



School of Law
UNIVERSITY OF GEORGIA

Digital Commons @ University of Georgia
School of Law

Popular Media

Faculty Scholarship

8-1-2006

Drawing the Line: One Taxpayer's Economic Development Incentive Is Often Another's Discriminatory Tax

Walter Hellerstein

University of Georgia School of Law, wallyh@uga.edu

Repository Citation

Hellerstein, Walter, "Drawing the Line: One Taxpayer's Economic Development Incentive Is Often Another's Discriminatory Tax" (2006). *Popular Media*. 8.
https://digitalcommons.law.uga.edu/fac_pm/8

This Article is brought to you for free and open access by the Faculty Scholarship at Digital Commons @ University of Georgia School of Law. It has been accepted for inclusion in Popular Media by an authorized administrator of Digital Commons @ University of Georgia School of Law. [Please share how you have benefited from this access](#)
For more information, please contact tstriepe@uga.edu.

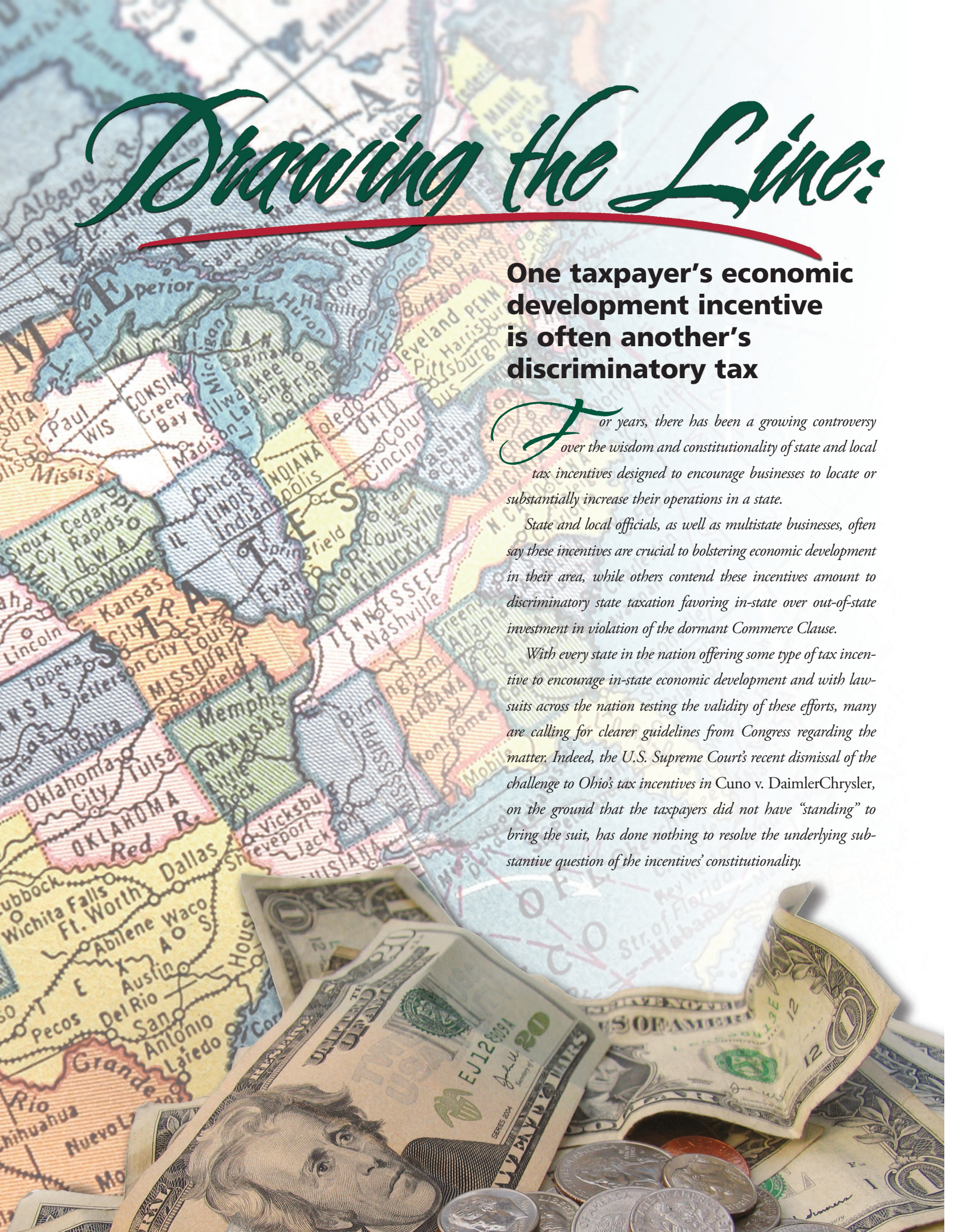
Drawing the Line:

One taxpayer's economic development incentive is often another's discriminatory tax

*F*or years, there has been a growing controversy over the wisdom and constitutionality of state and local tax incentives designed to encourage businesses to locate or substantially increase their operations in a state.

State and local officials, as well as multistate businesses, often say these incentives are crucial to bolstering economic development in their area, while others contend these incentives amount to discriminatory state taxation favoring in-state over out-of-state investment in violation of the dormant Commerce Clause.

With every state in the nation offering some type of tax incentive to encourage in-state economic development and with lawsuits across the nation testing the validity of these efforts, many are calling for clearer guidelines from Congress regarding the matter. Indeed, the U.S. Supreme Court's recent dismissal of the challenge to Ohio's tax incentives in *Cuno v. DaimlerChrysler*, on the ground that the taxpayers did not have "standing" to bring the suit, has done nothing to resolve the underlying substantive question of the incentives' constitutionality.



Walter Hellerstein, the School of Law's Shackelford Distinguished Professor of Taxation and who is generally regarded as the nation's leading legal academic authority on state and local taxation, was asked to provide testimony on these issues at a U.S. Senate hearing before the Subcommittee on International Trade of the Committee on Finance earlier this year.

Hellerstein also testified on this topic before a U.S. House of Representatives subcommittee last year and provided an overview of the American debate to the United Kingdom's Treasury Department, which faces similar issues in relation to Member States of the European Union seeking to encourage economic growth and productivity in their respective countries.

Below you will find a modified version of Hellerstein's testimony before the Subcommittee on International Trade of the Committee on Finance.

Why Congress should draw a line between appropriate economic development incentives and inappropriate state tax discrimination

It is not an overstatement to characterize the U.S. Supreme Court's dormant Commerce Clause doctrine imposing restraints on state taxation of interstate commerce as a "quagmire."

Indeed, almost half a century ago the U.S. Supreme Court itself described the doctrine that way,¹ and things have not gotten much better.²

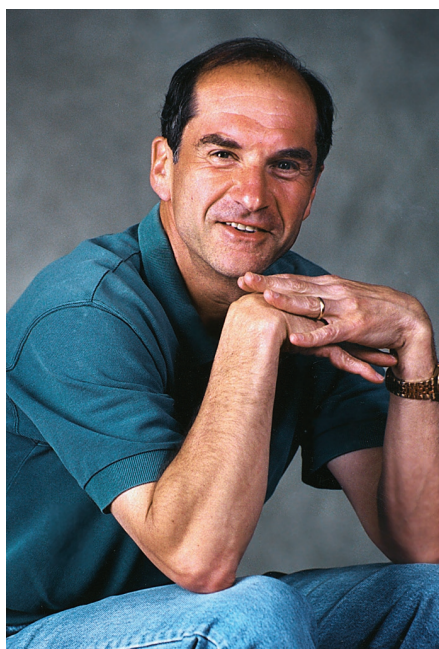
Moreover, in no context is the confusion and uncertainty created by the court's Commerce Clause doctrine more profound than in the domain of state tax incentives for economic development.

As I testified last year before a House subcommittee looking into the *Cuno* problem,³ perhaps the one point on which virtually all observers would agree is that "the law in this area is indeterminate" and that, "[l]ess charitably put, it is a mess, albeit a mess that keeps many lawyers and law professors busy."⁴

The *Cuno* case, of course, is a poster child for this "mess." How can anyone explain, as the *Cuno* case held, how (a) an income tax credit to attract business to a state violates the Commerce Clause while (b) a property tax abatement to attract that same business to the state does not?⁵ But *Cuno* is just the tip of the iceberg.

Important questions

There are literally hundreds of state tax incentives enacted for economic development purposes that arguably fall on one side or the other of the line the court has drawn between permissible and impermissible inducements. Whether they fall on



Shackelford Professor Walter Hellerstein

the right side or the wrong side of the line depends on an inquiry into such questions as whether the measure is:

- a permissible direct subsidy of domestic industry that "'does not ordinarily run afoul' of the negative Commerce Clause"⁶; or
- an incentive falling within the court's recognition that its decisions "do [] not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry"⁷; or
- an incentive designed to achieve that same objective - "to encourage the growth and development of intrastate commerce and industry" - but that "forecloses tax-neutral decisions"⁸; or
- an incentive that "provid[es] a direct commercial advantage to local business."⁹

Because the answers to these questions are often unclear, in many cases it is anyone's guess whether a particular economic development measure falls on the right or wrong side of that line.

For example, the Wisconsin Supreme Court is struggling with the question of whether the state's property tax exemption for airlines that operate "hub facilities" in the state violates the dormant Commerce Clause,¹⁰ a question that the Wisconsin Court of Appeals certified to the Wisconsin Supreme Court because it "presents issues of statewide and national importance involving the ability of the state to provide tax incentives for businesses to locate, upgrade, or remain in the state."¹¹

While perhaps not of the same pressing importance, except to my state and local tax students to whom I gave the problem as an examination question last semester, is the question of the constitutionality of Georgia's headquarters credit for new investment in the state.¹² I could have chosen a similar example from virtually any other state.

Resulting taxation issues

The problem created by this uncertainty for taxpayers and taxing authorities alike is self-evident.

Corporate taxpayers who have reasonably relied on these economic development incentives in the past have no assurance that these provisions will survive a Commerce Clause challenge and thereby deprive them of benefits on which they may have made locational and budgetary decisions.

Moreover, this uncertainty has a highly unsettling impact on future decision-making regarding industrial location.

State taxing authorities whose incentive provisions may be vulnerable to attack likewise face difficult administrative decisions in

determining how to redress the discrimination, especially in light of the constitutional requirement that those who have been the victim of unconstitutional state tax discrimination are entitled to “meaningful backward-looking relief.”¹³

The state budgetary implications of this requirement can also be daunting.

Accordingly, wholly apart from any question of whether state tax incentives are wise as a matter of policy - an issue on which others are better positioned to comment and to which my testimony is not directed - the existing indeterminacy of the law governing the constitutionality of these incentives under the Commerce Clause calls for a solution.

Congress should act

That solution will not come from the U.S. Supreme Court or from other courts that are bound to follow its guidance. As Associate Justice Felix Frankfurter observed nearly 50 years ago:

At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.

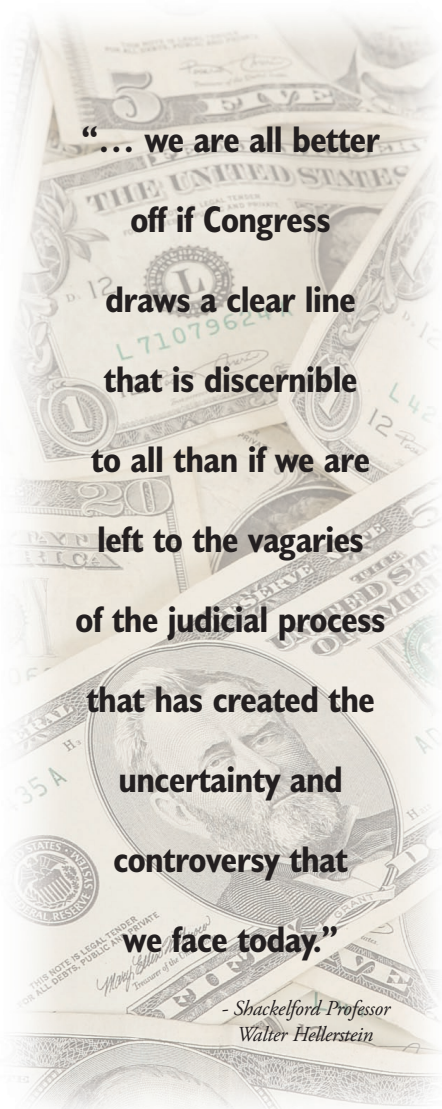
The problem calls for solution by devising a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power.¹⁴

In short, the problem raised by *Cuno* is broader than *Cuno* itself.

Failure by Congress to act on the underlying issue raised by *Cuno* will effectively

leave us in the “mess” we are in.

Wholly apart from the wisdom or effectiveness of state tax incentives or the defensibility of various competing readings of the dormant Commerce Clause that may be advanced, failure by Congress to act will



assure continuing uncertainty and, most probably, inconsistency in judicial determinations of the validity of state tax incentives.

To reiterate what I said to a House subcommittee last year: “However Congress may resolve the ultimate question of what types of tax incentives represent appropriate measures to encourage economic development, we are all better off if Congress draws a clear line that is discernible to all than if we are left to the vagaries of the judicial process that has created the uncertainty and controversy that we face today.”¹⁵

How Congress should draw the line between acceptable economic development incentives and unacceptable state tax discrimination

If Congress decides to legislate in this area and to draw a line between acceptable economic development incentives and unacceptable state tax discrimination, my principal recommendation is simple: be careful.

I say that for the following reason: one person’s “economic development incentive” is often another person’s “discriminatory tax.”

New York’s “economic development incentive” to attract sales to the New York exchanges was a “discriminatory tax” to the Boston Stock Exchange that viewed the incentive as diverting economic activity from the Boston exchange, a view with which the U.S. Supreme Court concurred.¹⁶

Hawaii’s “economic development incentive” for its fledgling wine industry was a “discriminatory tax” to sellers of alcoholic beverages produced in other states, a view with which the U.S. Supreme Court concurred.¹⁷

New York’s “economic development incentive” for businesses involved in export shipment from New York was a “discriminatory tax” for those making export shipments from other states, a view with which the U.S. Supreme Court concurred.¹⁸

And Ohio’s “economic development incentive” for gasohol produced in the state was a “discriminatory tax” to those who produced gasohol in other states, a view with which the U.S. Supreme Court concurred.¹⁹

Consequently, in drawing the line between acceptable and unacceptable economic development incentives, Congress must act with great care to assure that it is neither approving as “economic development incentives” provisions that, on further reflection, constitute unwarranted “state tax discrimination” nor, alternatively, that it is not condemning as “state tax discrimination” provisions that, on further reflection, constitute permissible “economic development incentives.”

Let me provide you with one recent example of the delicate task that Congress faces.

Recently, the Missouri House of Representatives passed by a resounding 152-1 margin an exemption from Missouri sales taxes for “all sales of new motor vehicles

assembled and sold in the state of Missouri after January 1, 2007.²⁰

The bill was obviously enacted with the wholly laudable and understandable purpose of encouraging economic development in Missouri by eliminating the tax on motor vehicles assembled in the state.

But it does not take a Nobel-prize winning economist to appreciate the implications of this legislation for the sale in Missouri of automobiles manufactured in Illinois, Ohio or Michigan.

The question Congress faces, then, is how to draw the appropriate line between *Cuno*-type incentives, which many believe are appropriate, and the Missouri incentive, which, I will venture to presume, many would find inappropriate.

Proposed legislation

Without speaking to the merits of the particular line that Congress may wish to draw, I nevertheless believe that the legislation introduced into Congress by U.S. Sen. George V. Voinovich and U.S. Rep. Patrick J. Tiberi²¹ makes an excellent start at the process of drawing such a line.

It represents a considered effort to strike a balance between the ability of the states, in their sovereign capacities, to adopt programs designed to attract economic activity to the state and the needs of the nation to maintain the national common market that has been essential to our country's economic prosperity.

Although I have studiously avoided expressing my views as to precisely where Congress should draw the line, and I have also expressed the view that the proposed legislation is in need of some revision, I do believe that the proposed legislation, which generally authorizes state tax incentives to encourage economic development, properly excludes the following types of state tax discrimination from its authorization:

- Tax incentives that favor in-state corporations or individual residents.
- Tax incentives that penalize out-of-state activity.
- Tax incentives that favor the purchase of in-state over out-of-state products.
- Tax incentives conditioned on other states offering reciprocal benefits.
- Tax incentives that require the use of locally produced property. ■

End notes

- 1 *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).
- 2 See generally 1 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation ch. 4* (3d ed. 1998 & Cum. Supp. 2005) (taking more than 300 printed pages to describe the U.S. Supreme Court's dormant Commerce Clause doctrine).
- 3 Walter Hellerstein, *Economic Development and the Dormant Commerce Clause: Lessons of Cuno v. DaimlerChrysler and its Effect on State Taxation Affecting Interstate Commerce*, Before the Subcomm. on the Constitution and the Subcomm. on Commercial and Administrative Law of the House Comm. on the Judiciary, 109th Cong., 1st Sess. (2005).
- 4 *Id.* at 10.
- 5 Although I must plead guilty to having tried to explain that very distinction, Walter Hellerstein & Dan T. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 Cornell Law Review 789 (1996), and acknowledge the Court of Appeals for the Sixth Circuit relied on that explanation in striking down Ohio's investment tax credit while sustaining the property tax abatement, *Cuno v. DaimlerChrysler, Inc.* 386 F.3d 738 (6th Cir. 2004) (citing *id.* at 806-09), I would be the first to admit (and have in fact admitted) the extraordinary difficulties in attempting to delineate "the ill-defined distinction between the constitutional carrot and the unconstitutional stick in state tax, subsidy, and related cases." Hellerstein & Coenen, *supra*, at 792.
- 6 *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 n.15 (1994) (quoting *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988)).
- 7 *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336 (1977).
- 8 *Id.* at 331. One may reasonably ask whether a tax incentive that does not "foreclose tax-neutral decisions" is even worthy of its name, since that is precisely what a tax incentive is designed to do.
- 9 *Id.* at 329 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)).
- 10 *Northwest Airlines, Inc. v. Wisconsin Dep't of Revenue*, 281 Wis. 2d 117, 697 N.W. 2d 475 (2005).
- 11 *Northwest Airlines, Inc. v. Wisconsin Dep't of Revenue*, No. 04-0319, 2005 WL 487882 (Wis. App. 2005).
- 12 Here was the question:
Georgia Code § 48-7-40.17 provides, in pertinent part:
 - (a) As used in this Code section, the term: ...
 - (3) "Headquarters" means the principal central administrative office of a taxpayer or a subsidiary of the taxpayer.
 - (b) A taxpayer establishing its headquarters in this state or relocating its headquarters into this state which:
 - (1) Within one year of the first date on which it withholds wages for employees at such headquarters ... employ at least 100 persons in new full-time jobs at such headquarters ... ; or
 - (2) Within one year of the first date on which it withholds wages for employees at such headquarters ... incurs within the state a minimum of \$1 million in construction, renovation, leasing, or other costs related to such establishment or relocation ... shall be allowed a credit for taxes imposed under this article equal to \$2,500.00 annually per eligible new full-time job.

Your client has recently relocated its headquarters to Georgia. It has added 75 persons in "new full-time jobs at such headquarters" within the meaning of the foregoing statute, and it has incurred \$500,000 of "construction, renovation, leasing, or other costs related to such establishment" within the meaning of the statute. The Georgia Department of Revenue has denied your client the credit described above, and your client has asked your advice as to whether a Commerce Clause challenge to such denial will be successful. Write a memorandum providing the requested advice.
- 13 *McKesson v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 31 (1990).
- 14 *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting). The Court expressed similar sentiments in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) and in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978).
- 15 Hellerstein, *supra* note 4, at 13.
- 16 *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977).
- 17 *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).
- 18 *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984).
- 19 *New Energy Co. v. Limbach*, 486 U.S. 269 (1988).
- 20 House Bill No. 1249, 93rd General Assembly, State of Missouri, March 2, 2006.
- 21 See S. 1066, 109th Cong., 1st Sess. (2005); H.R. 2471, 109th Cong., 1st Sess. (2005).