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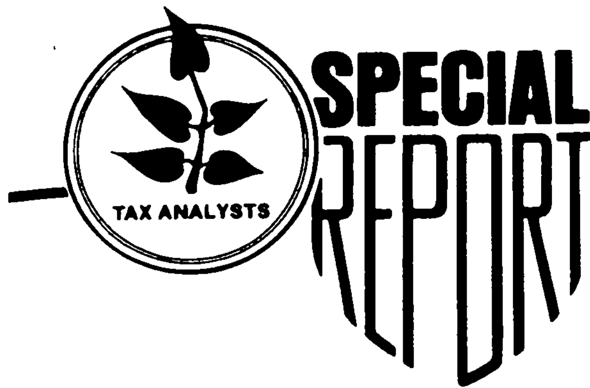

WEST LYNN CREAMERY AND THE CONSTITUTIONALITY OF STATE TAX INCENTIVES

by Walter Hellerstein

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In this article, Professor Hellerstein analyzes the Supreme Court's decision in *West Lynn Creamery v. Healy*, in which the Court struck down a Massachusetts milk pricing and rebate program that required milk dealers to make "premium payments" for milk sold in the state, but earmarked these payments for payments to Massachusetts milk producers. The author considers, on a preliminary basis, the implications of this decision for the constitutionality of state tax incentives.

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One of the more perplexing questions that has surfaced from time to time in the state tax field is how a constitutionally benign tax incentive program designed to attract industry to a state is to be distinguished from an unconstitutionally discriminatory taxing scheme "that forecloses tax-neutral decisions"[1] and "provid[es] a direct commercial advantage to local business."[2] On one hand, the U.S. Supreme Court has expressed the view that its decisions do "not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[3] On the other hand, the Court has frequently invalidated state tax regimes which were designed to do just that.[4]

The Court's recent decision in *West Lynn Creamery Inc. v. Healy*[5] sheds some additional light on the line the Court is apparently seeking to draw between the constitutional carrot and the unconstitutional stick in state tax cases. In *West Lynn Creamery*, the Court invalidated a Massachusetts milk pricing and rebate program that required milk dealers to make "premium payments" for milk sold in the state, but earmarked these payments for distribution to Massachusetts' milk producers. The Court drew heavily on its state tax precedents in holding that the Massachusetts pricing and rebate program discriminated against interstate commerce in violation of the Commerce Clause. This article analyzes the Court's opinion in *West Lynn Creamery* and considers, on a preliminary basis, its implications for the constitutionality of state tax incentives.

I. *West Lynn Creamery*

A. The Facts and Proceedings

To preserve its local dairy industry, maintain minimum prices for dairy farmers, and ensure a continuous supply of fresh milk for the state's market, the com-

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[1] *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 331 (1977).

[2] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959).

[3] *Boston Stock Exchange*, 429 U.S. at 336.

[4] *See, e.g.*, *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating liquor excise tax scheme designed to encourage development of local industry by exempting locally produced beverages); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984) (invalidating tax credit scheme designed to encourage development of local export trade).

[5] 114 S. Ct. 2205 (1994).

missioner of the Massachusetts Department of Food and Agriculture (the commissioner) issued a pricing order that required every milk dealer in Massachusetts to make a monthly "premium payment" into the "Massachusetts Dairy Equalization Fund." The premium payment was based on the dealer's milk sales in Massachusetts.[6] Each month, the fund generated by the premium payments was distributed to Massachusetts milk producers, in proportion to their contribution to the state's total production of raw milk.[7]

Two milk dealers sought to enjoin enforcement of the commissioner's pricing order on the ground that it violated the Commerce Clause. Under an expedited appellate procedure, the case proceeded directly to the Supreme Judicial Court of Massachusetts. That court sustained the commissioner's order on the ground that "the pricing order does not discriminate on its face, is evenhanded in its operation, and only incidentally burdens interstate commerce."[8]

B. The Supreme Court's Opinion

The Supreme Court reversed and held that the Massachusetts pricing and rebate scheme discriminated against interstate commerce in violation of the Commerce Clause. Writing for a five-member majority,[9] Justice John Paul Stevens declared that the pricing order was "clearly unconstitutional"[10] under its decisions striking down regulations and taxes that had "the same effect as a tariff or customs duty — neutralizing the advantage possessed by lower cost out-of-state producers."[11] The Court observed that the pricing order's

> avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States. The "premium payments" are effectively a tax which makes milk produced out of State more expensive. Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely (indeed more than) offset by the subsidy provided exclusively to Massachusetts dairy farmers. Like an ordinary tariff, the tax is thus effectively imposed only on out-of-state products. The pricing order thus allows Massachusetts dairy farmers who produce at higher cost to sell at or below the price charged by lower cost out-of-state producers.[12]

The Court analogized the Massachusetts price-rebate scheme to the taxing scheme in *Bacchus Imports Ltd. v. Dias*,[13] where the Court struck down a Hawaii liquor tax from which certain locally produced beverages were exempt. In the Court's view, both schemes involved a broad-based tax with preferential treatment for local producers. Although the taxing scheme in *Bacchus* involved a facially discriminatory exemption for local products rather than a broad-based tax coupled with a local subsidy, the Court declared that "the result in *Bacchus* would have been the same if instead of exempting certain Hawaii liquors from tax, Hawaii had rebated the amount of tax collected from the sale of those liquors."[14] It therefore followed that the Massachusetts scheme was unconstitutional because it amounted to a broad-based tax with a rebate limited to local producers.[15]

> ***The Court analogized the Massachusetts price-rebate scheme to the taxing scheme in Bacchus Imports.***

Having found that the pricing order violated first principles of its Commerce Clause jurisprudence, the Court then turned to the four defenses that the commissioner mounted in support of the pricing order's constitutionality.

1. The sum of the parts is less than the whole. The commissioner contended that because each component of the Massachusetts scheme — a nondiscriminatory tax on dealers and a subsidy to local dairy farmers — was valid, the combination of the two was equally valid. Accepting the commissioner's premises for the sake of argument,[16] the Court nevertheless rejected the

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[6]The premium payment was determined by subtracting the minimum "federal blend price" for milk from $15, dividing the difference by three, and multiplying the quotient times the dealer's sales of Class I milk in Massachusetts. *West Lynn Creamery*, 114 S. Ct. at 2210. For example, if the federal blend price was $12/cwt ($12 per 100 pounds), the $3 difference between that and $15 would be divided by three, and the quotient ($1/cwt) would be multiplied by the amount (in pounds) of the dealer's Class I milk sales in Massachusetts. *Id.*

[7]The disbursement was subject to two qualifications. First, any farmer who produced more than 200,000 pounds of milk was considered to have produced only 200,000 pounds. Second, no producer was entitled to payments that would make his net price of milk more than $15/cwt. Any excess in the fund would be returned to dealers. *See* 114 S. Ct. at 2210 n. 8.

[8]*West Lynn Creamery Inc. v. Commissioner of Department of Food and Agriculture*, 611 N.E.2d 239, 243 (Mass. 1993).

[9]Justice Stevens' opinion was joined by Justices O'Connor, Kennedy, Souter, and Ginsburg.

[10]*West Lynn Creamery*, 114 S. Ct. at 2211.

[11]*Id.* The Court cited, among other cases, *Baldwin v. G.A.F. Seelig Inc.*, 294 U.S. 511 (1935) (invalidating minimum price legislation) and *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating law exempting locally produced alcoholic beverages).

[12]*West Lynn Creamery*, 114 S. Ct. at 2212.

[13]468 U.S. 263 (1984).

[14]*West Lynn Creamery*, 114 S. Ct. at 2213.

[15]The tax-rebate scheme that the Court hypothesized in *Bacchus* was distinguishable from the Massachusetts "premium payment" rebate scheme in that the hypothetical rebate would be paid to the taxpayer who sold the locally produced products, whereas in *West Lynn Creamery*, the rebate was paid to the local producer rather than the taxpayer-dealer. The Court found that this merely reinforced the conclusion that the pricing order favored local producers. *Id.* at 2213 n.14. If the rebates had been paid to the dealers, even if only for locally produced milk, the dealers might not have used the funds to increase the price or quantity of milk purchased from local producers. *Id.*

[16]There was no question that the "premium payment," even considered as a tax, was independently valid because it was a nondiscriminatory levy imposed on all dealers in

(Footnote 16 continued.)

conclusion. The Court acknowledged that "[a] pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business."[17] However, because the subsidy was funded principally by the sale of milk produced in other states,[18] the commissioner's pricing order "not only assists local farmers, but burdens interstate commerce."[19] Consequently, the pricing order violated "the cardinal principle that a State may not 'benefit in-state economic interests by burdening out-of-state competitors.'"[20]

Because the subsidy was funded principally by the sale of milk produced in other states, the commissioner's pricing order 'burdens interstate commerce.'

The Court further observed that, merely because two state actions might be constitutionally unobjectionable on their own terms, they were not necessarily constitutionally acceptable when considered jointly. One of the bases for sustaining nondiscriminatory taxes, despite their impact on interstate commerce, is that "the existence of major in-state interests adversely affected . . . is a powerful safeguard against legislative abuse."[21] When, however, a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, the "political check" that can usually be relied on to prevent legislative abuse is undermined.[22] The Massachusetts pricing order was a case in point, because one of the natural opponents of the pricing order would have been the local dairy industry (along with dealers and local consumers), but the subsidy effectively silenced such potential political opposition.

Finally, the Court found the commissioner's focus on the two, formally distinct aspects of the Massachusetts pricing order as misplaced in light of the practical and fact-intensive nature of the Court's Commerce Clause jurisprudence. The Court declared that the constitutionality of the Massachusetts tax/subsidy scheme should be evaluated "as a whole,"[23] and not by reference to its component parts; that the substance of the state action, not "the form by which a State erects barriers to commerce,"[24] should be the touchstone of the constitutional analysis; and that this inquiry should be accomplished by a "sensitive, case-by-case analysis of purposes and effects."[25] Under these criteria, the Massachusetts program could not pass muster.

2. There is no competition between taxpayers and dairy farmers. The commissioner argued that because the Massachusetts milk dealers who make the premium payments were not competitors with the local dairy farmers who receive subsidies from the dairy equalization fund, the pricing order did not discriminate against interstate commerce. The Court summarily dismissed this argument, noting that "[f]or over 150 years our cases have rightly concluded that the imposition of a differential burden on any part of the stream of commerce — from wholesaler to retailer to consumer — is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer."[26]

3. The tax burdens only local consumers. The commissioner also sought to defend the Massachusetts tax/rebate program on the ground that the burden of the tax fell only on in-state consumers. Wholly apart from the questionable factual premise of the commissioner's argument,[27] the Court rejected it because "[s]tate taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional."[28] In so stating, the Court implicitly rejected an ill-considered *dictum* from *Goldberg v. Sweet*,[29] where it had declared that "[i]t is not a purpose of the Commerce Clause to protect state residents from their own state taxes."[30]

4. The burden on interstate commerce is incidental. Finally, the Court rejected the commissioner's argument that the incidental burden on interstate commerce was outweighed by the local benefits of

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milk in Massachusetts. The validity of the subsidy was somewhat more troublesome. The Court acknowledged that it has "never squarely confronted the constitutionality of subsidies" (*id.* at 2214 n.15) but that it had observed that " '[d]irect subsidization of domestic industry does not ordinarily run afoul' of the negative Commerce Clause" (quoting *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988)). While acknowledging in *New Energy* that a local subsidization program may constitute "a scheme no less discriminatory" than a discriminatory tax or regulation and "no less effective in conferring a commercial advantage over out-of-state competitors," *New Energy*, 486 U.S. at 278, the Court observed that "[t]he Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description in connection with the State's regulation of interstate commerce." *Id.* (emphasis in original). In any event, the Court in *West Lynn Creamery* found it unnecessary to address the constitutionality of direct subsidies, although it has made it clear that such subsidies are, in general at least, constitutionally unobjectionable.

[17] *West Lynn Creamery*, 114 S. Ct. at 2214.

[18] It was undisputed that the overwhelming majority of milk sold in Massachusetts was produced elsewhere. *Id.* at 2214 n.16.

[19] *Id.* at 2214.

[20] *Id.* (quoting *New Energy*, 486 U.S. at 273-74).

[21] *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473 n.17 (1981), quoted in *West Lynn Creamery*, 114 S. Ct. at 2215.

[22] *West Lynn Creamery*, 114 S. Ct. at 2215; *see generally* Walter Hellerstein, *State Taxation and the Supreme Court: Toward a More Unified Approach to Constitutional Adjudication?* 75 Mich. L. Rev. 1426 (1977) (noting significance of "political check" theory in many aspects of Court's state tax jurisprudence).

[23] *West Lynn Creamery*, 114 S. Ct. at 2215.

[24] *Id.*

[25] *Id.*

[26] *Id.* at 2216.

[27] The Court observed that "[t]he obvious impact of the order on out-of-state production demonstrates that it is simply wrong to assume that the pricing order burdens only Massachusetts consumers and dealers." *Id.* at 2217.

[28] *West Lynn Creamery*, 114 S. Ct. at 2216.

[29] 488 U.S. 252 (1989).

[30] *Id.* at 266.

preserving the Massachusetts dairy industry. It observed that "[p]reservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits,"[31] and that, for Commerce Clause purposes, the Court had "rejected any distinction 'between thriving and struggling enterprises.' "[32]

C. Justice Scalia's Concurring Opinion

Justice Antonin Scalia, joined by Justice Clarence Thomas, wrote a separate opinion concurring only in the Court's judgment. Justice Scalia's separate concurrence was motivated primarily by his unabashed hostility to the doctrine that the Commerce Clause by its own force limits state power[33] — a doctrine he has characterized as "arbitrary, conclusory, and irreconcilable with the constitutional text."[34] In Justice Scalia's eyes, the Court's Commerce Clause doctrine "lacks any clear theoretical underpinning,"[35] "takes us, self-consciously and avowedly, beyond the judicial role itself,"[36] and has spawned a "quagmire"[37] of case law reflecting "inherently unpredictable"[38] results. The explanation for the sorry state of the Court's Commerce Clause jurisprudence lies not only in the fact that "we have applied its standards poorly or inconsistently,"[39] but also "because it requires us . . . to accommodate, like a legislature, the inevitable shifting variables of a national economy."[40]

In Justice Scalia's eyes, the Court's Commerce Clause doctrine has spawned a 'quagmire' of case law reflecting 'inherently unpredictable' results.

Given Justice Scalia's attitude toward the Court's negative Commerce Clause jurisprudence, it is hardly surprising that he felt uncomfortable with the Court's opinion, which he characterized as "a broad expansion of current law."[41] In Justice Scalia's view, although the Court has frequently declared that the purpose of the Commerce Clause was to create a national market, "[i]t does not follow . . . that every state law which obstructs a national market violates the Commerce Clause."[42] Yet Scalia read the Court's opinion as saying just that. The Court, according to Scalia,

> seems to have canvassed the entire corpus of negative-Commerce-Clause opinions, culled out every free-market snippet of reasoning, and melded them into the sweeping principle that the Constitution is violated by any state law or regulation that "[a]rtificially encourag[es] in-state production even when the same goods could be produced at lower cost in other States."[43]

The implications of the Court's opinion, in Justice Scalia's judgment, "call[] into question a wide variety of state laws that have hitherto been thought permissible."[44] Among other state laws whose constitutionality is, according to Justice Scalia, thrown into doubt by the Court's opinion are most state subsidies funded from general revenues. Because general revenues include use taxes on out-of-state products, the result of the subsidy is not merely to "assist[] local business"[45] — a consequence the Court characterized as benign — but also to "burden[] interstate commerce"[46] — a consequence the Court characterized as violative of the Commerce Clause. Moreover, even where the funding does not come from taxes on out-of-state goods, the Court's reasoning would nevertheless condemn subsidies to assist local business because they "unquestionably neutralize[] advantages possessed by out-of-state enterprises."[47] Indeed, as Justice Scalia observed, such subsidies — or (what comes to the same thing) "tax forgiveness"[48] — typically have as their advertised purpose making it more profitable to conduct business within the subsidy-granting or credit-granting state.

Because of his unhappiness with the Court's rationale, Justice Scalia chose to rest his concurrence on a narrower ground that was consistent with his view that a state law may be stricken under the negative Commerce Clause only in two circumstances: (1) when the law facially discriminates against interstate commerce and (2) when it is indistinguishable from laws previously invalidated by the Court under the Commerce Clause. Applying the second criterion — the first was plainly inapplicable — Justice Scalia identified four devices that would have the same effect as the Massachusetts scheme at issue in *West Lynn Creamery*:

[31] *West Lynn Creamery*, 114 S. Ct. at 2217.

[32] *Id.* (quoting *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263, 272 (1984)).

[33] *See generally* Walter Hellerstein, "Justice Scalia and the Commerce Clause: Reflections of a State Tax Lawyer," in "Symposium: The Jurisprudence of Justice Antonin Scalia," 12 *Cardozo L. Rev.* 1763 (1991).

[34] *American Trucking Associations Inc. v. Smith*, 496 U.S. 167, 202 (1990) (Scalia, J., concurring in the judgment) (quoting David P. Currie, *The Constitution in the Supreme Court: the First Hundred Years 1789-1888* 234 (1985)).

[35] *Tyler Pipe Industries Inc. v. Department of Revenue*, 483 U.S. 232, 260 (1987) (Scalia, J., concurring in part and dissenting in part).

[36] *American Trucking Associations*, 496 U.S. at 202.

[37] *Tyler Pipe*, 483 U.S. at 259 (Scalia, J., concurring in part and dissenting in part) (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)).

[38] *American Trucking Associations*, 496 U.S. at 203 (Scalia, J., concurring in the judgment).

[39] *Id.*

[40] *Id.*

[41] *West Lynn Creamery*, 114 S. Ct. at 2218 (Scalia, J., concurring in the judgment).

[42] *Id.* at 2219.

[43] *Id.* (quoting the Court's opinion, 114 S. Ct. at 2211).

[44] *Id.*

[45] *West Lynn Creamery*, 114 S. Ct. at 2214.

[46] *Id.*

[47] *Id.* at 2219 (Scalia, J., concurring in the judgment).

[48] *Id.*

(1) a discriminatory tax upon the industry, imposing a higher liability on out-of-state members than on their in-state competitors; (2) a tax upon the industry that is nondiscriminatory in its assessment, but that has an "exemption" or "credit" for in-state members; (3) a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursed as "rebates" or "subsidies" to in-state members of the industry (the situation at issue in this case); and (4) with or without nondiscriminatory taxation of the industry, a subsidy for the in-state members of the industry, funded from the State's general revenues.[49]

The first two devices were unconstitutional under settled Commerce Clause doctrine.[50] The fourth had not been condemned under prior law and, under Justice Scalia's self-imposed restraint not to extend the negative implications of the Commerce Clause beyond its preexisting limits, it was constitutionally unobjectionable. Although regarding the question as "close," Justice Scalia concluded that the Massachusetts scheme was more closely analogous to the second device than to the fourth. It was distinguishable from the second device — discriminatory exemptions or credits from nondiscriminatory taxes — only in that "the money is taken and returned rather than simply left with the favored in-state taxpayer in the first place."[51] On the other hand, the difference between the third and fourth devices was the "difference between assisting in-state industry through discriminatory taxation, and assisting in-state industry by other means."[52] Accordingly, because the Massachusetts pricing order was essentially indistinguishable from discriminatory taxing regimes the Court had invalidated in the past on negative Commerce Clause grounds, Justice Scalia was willing to join the Court's judgment condemning it. Justice Scalia acknowledged, however, that he would "allow a State to subsidize its domestic industry so long as it does so from nondiscriminatory taxes that go into the State's general revenue fund."[53]

D. The Dissent

Chief Justice William H. Rehnquist, who has generally been unfriendly to Commerce Clause challenges to state taxing and regulatory schemes, dissented from the Court's judgment in an opinion that Justice Blackmun joined. Stressing the plight of the depressed dairy industry in Massachusetts and the state's legitimate interest in protecting it, the Chief Justice found the coupling of a nondiscriminatory tax and a subsidy for local producers constitutionally inoffensive. Unlike minimum price legislation that the Court had condemned in the past because it neutralized the advantages enjoyed by low-cost producers, Chief Justice Rehnquist observed, Massachusetts milk dealers still had the same incentives to purchase lower-priced milk from out-of-state producers. Moreover, he found the analogy the Court drew between the Massachusetts scheme and the discriminatory tax exemption struck down in *Bacchus* "strained"[54] because the rebate did not go to the taxpayers (the milk dealers) but rather to dairy farmers.

II. Implications

The relatively unusual facts of *West Lynn Creamery* — a nondiscriminatory tax[55] linked to a direct subsidy for local business — diminishes its immediate consequences for existing state and local tax regimes. Moreover, the ease with which the states can apparently avoid the precise holding of the decision — by funding subsidies for local business out of general revenues[56] — further reduces the direct impact of the case. However, one cannot dismiss so quickly the Court's reaffirmation of the fundamental principle that broad-based taxes coupled with narrowly focused credits or exemptions favoring local interests offends the negative Commerce Clause. It suggests that provisions commonly found in state tax statutes across the country — a tax credit or exemption targeted to specific in-state activity — may be vulnerable to constitutional challenge.

A. State Tax Credits and Targeted Exemptions

The statute books are filled with tax credits and exemptions that arguably violate the Court's proscription of exemptions from or credits against nondiscriminatory exactions that are limited to those engaged in local activities. Such provisions are most commonly found in income tax statutes. For example, Alabama provides an income tax credit for new investment in Alabama;[57] Alaska provides an income tax credit for investment in gas processing and mineral development facilities in Alaska;[58] Arizona provides an income tax credit for taxpayers that increase research activities in Arizona;[59] Arkansas provides an income tax credit for any motion picture production company that spends more than a specified amount producing films in Arkansas;[60] California provides an income tax credit for hiring unemployed residents of high-density unemployment areas in California;[61] Colorado provides

[49] *Id.* at 2220.

[50] *See, e.g., Guy v. Baltimore*, 100 U.S. 434 (1880) (invalidating tax applied only to out-of-state products); *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984) (invalidating tax credit proportioned to extent of in-state activity).

[51] *West Lynn Creamery*, 112 S. Ct. at 2220-21 (Scalia, J., concurring in the judgment).

[52] *Id.* at 2221.

[53] *Id.*

[54] *Id.* at 2223 (Rehnquist, C.J., dissenting).

[55] Although the case technically involved a pricing order rather than a tax, the Court treated the pricing order as a tax, *see* text accompanying note 12 *supra*, and it is therefore appropriate to read the opinion under the same assumption that the Court wrote it.

[56] The five-member majority indicated that such subsidies are "ordinarily" constitutionally unobjectionable. *See* text accompanying notes 16-17 & n.16 *supra*. The four concurring and dissenting Justices believe that such subsidies are always unobjectionable. *See* text accompanying notes 53-54 *supra*.

[57] Ala. Code section 41-23-24(a) (1991).

[58] Alaska Stat. section 43.20.042 (1990).

[59] Ariz. Rev. Stat. Ann. section 43-1168 (Supp. 1993).

[60] Ark. Code Ann. section 26-4-206 (1992).

[61] Cal. Rev. & Tax. Code section 23623 (West Supp. 1994).

an income tax credit for investment in qualifying Colorado property;[62] Connecticut provides an income tax credit for investing in certain new manufacturing facilities in Connecticut;[63] Delaware provides an income tax credit for investing in qualified new business facilities in Delaware;[64] Florida provides an income tax credit for investments in Florida export finance corporations;[65] Georgia provides an income tax credit for taxpayers that increase employment by 10 or more in designated counties in Georgia;[66] and so forth.[67]

The statute books are filled with tax credits and exemptions that arguably violate the Court's proscription.

Most states also provide sales and use tax incentives to encourage new or expanded industry within the state. Thus, states provide sales and use tax refunds, credits, or exemptions for the construction or improvement of existing facilities, the relocation or expansion of a business, the hiring of new employees, etc.[68] Similarly, a number of states provide property tax incentives for new or expanded facilities in the state.[69] In contrast to the income tax credits described in the preceding paragraph, however, property and sales tax incentives are often coextensive with the property values or sales receipts that are potentially subject to tax. In such cases, it is more difficult to contend that the incentive favors local over out-of-state activity, because the taxpayer does not reduce its liability for a tax otherwise due by engaging in local activity.

B. Pre-*West Lynn Creamery* Precedents

West Lynn Creamery was not the first case to address the question of the constitutionality of a state tax incentive that took the form of a selective credit or exemption from a broad-based tax. Indeed, the Court has handed down several decisions in recent years that provided the doctrinal underpinnings for the opinion in *West Lynn Creamery*. These decisions, along with *West Lynn Creamery*, may put some of the provisions described above in constitutional jeopardy.

1. ***Boston Stock Exchange.*** In *Boston Stock Exchange v. State Tax Commission*,[70] the Court considered a New York stock transfer tax scheme that provided reduced rates for certain transfers of stock through New York transfer agents when the sale of the stock was effected through the New York Stock Exchange. The taxing scheme was specifically intended to improve the competitive position of local vis-à-vis out-of-state stock exchanges by inducing sellers to use local brokers in order to reduce their stock transfer tax liability.[71] The Court struck down the tax, observing:

> The obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges. Rather than compensating New York for a supposed competitive disadvantage resulting from [the former statute], the amendment [providing the tax break] forecloses tax-neutral decisions and creates both an advantage for the exchanges in New York and a discriminatory burden on commerce to her sister States.[72]

2. ***Maryland v. Louisiana.*** In *Maryland v. Louisiana*,[73] the Court invalidated Louisiana's first-use tax on natural gas because various credits and exclusions that were available only to local interests effectively insulated local interests from the tax and discriminated against out-of-state enterprises.[74] The "obvious" effect of the favoritism toward local interests — in particular the credits against the tax for other taxes paid on local activities — was to encourage natural gas owners to undertake specified activity in Louisiana rather than in other states.[75] Although the precise amount of discrimination had not been determined, the Court declared that "[w]e need not know how unequal the Tax is before concluding that it unconstitutionally discriminates."[76]

3. ***Bacchus.*** In *Bacchus Imports, Ltd. v. Dias*,[77] which the Court relied on heavily in *West Lynn Creamery*, the Court struck down an exemption for locally produced alcoholic beverages from an excise tax on the wholesale sale of liquors. The holding on the Commerce Clause issue followed inexorably from settled principles of Commerce Clause adjudication. The tax plainly discriminated against interstate commerce by providing a direct commercial advantage to local business. The state sought to avoid the force of this principle on several grounds. It contended that the locally produced beverages in question did not compete with other products sold by the wholesalers and that this in substance mooted the Commerce Clause issue. The Court rejected this argument on the ground that some competition existed between the exempted and the nonexempted liquors and that the extent of the competition was irrelevant under Commerce Clause analysis. The state also claimed that its exemption was designed to promote a struggling industry, but the Court refused to draw a distinction between struggling and thriving industries for Commerce Clause purposes.

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[62] Colo. Rev. Stat. 39-22-507.6 (Supp. 1992).

[63] Conn. Gen. Stat. Ann. section 12-217e (West 1993).

[64] Del. Code Ann. tit. 30, section 2011(a) (1985).

[65] Fla. Stat. Ann. section 220.188 (Harrison 1990).

[66] Ga. Code Ann. section 48-7-40(e) (Supp. 1994).

[67] One could continue to proceed alphabetically through the states with similar examples. *See* 1 *Multistate Corporate Income Tax Guide* (CCH) para. 180 (1994).

[68] *See generally* 1 *Multistate Sales Tax Guide* (CCH) para. 975 (1994).

[69] *See* 2 *State Tax Guide* (CCH) para. 20-200 *et seq.* (1994).

[70] 429 U.S. 318, 329 (1977).

[71] The stock transfer tax would generally be applicable even if the sale was effected through an out-of-state broker because some aspect of the stock transfer, e.g., the issuance of the stock certificate, was accomplished in New York.

[72] *Boston Stock Exchange*, 429 U.S. at 331.

[73] 451 U.S. 725 (1981).

[74] *Id.* at 756.

[75] *Id.* at 757.

[76] *Id.* at 760.

[77] 468 U.S. 263 (1984).

4. ***Westinghouse.*** In an effort to provide tax incentives for American corporations to increase their exports and to help solve the nation's balance of payments problems, Congress, in 1971, accorded preferred status to an entity it denominated a Domestic International Sales Corporation (DISC).[78] Under the federal tax laws, DISCs were not taxable on their income, and their shareholders were taxable only on a portion of such income. Unlike the federal tax code, New York's corporate franchise tax included DISC income in the tax base by combining the income of the DISC and its parent.[79] At the same time, in order to encourage DISC activity in New York, the state provided a credit against the corporate franchise tax for the portion of the tax attributable to the federally exempt DISC income included in the New York tax base.[80] The credit was limited, however, by reference to the percentage of DISC receipts from export shipments from New York.[81] As a result, New York taxed the income attributable to export shipments from New York at 30 percent of the rate applicable to income attributable to export shipments to other states.

In *Westinghouse Electric Corp. v. Tully*,[82] the Court held that the credit discriminated against interstate commerce in violation of the Commerce Clause. The credit transgressed the fundamental principle that "[n]o State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.'"[83] Furthermore, by encouraging the diversion of DISC-related activity to and the discouragement of DISC-related activity from the state, New York had " 'foreclose[d] tax neutral decisions and . . . created . . . an advantage' for firms operating in New York by placing 'a discriminatory burden on commerce to its sister States.' "[84]

5. ***New Energy.*** The Court's most recent encounter with state tax incentives prior to *West Lynn Creamery* occurred in *New Energy Co. of Indiana v. Limbach*,[85] a case the *West Lynn Creamery* Court cited throughout its opinion. In *New Energy*, the Court struck down an Ohio fuel tax credit for fuel dealers who sold gasohol because the credit was limited to gasohol produced in Ohio or in states that provided reciprocal advantages to Ohio-produced gasohol. The Court observed that the tax credit discriminated on its face against interstate commerce by explicitly depriving "certain products of generally available beneficial tax treatment because they are made in other States."[86]

C. Assessing the Constitutionality of Incentives

West Lynn Creamery and the decisions on which it rests reaffirm the Court's strong stance against state taxes that favor local over out-of-state activities and cast a constitutional pall over state tax incentives embodied in many state taxing statutes. The principle emerging from these cases is simple enough: the incentive must not discriminate against conduct of activity in other states, although it may encourage in-state activity by reducing the tax burden on particular classes of activities without regard to their geographic location. The various income tax credits described above,[87] for example, would appear to be vulnerable under a straightforward application of this principle. Thus, if one is given a credit for creating new jobs, investing in facilities, or conducting certain activities in the taxing state but not in other states, such a credit would appear to be invalid under the reasoning of such cases as *Westinghouse*, *Boston Stock Exchange*, and *Maryland v. Louisiana*, even though these incentive programs may be motivated by the states' benign purpose of "structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[88]

> ***West Lynn Creamery and the decisions on which it rests cast a constitutional pall over state tax incentives embodied in many state taxing statutes.***

Although we have yet to see many constitutional attacks on these tax incentive provisions, one recent challenge reinforces the conclusion suggested above. Wisconsin generally conforms to the Internal Revenue Code in determining a taxpayer's apportionable tax base. The conformity includes adoption of the federal depreciation rules. For the tax years in question, however, while the Wisconsin statutes permitted depreciation deductions for property located in Wisconsin to be taken according to the federal Accelerated Cost Recovery System (ACRS), depreciation deductions for property located outside Wisconsin had to be taken according to the slower (and, therefore, less favorable) depreciation methods provided by prior federal law.

Such a limitation of ACRS depreciation to in-state property might easily be characterized as a tax incentive program designed "to encourage the growth and development of intrastate commerce and industry."[89] Nevertheless, in *Beatrice Cheese Inc. v. Wisconsin Department of Revenue*,[90] the Wisconsin Tax Appeals Commission struck down the limitation as violative of the Commerce Clause. The commission declared:

> The effect of this differential treatment, apparent from the language of the statute under attack, is to

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[78] IRC sections 991-97. In 1984, Congress largely repealed the DISC legislation and replaced it with special provisions governing new entities it described as foreign sales corporations (FSCs). IRC sections 921-27.

[79] N.Y. Tax Law, former section 208.9(i)(B).

[80] N.Y. Tax Law, former section 210.13(a).

[81] N.Y. Tax Law, former sections 210.13(a)(1) - (a)(6).

[82] 466 U.S. 388 (1984).

[83] *Id.* at 403 (quoting *Boston Stock Exchange*, 429 U.S. at 329 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959))).

[84] *Westinghouse*, 466 U.S. at 406 (quoting *Boston Stock Exchange*, 429 U.S. at 331).

[85] 486 U.S. 269 (1988).

[86] *Id.* at 274.

[87] *See* text accompanying notes 57-66 *supra*.

[88] *Boston Stock Exchange*, 429 U.S. at 336.

[89] *Id.*

[90] 2 [Wis.] *St. Tax Rptr.* (CCH) para. 203-396 (1993).

impose a higher franchise tax burden on a business solely because some or all of its depreciable property is located outside rather than inside the confines of the state of Wisconsin. This is clearly facial discrimination against interstate commerce and runs afoul of a long line of court decisions invalidating such state tax provisions as violative of the Commerce Clause of the United States Constitution.[91]

Analogous reasoning would invalidate many of the tax incentives described above. This is not to suggest, however, that they would all necessarily be struck down. If, for example, the credit was fairly apportioned to the in-state income (in contrast to the skewed credit in *Westinghouse*), the credit would likely pass muster. Moreover, if particular requirements for obtaining the credit were not met in other states, one might argue that the credit should survive constitutional scrutiny — although such an argument would be difficult to reconcile with the Court's doctrine that it is the risk of burdens on interstate commerce — not merely their actuality — that violates the Commerce Clause.[92] Furthermore, despite the Court's admonition that the states may not "foreclose tax neutral decisions,"[93] it would be astonishing if the Court were to strike down exemptions or credits that are coextensive with the base that the state seeks to tax (*e.g.*, an exemption for new construction from property taxation). Such incentives put no additional burden on a taxpayer for conducting activity outside the taxing state; they merely remove the potential burden the taxpayer may incur from engaging in local activity.[94]

III. Conclusion

As this brief (and preliminary[95]) analysis of *West Lynn Creamery* and the constitutionality of state incentives suggests, there are many state taxing statutes that appear vulnerable to constitutional attack on the basis of *West Lynn Creamery* and the precedents on which it rests. We have, however, just begun to explore the constitutional questions raised by state tax incentives, and it is doubtful that *West Lynn Creamery* will be the Court's last word on this subject.

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[91] *Id.* at 15,076.

[92] *See* Walter Hellerstein," Is "Internal Consistency" Foolish?: Reflections on an Emerging Commerce Clause Restraint on State Taxation," 87 *Mich. L. Rev.* 138, 165-70 (1988). Whatever else may be said about these tax incentive statutes, they do not appear to violate the Court's "internal consistency" doctrine. Under the "internal consistency" doctrine, a tax must not impose a greater burden on interstate commerce than on intrastate commerce on assumption that every state has adopted the tax in question. Most state tax incentives of the type described above will pass the "internal consistency" test, because if every state adopted the challenged incentive, then the taxpayer would enjoy the benefits of the incentive regardless of the state in which the taxpayer conducted its activity.

[93] *Boston Stock Exchange*, 429 U.S. at 331.

[94] Whether this suggested distinction can withstand more protracted analysis remains to be seen, however. *See* note 95 *infra*.

[95] I am currently preparing a more thorough and systematic treatment of the constitutionality of state tax incentives, which will be forthcoming in due course.

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