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AGGLOMERATION AND STATE PERSONAL INCOME TAXES: TIME TO APPORTION (WITH CRITICAL COMMENTARY ON NEW HAMPSHIRE'S COMPLAINT AGAINST MASSACHUSETTS)

Darien Shanske[*]

INTRODUCTION

Sometimes easy cases make bad law — or at least *might* make bad law. The Supreme Court is currently considering granting certiorari in *New Hampshire v. Massachusetts*.[1] At issue is the State of New Hampshire's (and its amici's) claim that Massachusetts's insistence on applying its income tax to residents of New Hampshire, who once commuted to work for businesses in Massachusetts but now remotely work for those businesses in New Hampshire because of the COVID-19 pandemic, violates the Due Process Clause and dormant Commerce

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1. *New Hampshire v. Massachusetts*, SCOTUSBLOG [hereinafter SCOTUSBLOG], https://www.scotusblog.com/case-files/cases/new-hampshire-v-massachusetts/ [https://perma.cc/F8YY-RC3X] (last visited Mar. 12, 2021).

Clause.[2] The claim is simple and seductive: if these New Hampshire residents barely leave their own homes, much less their state, how can it accord with due process for Massachusetts to tax them?

This simple analysis, however, should be rejected because it would be applying an old economy heuristic (you earn where you physically are) to a new economy problem (work can happen in many places). If the Supreme Court agrees to hear this case (and I think it should not), and if it were to hold in favor of New Hampshire (and I argue in this Essay that it should not), it would deal a severe and almost comically mistimed blow to the modern urban economy by undermining the ability of central urban areas to impose income taxes on an increasingly mobile workforce.[3]

This Essay proceeds in three parts. Part I provides background about the current lawsuit as well as the policy and doctrinal issues it raises. Part II argues why Massachusetts's arguments against the taxation of remote workers are incorrect as a matter of constitutional law. Part III acknowledges that current state law regarding the sourcing of employee income is not ideal from a policy perspective and suggests an old solution to this relatively new problem: apportionment by formula. In this context, apportionment means achieving a reasonable division as to a matter in which there is no clear right answer. In the case of a remote employee living in one state but working remotely in an agglomeration of talent made possible by another state, this Part argues that the right answer is that both states have some reasonable claim to a portion of that worker's income.

I. BACKGROUND

A. The Lawsuit: *New Hampshire v. Massachusetts*

As of the time of writing this Essay, New Hampshire has asked the Supreme Court to exercise original jurisdiction over its claim that Massachusetts regulators' choice to treat no-longer commuting New Hampshire residents as Massachusetts employees violates the Due Process Clause and dormant Commerce Clause.[4] The Supreme Court has called for the U.S. Solicitor General's view on the matter.[5]

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2. *See* Motion for Leave to File Bill of Complaint at 1–2, New Hampshire v. Massachusetts, No. 220154 (Oct. 19, 2020) [hereinafter *New Hampshire* Complaint].

3. *See* Erin Scharff, *Cities on Their Own: Local Revenue When Federalism Fails*, 48 FORDHAM URB. L.J. 919 (2021) (explaining the importance of having multiple broad tax bases).

4. *See New Hampshire* Complaint, *supra* note 2, at 23–24.

5. *See* SCOTUSBLOG, *supra* note 1.

On a procedural level, the case faces many challenges, including whether New Hampshire has standing and whether this is the right case at the right stage of development for the Court to exercise original jurisdiction.[6] I am inclined to agree with Massachusetts that this is not a case the Court should hear,[7] but I will leave those arguments to one side and consider the merits of the case in this Essay. It is worth getting to the merits because New Hampshire and its many amici are surely right that the basic issues here are important and unlikely to go away.[8] In particular, this case presents the questions of when and how much a state can tax remote employees. New Hampshire and its amici argue that New Hampshire residents who have not worked in Massachusetts since March 2020 should not be subject to Massachusetts's personal income tax.

B. Agglomeration Economics

On its face, one might think this fight is a battle between states. States are the sovereigns imposing these income taxes, and it is states that are given the privilege of asking for the Court's original jurisdiction. This case, however, is about cities — or, at least, the proper resolution of the case requires thinking about cities. This is not because the dormant Commerce Clause applies differently to cities.[9] Rather, it is because thinking about cities provides the answer to the question of whether a state like Massachusetts is entitled to tax these remote workers.

One might question why Massachusetts is taxing New Hampshire residents who have not been in the state for months and are not likely to come back for months, but the puzzle here is something of an optical illusion. Many of New Hampshire's residents are clustered around the border of Massachusetts because of its proximity to Boston.[10] From

6. *See* Brief in Opposition to Motion for Leave to File Complaint at 11–12, New Hampshire v. Massachusetts, No. 220154 (Dec. 11, 2020).

7. Even Steve Wlodychak, a prominent commentator who agrees with New Hampshire, does not think that the Court will or should take the case. *See generally* Steve Wlodychak, New Hampshire v. Massachusetts*: Wrong Court, Right Case*, 99 TAX NOTES ST. 107 (2021).

8. For a list of New Hampshire's amici curiae, see SCOTUSBLOG, *supra* note 1.

9. *See* Fort Gratiot Sanitary Landfill, Inc. v. Mich. Dep't of Nat. Res., 504 U.S. 353, 361 (1992).

10. *See* KENNETH JOHNSON, CARSEY INST., NEW HAMPSHIRE DEMOGRAPHIC TRENDS IN THE TWENTY-FIRST CENTURY 5 (2012), https://scholars.unh.edu/cgi/viewcontent.cgi?article=1163&context=carsey [https://perma.cc/4VMD-CYKV]; Byron Lutz, *Quasi-Experimental Evidence on the Connection Between Property Taxes and Residential Capital Investment*, 7 AM. ECON. J. 300, 317 (2015); *see also New Hampshire* Complaint, *supra* note 2, at 59–60.

the perspective of real economic units, these New Hampshire residents are functionally residents of the greater Boston metropolitan area. It is not surprising or odd that the Boston metropolitan area would want to tax residents, even if those residents technically live in a different state.

But why are these residents of New Hampshire paying higher housing prices to live near Boston?[11] Not so very long ago, the dominant economic model of local jurisdictions featured people and businesses shopping among competing jurisdictions for the best deal — the best set of amenities at the best price.[12] This is the so-called Tiebout model,[13] and there is some evidence that "homevoters" do behave in this way.[14] To give a classic example, homebuyers will often be very aware of the quality of local public schools and will pay more — or less — for a home based on the perceived qualities of the schools in a given school district.[15]

When New Hampshire complains in the current suit that it has an "advantage" because it does not levy an income tax — an advantage that Massachusetts undermines — it is in effect stating that it is engaging in Tiebout-type competition with the rest of the Boston metropolitan area.[16] However, armed with only the Tiebout model, it is odd that so many people are clustered together and paying high housing prices around Boston, whether with income taxes or not. And, even more peculiarly, these New Hampshire residents were not so hostile to state income taxes that, at least until the pandemic, they were commuting into Massachusetts and incurring a state personal income tax. The Tiebout model cannot explain this behavior. Considering

11. *See* Lutz, *supra* note 10, at 300.

12. *See* David Schleicher, *Local Government Law's "Law and ___" Problem*, 40 FORDHAM URB. L.J. 1951, 1958 (2013) (reviewing literature).

13. For the seminal article on the topic, see Charles M. Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 416 (1956). *See also* Darien Shanske, *Above All Else Stop Digging: Local Government Law as a (Partial) Cause of (and Solution to) the Current Housing Crisis*, 43 U. MICH. J.L. REFORM 663, 672–73 (2010) (providing additional discussion and context of the Tiebout model).

14. *See* WILLIAM A. FISCHEL, THE HOMEVOTER HYPOTHESIS: HOW HOME VALUES INFLUENCE LOCAL GOVERNMENT TAXATION, SCHOOL FINANCE, AND LAND-USE POLICIES (2001) (amassing evidence for the Tiebout model); *see also* Richard Briffault, *Our Localism: Part II — Localism and Legal Theory*, 90 COLUM. L. REV. 346, 405–06, 416–17 (1990).

15. *See, e.g.*, Michele Lerner, *School Quality Has a Mighty Influence on Neighborhood Choice, Home Values*, WASH. POST (Sept. 3, 2015), https://www.washingtonpost.com/realestate/school-quality-has-a-mighty-influence-on-neighborhood-choice-home-values/2015/09/03/826c289a-46ad-11e5-8ab4-c73967a143d3_story.html [https://perma.cc/ST3C-5PR9].

16. *See New Hampshire* Complaint, *supra* note 2, at 15.

only housing prices, given there is no income tax anywhere in New Hampshire, why are so many residents of New Hampshire paying more to live near Massachusetts?

The newer economic models revolve around the benefits of agglomeration — of bunching together. Density in businesses, especially similar types of businesses, can be a big positive, especially for the flow of ideas.[17] If, for example, a person works as a software engineer, then it makes sense to live near a thriving software industry. This is good not only for obtaining a job to begin with but to sharpen skills, hire other employees, and network to obtain one's next job. Thus, the answer to the riddle of the cluster around the border of Massachusetts: there is an agglomeration of talent in the Boston area that these workers benefit from.

Agglomeration economics is an essential tool for explaining why metropolitan areas exist at all, and, though the types of agglomeration might change in the future, it seems doubtful that its benefits will ever completely go away.[18] I acknowledge that this is something of conjecture. If agglomerations were ever not to matter, or not matter very much, then the analysis that followed might be different, at least as a policy matter.

It turns out that major agglomerations have often not followed state or interstate lines. While this has led to a variety of governance issues that should generally prompt reconsideration of several constitutional doctrines and of how the federal government should regulate interstate taxation, a greater discussion of these issues is beyond the scope of this Essay. Instead, this Essay questions whether the Supreme Court should address the issue of increased remote work by imposing a new physical presence rule. That such a rule is not advisable is made apparent by the example of agglomerations that cross state lines — that is the very case before the Court. If there were such a rule, then a software engineer in the greater Boston area who lives in New Hampshire could carefully avoid some physical presence threshold as to Massachusetts, and thus avoid paying personal income tax to the primary jurisdiction enabling that worker to earn a high income.

17. *See* Edward L. Glaeser & Joshua D. Gottlieb, *The Wealth of Cities: Agglomeration Economies and Spatial Equilibrium in the United States*, 47 J. ECON. LITERATURE 983, 1023 (2009) (emphasizing information spillovers); Daniel B. Rodriguez & David Schleicher, *The Location Market*, 19 GEO. MASON L. REV. 637, 641–43 (2012) (summarizing literature and identifying three benefits of agglomeration: reduced transportation costs, larger market size, and information spillovers).

18. *See* Jeffrey D. Sachs, *Jerry Seinfeld Is Right About New York's Future*, CNN (Aug. 30, 2020, 10:21 AM), https://www.cnn.com/2020/08/27/opinions/jerry-seinfeld-right-about-new-york-sachs/index.html [https://perma.cc/HE53-7M2G].

The Supreme Court excised a similar physical presence rule in a 2018 case called *South Dakota v. Wayfair, Inc.*[19] For the 50 years prior to *Wayfair*, the Court had held that only remote vendors with a physical presence in a state could be forced to collect the use tax on behalf of the state. Now, the post-*Wayfair* rule dictates that any business with a substantial economic presence in the state can be forced to collect the use tax. A similar standard should, and does, govern whether a state can impose an income tax.

C. Doctrine

When a state imposes a tax, the tax can be challenged on numerous constitutional grounds. The most important ones — and the primary ones relied on in *New Hampshire v. Massachusetts* — involve the Due Process Clause and the dormant Commerce Clause. The Due Process Clause "'requires some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax,' and that the 'income attributed to the State for tax purposes must be rationally related to values connected with the taxing State.'"[20] Since 1992, due process has not required that a taxpayer be physically present in a state.[21] New Hampshire and its amici assert, however, that Massachusetts's claim to the income of formerly non-remote employees does not even satisfy the requirements of the Due Process Clause.

Derived from *Complete Auto Transit, Inc. v. Brady*, the dormant Commerce Clause subjects a state tax to a four-part test: (1) a state can only impose a tax on an activity with which it has a substantial nexus, (2) the tax must be fairly apportioned, (3) the tax must not discriminate against out-of-state taxpayers, and (4) the tax must have a fair relation to state services.[22] In this case, only two prongs are particularly relevant — (1) substantial nexus and (2) fair apportionment. First, regarding the substantial nexus, the Court in *Wayfair* declared that it would no longer require physical presence.[23] Rather, some combination of economic and virtual contacts could suffice.[24]

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19. *See* 138 S. Ct. 2080, 2099 (2018).

20. Quill Corp. v. North Dakota, 504 U.S. 298, 306 (1992) (citations omitted) (quoting Miller Bros. Co. v. Maryland, 347 U.S. 340, 344–45 (1954); and then quoting Moorman Mfg. Co. v. Bair, 437 U.S. 267, 273 (1978)), *overruled in part by Wayfair*, 138 S. Ct. at 2099.

21. *See id.* at 307.

22. *See* Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977).

23. *See Wayfair*, 138 S. Ct. at 2099.

24. *See id.*

Second, regarding fair apportionment, the basic idea is that a state can only tax a reasonable share of the income of an interstate enterprise, and thus it may not (a) in effect, tax income earned elsewhere or otherwise (b) overtax or overburden interstate businesses.[25] For example, consider Apple. California and New York can tax Apple because it is a major multistate business with substantial economic presence in both states. Assume both states have a 5% corporate income tax and Apple has $100 billion in income. If both California and New York tax Apple on all of its income, then Apple's income will be taxed twice. In other words, some states will necessarily be taxing income earned out of state if all the income of an interstate business is being taxed multiple times. Imagine all 50 states imposed such a tax on all of Apple's income — that would be *5% * $100bn * 50 = $250bn* — $250 billion in taxes on $100 billion in total income. Apportionment is needed to ensure Apple's $100 billion income is reasonably divided among the states.

States first encountered the problem of taxing large multi-jurisdictional businesses with the railroad industry in the nineteenth century. The states argued that the pieces of property occupied by railroad tracks were part of a larger, unified system that was very valuable. In turn, railroads argued that their property value was minimal because they just owned a little bit of land, wood, and iron stakes. The Supreme Court agreed with the states.[26] Thus, the "unitary business principle" was born, permitting states to consider that they are taxing a unitary business even if the value or income of that business is earned in several states.

Acceptance of the unitary business principle immediately led to another conundrum, namely, how to divide up the value or income of a unitary business. The Supreme Court adopted a flexible rule permitting any reasonable formula and placed the burden on the taxpayer to "prove by 'clear and cogent evidence' that the income attributed to the State is in fact 'out of all appropriate proportions to the business transacted in that State.'"[27] Thus, in the case of railroads, a state could apportion the value of a railroad on the basis of the percentage of tracks in the state.

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25. *See generally* Bradley W. Joondeph, *The Meaning of Fair Apportionment and the Prohibition on Extraterritorial State Taxation*, 71 FORDHAM L. REV. 149 (2002).

26. *See* Adams Express Co. v. Ohio State Auditor, 165 U.S. 194, 228–29 (1897); State R. Tax Cases, 92 U.S. 575, 611–12 (1875); *In re* Del. R.R. Tax, 85 U.S. 206, 219–20 (1873).

27. Container Corp. v. Franchise Tax Bd., 463 U.S. 159, 170 (1983) (quoting Hans Rees' Sons v. North Carolina *ex rel.* Maxwell, 283 U.S. 123, 135 (1931)).

This permissibility as to formulas is appropriate for several reasons.[28] First, for a unitary business, locating the exact source of its income or value is difficult, if not impossible. Where is the value of an interstate railroad? The great stations are worthless without humble tracks crossing great distances with nothing around. Second, state tax bases are often opaque — and deliberately so — which makes it difficult to identify the tax base to be apportioned. As an example, consider Texas's Margin Tax.[29] The tax base of the Texas Margin Tax is determined by using one of four methods of calculation, whichever method results in a lower margin: (1) permitting a deduction of total gross revenue by 30%, (2) a deduction of $1 million, (3) a deduction by costs of goods sold, or (4) a deduction by employee compensation.[30] To the extent this tax is measured by 30% of gross receipts, it is a gross receipts tax. To the extent this tax is measured by a deduction for the cost of goods sold for some taxpayers, it is more a type of income tax. Therefore, the Texas Margin Tax, unlike a traditional income tax or property tax, is not targeted towards one type of value. The tax surely needs to be apportioned — and it is — by proportion of sales within the state; this measure, however, is very rough because the underlying value that Texas is trying to tax a fair proportion of is protean. If the apportionment rule needs to hew closely to the underlying theory of the tax, the problem would not simply be about creating endless work for economists and lawyers (the classic railroad problem), but that the underlying tax base is hard to quantify even without the problem of interstate apportionment. But the states are allowed to levy complicated, hybrid taxes. Thus, a reasonable attempt by a state to tax only its fair share should and does suffice.

One final aspect of current doctrine is important. There are two principles on which a government can impose a tax: residence (where one lives) and source (where one earns income). Thus, for example, California can tax a person on all of her income, including the rental property she might own in New York, because she is a resident. New York can also tax the same person on that rental income. In order to avoid double taxation on the rental income, the national and international norm is that the jurisdiction of residence grants a credit to the resident taxpayers for taxes paid to the source jurisdiction.

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28. *See generally* Joondeph, *supra* note 25.
29. TEX. TAX CODE ANN. § 171.106(a) (West 2018).
30. *See id.*

As a matter of federal constitutional law, taxing according to both principles is well established.[31] Federal constitutional law does not, however, prescribe a rule of priority between residence and source.[32] What federal constitutional law does is impose a rule called "internal consistency,"[33] which means a state cannot choose a tax structure that, if universally copied, would result in double taxation. So, a state can tax only on the basis of residence *or* source because, if every state did so, then interstate taxpayers would be no worse off.[34] Once a state taxes on the basis of residence *and* source, then the state must give credits (unless it is going to tax its own residents who earn income in-state twice), as they essentially all do, and prioritize the source jurisdiction, which all states do.

Both New York and New Jersey impose income taxes that follow this basic structure. As a result, when a New Jersey resident commutes to New York, that employee is taxed by New York (source) first. New Jersey, as the resident state, then gets to tax its resident on the same income but gives a credit for paying taxes to New York. If New York taxes are as high or higher than New Jersey taxes, then New Jersey effectively gets no personal income tax revenue from these residents.

New Jersey has joined New Hampshire as an amicus in the current litigation, arguing that New York's apportionment rule violates the Due Process Clause and the dormant Commerce Clause.[35] Specifically, New Jersey argues that New York's longstanding rule for assessing whether an employee is a resident in the state, the "convenience of the employer test," is unconstitutional because it has the effect of sourcing the income of remote workers to New York.[36]

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31. *See, e.g.*, New York *ex rel.* Cohn v. Graves, 300 U.S. 308, 312–13 (1937) (recognizing the principle of taxing according to residence); Shaffer v. Carter, 252 U.S. 37, 51 (1920) (recognizing the principle of taxing according to source).

32. *See* Comptroller of the Treasury of Md. v. Wynne, 135 S. Ct. 1787, 1803–05 (2015).

33. *Id.* at 1804.

34. *See generally* Bradley W. Joondeph, *The States' Multiple Taxation of Personal Income*, 71 CASE W. RSRV. L. REV. 121 (2020).

35. Brief for States of New Jersey et al. as Amici Curiae in Support of Plaintiff at 5–6, New Hampshire v. Massachusetts, No. 220154 (Dec. 22, 2020).

36. *See id.* For a more in-depth discussion of this test, see *infra* Part II. Note that there is a separate question as to whether this is how the New York test should be interpreted to operate during the COVID-19 pandemic. *See* Walter Hellerstein, *Nonresident NY Employees Are Not Currently Working at Home for Their 'Convenience,'* TAX NOTES (Apr. 2, 2020), https://www.taxnotes.com/featured-analysis/nonresident-ny-employees-are-not-currently-working-home-their-convenience/2020/04/02/2cbx8 [https://perma.cc/7MGV-4RHC]. The fact that the New York test might not even have the purportedly unconstitutional effect is another reason the Court should not take this case.

II. MISTAKEN CONTENTIONS OF NEW HAMPSHIRE AND ITS AMICI

New Hampshire and its amici make two primary contentions. First, they argue that the Massachusetts regulation is unconstitutional because it asserts nexus under the Due Process Clause and dormant Commerce Clause on taxpayers who are not residents in the state and whose income is only sourced to the state because of their employers' location.[37] Second, they argue that the tax is unconstitutional under the Due Process Clause and dormant Commerce Clause because it is not fairly apportioned.[38]

New Hampshire and its amici's arguments regarding the nexus are mistaken.[39] The Supreme Court held 29 years ago in *Quill* that physical presence is not required for nexus under the Due Process Clause,[40] and it held three years ago in *Wayfair* that physical presence is also not required for nexus under the dormant Commerce Clause.[41] Accordingly, under current law, a business can incur the liability to collect the use tax with as little as $100,000 in sales made within a state.[42] It is hard to understand why an employee who formerly worked full-time out of an office in Boston does not continue to have nexus with Massachusetts sufficient to pay a tax if that employee is working remotely for a Massachusetts employer on account of a public health emergency. To be sure, there is a different question if the employee were never to return to commuting, but that is not the question in this case.

And the move from physical presence was, and is, the right move. As all the Justices agreed in *Wayfair*, it was never a constitutional requirement to base nexus to tax on physical presence, and, as the majority in *Wayfair* emphasized, this heuristic was particularly

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37. *See New Hampshire* Complaint, *supra* note 2, at 91.

38. *See id.* at 92.

39. The main state and local tax treatise arrives at a similar, if not more tentative, conclusion about the requirement of physical presence for nexus. *See* WALTER HELLERSTEIN, STATE TAXATION § 20.05, at 12 (3d ed. 2020). Note that the same treatise is skeptical of the New York rule and believes it requires apportionment. *See id.* At the level of policy, I think this is correct, but I disagree that this is required as a matter of law. *See* discussion *supra* Part I.

40. *See* Quill Corp. v. North Dakota, 504 U.S. 298, 308 (1992).

41. *See* South Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2099 (2018).

42. For another interesting parallel, see *International Harvester Co. v. Wisconsin Department of Taxation*, 322 U.S. 435, 441 (1944). There, the Court explained that "[p]ersonal presence within the state of the stockholder-taxpayers is not essential to the constitutional levy of a tax taken out of so much of the corporation's Wisconsin earnings as is distributed to them." *Id.* at 441. If out-of-state shareholders can be taxed on income reasonably sourced to a state, then why should out-of-state employees not be so taxed?

problematic in the age of the internet.[43] *Wayfair* was a case about collection of the use tax by businesses, but the same logic holds for individuals. If virtual contacts suffice for nexus for a business, what is the warrant for a physical presence rule for individuals as matter of constitutional law? And so there are important differences between individuals and businesses of course, and one might quite reasonably argue that residence is more important for individuals.[44] Yet the question is whether those differences are of sufficient weight to be made into a constitutional principle. I think these differences are not because that would, in effect, be to deny that a state may assert nexus based on the lessons of aggregation economics. To make the point another way, New Hampshire and its amici are likely right that there is going to be more remote work in the future, but this means it is all the more important that a tax nexus not be entwined with an outdated understanding of where and how work happens. If more work is to be done remotely in the future, then it is all the more important that physical presence not be made a constitutional bright line rule again.

Agglomeration economics addresses the underlying intuition that it is not fair to tax someone who is not physically present or not present full time. Cities are enabling the agglomerations of talent and capital that make it possible for earning to happen in these metropolitan areas, especially for those with higher salaries. This is even more true when state lines happen to cut through a metropolitan area. It is one thing for a remote worker in Montana to challenge the Massachusetts or New York rules,[45] but the residents in New Hampshire and New Jersey are, in fact, typically living in the Boston and New York metropolitan areas.

New Hampshire and its amici's second argument as to apportionment presents trickier questions. The first step is to return to the two basic grounds for taxation: residence and source. States with income taxes can tax all of the income of their residents but give a credit for tax paid on income earned with a source in another state. States will then tax non-residents on their in-state source income.

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43. *See Wayfair*, 138 S. Ct. at 2095 ("A virtual showroom can show far more inventory, in far more detail, and with greater opportunities for consumer and seller interaction than might be possible for local stores. Yet the continuous and pervasive virtual presence of retailers today is, under *Quill*, simply irrelevant. This Court should not maintain a rule that ignores these substantial virtual connections to the State.").

44. *See generally* Young Ran (Christine) Kim, *Taxing Teleworkers*, 55 U.C. DAVIS L. REV. (forthcoming 2021).

45. And to be clear, I think the source states do have a claim on the income of a worker in Montana, just a lesser one. See discussion *infra* Part III for thoughts on how to administer the tax in this case.

There is no question that Massachusetts, as the source state, cannot tax the employees on all of their income; it can only tax their income with a source in the state.[46]

Does Massachusetts's apportionment rule fail the (appropriately) flexible standard for apportionment? It seems not. Until the beginning of March 2020, few people, if anyone, challenged the idea that the state in which an employee worked can tax *all* of that employee's income as sourced to the state because those services were physically performed in the state. It seems reasonable for Massachusetts to assume that it remains the source for the length of the pandemic because those workers will return. They will return because of the reason they were there to begin with — these workers (and their employers) benefit by being located next to similar workers. To the extent that some workers will not return, then at some point, they will not be Massachusetts employees anymore, but Massachusetts does not have to assume that none will return.[47]

But, as to both the nexus and apportionment questions, one might ask how far this can go. Suppose a New Hampshire resident never returns to work in Massachusetts even after the pandemic is over. Surely, at some point, Massachusetts cannot tax the employee, right? The answer is yes and no. On the one hand, there is a point at which Massachusetts cannot tax a remotely working New Hampshire resident employed by a Massachusetts taxpayer *as if* that employee commuted into Massachusetts every day. There would need to be some other rule used to test whether the nexus is sufficient and, if so, to measure the resulting share of income apportioned to Massachusetts. New York's convenience of the employer test is such an apportionment rule.[48] The New York rule asks if the worker is not at her employer's location for the employer's convenience. If the answer is "no," then, for the day in question, the income is apportioned to New York.

But how much of nexus is sufficient for purposes of the Due Process Clause and the dormant Commerce Clause? I have no bright line rule to propose, just as there is no bright line rule for other nexus and related jurisdictional questions. If an individual is, in a conventional sense, based out of an office located in a state, even if the individual never sets foot in that state, that state should have nexus. Consider a junior lawyer working remotely. At least for now, there will likely be

46. Formally, New York's convenience of the employer test is an apportionment rule for source income.

47. And again, to be clear, if they become permanent remote workers, then Massachusetts still has a claim under some circumstances.

48. *See* N.Y. COMP. CODES R. & REGS. tit. 20, § 132.18(a) (1995).

a place in physical space that contains more of the lawyer's supervisors, co-workers, and support staff than any other place. The state that contains that space, at least, has nexus because of the employee's substantial virtual presence in the state.

III. CONSTITUTIONAL DOES NOT MEAN OPTIMAL: OTHER OPTIONS

As discussed *supra*, the current constitutional rules are correct, and the current New York and Massachusetts rules are constitutional under those rules. Indeed, the New York rule is better than those of many other states that rely on physical presence precisely because it does not.[49] Nevertheless, the New York approach may not necessarily be the best as a matter of policy.

Consider the following not-so-hypothetical and only somewhat stylized scenarios. In the first scenario, Google opens up a new office in New York that only has space for 100 employees.[50] Google, in fact, has 100 employees who regularly come to the office, and they are all commuters from New Jersey. Under the current regime, New York is the source for all that income, and, in effect, New Jersey will receive very little income tax from these residents even though New Jersey has a reasonable claim to tax a substantial portion of that income.

In the second scenario, suppose this New York Google office hires 100 entirely remote employees. If they are considered fully remote, and as such their location is at the convenience of the employer, then New York will receive no income tax at all from these new employees — even though, as explained at the outset, the logic of agglomeration indicates that New York does have a claim to tax some of that income.

In the third scenario, suppose Google adds 25 office spaces in New York and 100 employees who are formally based out of the New York office, with the expectation that each of the remote employees come to the office about 25% of the time. In this scenario, there would likely be a battle over whether New York can tax these employees at all (the taxpayers' presumable position) or whether New York can tax all of their income (perhaps New York's position). A different approach —

49. *See* Ellen S. Brody & Cory M. Paul, *In Defense of the "Convenience of the Employer" Test*, 12 COLUM. J. TAX L. (2020), https://journals.library.columbia.edu/index.php/taxlaw/announcement/view/350 [https://perma.cc/EWV8-XCZU].

50. *See* Matthew Haag, *Manhattan Emptied Out During the Pandemic. But Big Tech Is Moving In.*, N.Y. TIMES (Nov. 9, 2020), https://www.nytimes.com/2020/10/13/nyregion/big-tech-nyc-office-space.html [https://perma.cc/W4ZE-YTX3].

which may be how the matter is resolved under current New York law[51] — would be that 25% of these remote employees' income would be sourced to New York.

Apportioning 25% of the remote workers' income to New York is not a perfect solution, to be sure, but it is reasonable — so reasonable that it makes one wonder about the first two scenarios where apportionment did not seem to have a role.[52] But I think it should. Returning to the second scenario, it seems that New York has some claim to the income that remote employees earn through taking advantage of New York's agglomerations. An apportionment solution would seem appropriate here, and evolving law and practice involving the corporate income tax suggests how this might be implemented.[53] I am assuming that some agglomeration will continue, and thus large multistate employers will have agglomerations of employees.[54] For example, if Google were to have 10% of its workforce in New York and then have a certain number of permanently remote employees reporting to multiple offices, then apportioning 10% of the remote employee's income to New York seems reasonable and appropriate.[55]

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51. *See* OFF. OF TAX POL'Y ANALYSIS TECH. SERVS. DIV., N.Y. STATE DEP'T OF TAX'N & FIN., NEW YORK TAX TREATMENT OF NONRESIDENTS AND PART-YEAR RESIDENTS APPLICATION OF THE CONVENIENCE OF THE EMPLOYER TEST TO TELECOMMUTERS AND OTHERS (2006).

52. Apportionment is currently standard in special cases, such as athletes. *See* Timothy P. Noonan & Doran J. Gittelman, *Taxing Times to Be a Telecommuter: Convenience Rules During COVID-19*, TAX NOTES ST. (Sept. 17, 2020), https://www.taxnotes.com/featured-analysis/taxing-times-be-telecommuter-convenience-rules-during-covid-19/2020/09/17/2cyh2 [https://perma.cc/YB3S-XD9H].

53. This proposal is similar to and inspired by one Ed Zelinsky made. *See generally* Edward A. Zelinsky, *Apportioning State Personal Income Taxes to Eliminate the Double Taxation of Dual Residents: Thoughts Provoked by the Proposed Minnesota Snowbird Tax*, 15 FLA. TAX REV. 533 (2014). However, Zelinsky proposed to use apportionment to divide up residence, not source — as for source, he seemed to believe a physical presence rule is required. He submitted an amicus brief on behalf of New Hampshire. *See* Brief of Professor Edward A. Zelinsky as Amicus Curiae in Support of Plaintiff's Motion for Leave to File Bill of Complaint, New Hampshire v. Massachusetts, No. 220154 (Dec. 10, 2020); *see also* SCOTUSBLOG, *supra* note 1.

54. In fact, a collateral benefit of re-thinking the sourcing rules could be to encourage de-agglomeration. After all, before the pandemic and recession, there was great concern about too much concentration in large urban areas.

55. See MULTISTATE TAX COMM'N, MODEL GENERAL ALLOCATION & APPORTIONMENT REGULATIONS WITH AMENDMENTS SUBMITTED FOR ADOPTION BY THE COMMISSION 80–81 (2017), https://www.mtc.gov/getattachment/Events-Training/2017/Special-Meeting/FINAL-APPROVED-2017-Proposed-Amendments-to-General-Allocation-and-Apportionment-Regulat.pdf.aspx [https://perma.cc/A9VY-W7WY] (regulating and apportioning income based on proportion of payroll). There is a certain circularity here given that it is known where

The same is true for the first scenario. The operation of the residence principle under current law is paradoxical. On the one hand, the resident state can tax a resident on all of her income, which seems like quite a lot, and likely more than can be justified from a God's eye view (does no other state contribute anything?).[56] Yet the source rule typically also attributes 100% of income to the source, again more than can be justified from a God's eye view. And thus, the norm that each state gives tax credits as to taxes paid to the source state means that the resident state often gets very little. In the current litigation, we could re-characterize New Jersey's position as saying "enough is enough" — it is one thing for New York to get first crack at the income of physical commuters, but too much to also get first crack at the income of workers who are temporarily working remotely. This complaint makes sense as a matter of policy, though, as already explained, it is not persuasive as a matter of constitutional law.[57]

Now, as to the first scenario, there is a question of how to apportion the income of commuters. A first step is to consider what would happen if there were one metropolitan area government covering New York and New Jersey — that government would be entitled to tax 100% of the employee's income. What to do if there are two governments? One very rough solution would be to split the income 50–50,[58] though a lot of other divisions could be defended. For instance, perhaps the source jurisdiction should get two-thirds of the

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some employees are located — hence it is crucial for this proposal that agglomerations continue, if perhaps in different forms and locations.

56. In a sense, this winner-takes-all source rule is another example of the flexibility of the command that a tax be apportioned. The Court has long accepted that the sales tax need not be apportioned. *See* Okla. Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 186 (1995) ("We have . . . consistently approved taxation of sales without any division of the tax base among different States . . . ."). The Court's position can be understood on two related grounds. First, the Court understands the pragmatic difficulties the state would encounter as to apportioning some forms of income. Second, because of the widespread use of credits, this seeming violation of the apportionment principle does not offend against the core value the Court is concerned about: non-discrimination against interstate commerce. *See* Joondeph, *supra* note 25, at 181–82.

57. Another way of putting this Essay's constitutional argument would be that if apportionment were required in this case, then it would call into question other areas, like the sales tax, where the Court has relaxed the apportionment requirement when there is no discrimination. *See supra* text accompanying note 55.

58. In *Holt Civic Club v. City of Tuscaloosa*, the Supreme Court approved the exercise of limited extra-jurisdictional authority by a city over a neighboring unincorporated community against an Equal Protection Clause challenge. *See* 438 U.S. 60, 61–63 (1978). Note that as part of the Court's approved structure, those subjected to extra-jurisdictional authority still needed to pay fees to the city, but at half the rate of city residents.

income based on the argument that the residence jurisdiction can also levy a property tax to pay for local services.

New Jersey currently taxes commuters into New Jersey on all of their source income, and so benefits from the same rule that costs it revenue. But even if New Jersey moved to an apportionment regime, this would not help New Jersey taxpayers unless New York did so as well. This collective action problem does not mean that the Court needs to put its thumb on the scale in this murky area. Rather, the Court needs to allow states to negotiate and, ideally, prompt congressional action.[59] Neither is wholly impossible. As to the states acting, consider for example that it is not clear if New York will lose from a shift to an apportionment regime of the type outlined above if current trends continue. It is precisely because of this veil of ignorance, i.e., it being unclear which jurisdictions will do better and which will do worse, that the states might be amenable to moving to an apportionment regime themselves or accepting a broad apportionment regime imposed by Congress. If the Court imposes a physical presence rule, particularly one based on due process, then such development would be impossible.[60]

CONCLUSION: THE COURT SHOULD NOT DICTATE A RULE

At the end of the nineteenth century and the beginning of the twentieth, the courts needed to adjust to the rise of large multistate enterprises. How does one reasonably tax a railroad? The notion of dividing up the enterprise's income by formula was new, but it worked and was upheld. States already tax individuals on the basis of days worked in one state or another. It will require another shift to

59. Developing what Congress should do is beyond the scope of this Essay, though I think a uniform apportionment approach is the proper reform. Congress certainly should not itself impose a new physical presence test, as current proposals before Congress would. *See* American Workers, Families, and Employers Assistance Act, S. 4318, 116th Cong. (2020) (broader relief bill); Remote and Mobile Worker Relief Act of 2020, S. 3995, 116th Cong. (2020) (remote worker bill).

60. In *Quill Corp. v. North Dakota*, the Court ruled for the taxpayer but only on dormant Commerce Clause grounds, which gave Congress the chance to craft a different (better) rule. *See* 504 U.S. 298 (1992). Despite repeated attempts, Congress could not do so because of divisions between the states and different industry groups. It seems very likely that the same veto points would have the same effect (not legislation) if the Court again looks to Congress to fix its mistakes. The difference between ruling for New Hampshire in this case on the dormant Commerce Clause and maintaining current law and ruling against New Hampshire is that once New Hampshire and its amici win, then there will be no need for many states to negotiate further. Under the current regime, every state is both a potential winner and loser and hence the possibility of progress.

understand when and how states can fairly and reasonably tax workers who are virtually present in one state or another. In this Essay, I have not argued exactly what this new regime should look like. Rather, I have argued that the courts — and especially the Supreme Court — should not hamper the emergence of this solution by imposing a novel physical presence requirement on the taxation of individual income.