 more. The difference is *solely a function of New York’s high tax rates*. New York residents are probably intelligent enough to discover that – and probably would not blame their nonresident fellow workers. Assuming the difference would be enough to motivate them, residents could either (a) move to another state, or (b) complain to their New York legislators and/or vote against them next election. It costs much more to move than to vote against non-responsive legislators. In addition, it probably would not be economically beneficial to move. The increased cost of commuting would most

likely more than offset any tax reduction. If non-deductible commuting costs are added to everyone’s total tax, the New York resident would probably have the least cumulative cost.

Note that if the two other states act as suggested by New York, the three sisters would pay identical amounts – which “just happens” to be the amount of New York’s tax. The result is better than the current situation because double taxation is eliminated. However, the result is still less favorable than if New York would drop the “convenience of the employer” rule because, under New York’s suggested solution, all three taxpayers pay New York rates on 100% of their income and the other states collect nothing, except from the New York resident, who receives a credit against her home-state taxes (and continues to vote for incumbent politicians).