Cuno and Competitiveness: Where to Draw the Line

Walter Hellerstein
University of Georgia School of Law

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CUNO AND COMPETITIVENESS:
WHERE TO DRAW THE LINE

HEARING
BEFORE THE
SUBCOMMITTEE ON INTERNATIONAL TRADE
OF THE
COMMITTEE ON FINANCE
UNITED STATES SENATE
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States, and we think is important to the effective functioning of the Economic Development Act.

That, just briefly, says that “nothing in this section shall be construed to create any inference with respect to the validity or invalidity under the Commerce Clause of the U.S. Constitution of any tax incentive described in this section.”

Briefly put, what that says is, if an incentive is found to run afoul of one of the restrictions in section 3A, it is not, per se, invalid. Instead, there would need to be a separate determination by the Court, whoever is considering it, that it rose to the levels of impermissible discrimination under the Commerce Clause. We think this is important in preserving the situation as it existed prior to Cuno, and does in fact do a lot to alleviate some of the uncertainty.

Thank you, Mr. Chairman.

Senator THOMAS. Thank you, sir. Appreciate it.

[The prepared statement of Mr. Duncan appears in the appendix.]

Senator THOMAS. Mr. Hellerstein?

STATEMENT OF WALTER HELLERSTEIN, FRANCIS SHACKELFORD DISTINGUISHED PROFESSOR OF TAXATION LAW, UNIVERSITY OF GEORGIA SCHOOL OF LAW, ATHENS, GA

Mr. HELLERSTEIN. Thank you very much, Mr. Chairman. I am honored by the invitation to testify before you today. My testimony can be summarized in two sentences.

Mr. HELLERSTEIN. First, Congress should draw a line between acceptable economic development incentives and unacceptable State tax discrimination. Second, in doing so, Congress should act very, very carefully.

Why should it draw a line? It should draw a line because the law in this area is, as the Supreme Court itself has said, a quagmire and, as I have said somewhat less charitably, a mess.

While the Court has said, as Professor Enrich suggests, that discrimination is one of the basic principles, what is discrimination? The Cuno case is a poster child for this problem.

The Court held that, on the one hand, an investment tax credit to attract business to the State is unconstitutional, but a property tax exemption to attract business to the State is constitutional. How can that be? Well, I must confess, I wrote a Law Review article drawing just that distinction, which the Court relied on.

But Professor Enrich, in his Law Review article, thinks all this stuff is unconstitutional. Other people who have written Law Review articles say that none of it is unconstitutional. The point of the matter is, there is no agreement as to what discrimination means. The Cuno case, I think, demonstrates that.

There is, as Senator Voinovich has suggested, litigation all over this country, and as Mr. Duncan has suggested, tax incentives all over the country. It is anybody’s guess as to whether or not these will or will not survive constitutional scrutiny.

The uncertainty created by this, which has been alluded to by Senator Voinovich, is very serious, both, from a taxpayer standpoint, in terms of what they have relied on in the past and what they may rely on in the future.
In terms of States, if States lose these cases, under Supreme Court doctrine they have to provide meaningful backward-looking relief. That could mean coughing up hundreds and millions of dollars to those who were discriminated against. In the future, budgetary considerations are quite uncertain.

The answer to this is not going to come from the courts. Supreme Court Justice Frankfurter said, “At best, the Court can only act negatively. It can determine whether a specific State tax is imposed in violation of the Commerce Clause.

“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. The problem calls for a solution by devising a Congressional policy.”

In short, the problem raised by *Cuno* is much broader than *Cuno* itself. Unless Congress acts, I think we will remain in the “mess that we are in.”

How should Congress draw the line? Here, I think the message is—and in this sense I agree with much of what Professor Enrich said—very, very carefully. One person’s economic development incentive is another person’s discriminatory tax. When New York tried to lure business to the New York Stock Exchange, that was an economic incentive to New York. That was a discriminatory tax to the Boston Stock Exchange.

When Hawaii decided to develop its fledgling pineapple wine industry, that was just an economic development incentive to Hawaii. That was a discriminatory tax to those selling liquor from out of State, and the Court struck it down. The Court struck down the New York case.

Again, New York wanted to induce export shipment from the State in the *Westinghouse* case. Westinghouse said that was a discriminatory tax, even though to others that was an incentive. So the line between these is very thin, and I think Congress must act with extraordinary care in doing this.

Just one recent example: Missouri. Two weeks ago today, the Missouri legislature, by a vote of 152 to 1, did something that makes a lot of sense. They said, look, we want people to buy cars that are manufactured in Missouri, so we will just exempt them from Missouri sales and use tax. Well, that is fine.

But suppose the car is manufactured in Illinois or in Michigan? It does not take a Nobel Prize-winning economist to realize that that may be an incentive that Congress would rather not bless. So my point here is, simply, you must act with extraordinary care in drawing this line, although I think it is terribly important, for the reasons I have suggested, to draw that line.

In an attachment to this testimony, with which I will not burden this hearing, I have suggested a number of technical suggestions that I think address a number of the problems that Professor Enrich was referring to.

I think the Voinovich bill makes an excellent start at this process, but I do think that it needs some additional fine tuning in order to make sure that Congress is not throwing out the baby with the bath water.

Thank you very much.

Senator THOMAS. Thank you, sir.
Yet, these countries have much lower operating costs to begin with. Looking at the economic growth these countries have achieved over the last decade, it is difficult not to surmise that their policies to encourage new jobs and investment in their countries have been effective.

The United States is the greatest country in the world and has the most robust and productive economy the world has ever known. These benefits stem from the belief in the power of competition, and free markets to reward innovation and risk-taking.

Competition makes us all better and more focused on achieving positive results. Federal legislation which would impede the ability of States to control their economic destiny, in the face of increasingly intense global competition, would be short-sighted and detrimental to the American worker, American investors, and American institutions.

In the best tradition of States’ rights, this is an area where the State political process should be used to weigh the pros and cons of any individual tax credit or incentives policy.

Thank you very much.

[The prepared statement of Mr. Renzas appears in the appendix.]

Senator THOMAS. Thank you. That is a very impressive panel.

We thank you so much.

We will ask some fairly short questions. I hope you can give us some fairly short answers. We are kind of pushed. We are going to start voting at 10:30, I believe, and maybe go on through the day. It does not sound good.

Dr. Fisher, you have made the case that there is evidence suggesting State tax incentives are not effective. Assuming for a moment you are correct, how does it make them unconstitutional, and how can you tell States they are not permitted to offer them without infringing on their taxing jurisdiction?

Dr. FISHER. Well, I think you started out with an economic question and ended with a legal one. Maybe I would have to defer the latter part of that to another member of the panel.

But I would simply say that any legislation is designed to clarify the issues in this area. I would recommend that it be drawn in a way that is restrictive of the States and actually reduces the use of this particular kind of weapon in the economic war among the States.

Senator THOMAS. So you maintain it is ineffective.

Dr. FISHER. I maintain that they are largely ineffective. Not completely ineffective.

Senator THOMAS. I understand.

Dr. FISHER. And very expensive.

Senator THOMAS. Professor Enrich, you have argued incentives are not material to the taxpayers’ investment decisions. I am curious whether you have return-on-investment information on investments made with the help of those incentives versus those without the benefits.

Professor ENRICH. Senator, again, you are asking the legal expert the economic question. In the course of my scholarship and in the course of my work as a State official, I have had the occasion to look at a lot of evidence about the size of differences the tax incentives do make to business bottom lines.
I do not hold myself out as an economist or an expert, but the overwhelming evidence is that tax incentives offered at the State level are not terribly effective.

When I was general counsel to Massachusetts’ Executive Office for Administration and Finance, I had the opportunity to oversee a task force that was putting together a document that was discussing how Massachusetts had effected economic growth. We found a lot of ways that it had. We ended up deleting the entire chapter we were planning to write about the efficacy of tax incentives because the evidence simply did not bear it out.

Senator Thomas. Would you not imagine that if that were true, the State tax people would not use it?

Professor Enrich. The political pressures on State political policy makers to adopt tax incentives, especially when other States are adopting them, are intense.

Senator Thomas. All right.

Professor Enrich. And I think the whole reason that the Commerce Clause steps into these areas, is to protect States from that inevitable competition.

Senator Thomas. Thank you.

Mr. Hellerstein, if the Court dismisses or overturns the Sixth Circuit decision, should Congress act to allow State and local incentives?

Mr. Hellerstein. Yes, for the reasons I have suggested. The law will remain indeterminate. All the Court will do is decide this case, about this one particular incentive. It will leave open for debate and certainty all of the incentives all over the country.

Senator Thomas. All right. Thank you.

Senator Bingaman?

Senator Bingaman. Thank you all for your testimony.

It strikes me, what we are talking about here are several different things. First, there is the legal question that is posed by the Cuno decision, and whether or not there is a legal prohibition against States and localities providing these types of tax incentives. Then there is the larger policy question about whether it is good policy.

As regards the second of those questions, policy, it strikes me, there are two different competitions that we are talking about. One is the competition among States and among communities. The other, of course, is the competition that our entire country faces relative to the rest of the world.

Now, I do think, myself, I have seen examples in my State where companies were solicited to move to Ireland, or to Singapore, or wherever it happens to be. Frankly, it is not a very fair competition.

It strikes me that this really, as a matter of policy, ought to be done at the Federal level. I mean, if, in fact, we are going to provide some kind of response to the very substantial tax incentives
provided by other countries, we should be doing that at the Federal level.

Our Department of Commerce or someone in the Federal Government ought to be empowered to counter those kinds of offers or deal with it in some way. If we do not do that, if we are not willing to do that or smart enough to do that, which has been the case so far, it strikes me as problematic to say that States and localities are also prohibited from competing to keep those jobs. I mean, I do not know how effective their competition is through tax incentives, but I would hesitate to pass a law saying you are prohibited from doing anything.

Not only will we not do it at the Federal level, we will not do anything at the Federal level to keep Ireland from wooing more and more of our manufacturing to Ireland, but we will not allow States to do it either, and we will not allow communities to do it either. So, that is sort of the circumstance I find myself in. I do not know exactly what question to pose to any of you.

I guess one obvious question is, if we are in fact going to restrict States and localities from doing some of these things by statute, as Senator Voinovich has recommended, should we not take on some responsibility at the Federal level to at least respond in this competition we have with foreign governments? Professor Enrich?

Professor ENRICH. I think you are entirely correct, that there is an important role for the Federal Government to play in this area. It may even be an important role for the Federal Government to identify specific ways in which States can use their tax systems to further the Federal effort at competing internationally. That is not what is happening now.

What is happening now is the States are predominantly competing among themselves. It is a grossly inefficient way to compete internationally, and it is having the consequence of really hurting us in international competitiveness.

I know I was out in New Mexico talking to tax practitioners there last week. The problem they are seeing is, because of the tax breaks that New Mexico is having to give to compete with other States, they are losing the funding they need to support a strong educational system and strong infrastructure, which would enhance international competitiveness.

Senator BINGAMAN. Do any of the others have comments on that issue? Nobody?

Dr. FISHER. I would.

Senator BINGAMAN. Go ahead, please.

Dr. FISHER. I would agree with what Peter Enrich just said. I would point out that there are lots of ways of competing. Labor costs, for example, are about 14 times the average State and local tax cost.

Efforts to enhance labor productivity are probably, therefore, much more important than to make a small change—even a large change—in the State and local tax bill, which is not going to be able to offset much of a difference in labor costs. It would simply be swamped by differences in labor costs. I think the question is not whether they can occasionally be effective.

The question is, what is the most cost-effective use of limited resources? I would argue that investments in education, particularly
at this juncture, are a much more cost-effective use of our scarce resources than competing with one another on the taxes.

Senator BINGAMAN. Thank you, Mr. Chairman.

Senator THOMAS. Thank you, sir.

Mr. Duncan, do you think the Court’s decision in this case, regardless of whether they uphold the law, will provide sufficient clarity regarding what is permitted and what is not?

Mr. DUNCAN. I think it is always problematic to project what the Court might do. They most likely will take the narrowest approach that they can to try to deal with it in the fashion that they want. So it is not going to clarify the field and make everything crystal clear.

But they will certainly have an opportunity to speak to where a lot of legal commentators believe Cuno went—which was much farther than other courts have gone—in trying to differentiate between efforts to benefit in-State as opposed to penalizing out-of-State businesses.

So I think they will probably be narrow and not clarify everything, but they can probably take away a fair amount of uncertainty over the sort of plain old vanilla investment tax credits as well.

Senator THOMAS. Thank you.

Professor Enrich, is there precedent for Congress overturning a Court ruling involving this type of Commerce Clause issue?

Professor ENRICH. Senator, there is no question that Congress has the ultimate authority in areas affected by the Commerce Clause. The challenge is to use that power wisely, and I trust the Senate will struggle with that.

Senator THOMAS. Wisely? All right. So there is an opportunity to do that, to come in and fill the holes that might be left by the decision.

Professor ENRICH. Not just to fill the holes.

Senator THOMAS. Even if overturned.

Professor ENRICH. It is a grant of authority to Congress. The courts have played the role of stepping in where Congress has not acted. Congress certainly has the power, and in previous instances has exercised that power, to supersede decisions that the courts have made.

Senator THOMAS. Mr. Hellerstein, do you want to comment on that?

Mr. HELLERSTEIN. Well, again, clearly Congress has the power. There is historical precedent for Congress reacting to Supreme Court precedents, indeed, a precedent which allowed the States to tax. Congress turned around and said the States could not.

I just want to return for a moment, without keeping you from your vote, to what Senator Bingaman was suggesting. I think it is very important to keep in mind that there are two issues here. The one that Senator Bingaman spoke about as a bigger problem, which I think is not within my area of expertise, is terribly important, but we should not let the problems with that issue, I think, stop Congress from resolving the sort of narrow or legal problem of clearing up this uncertainty. Even assuming we can keep the law as it is, at least let us make it clearer. That is my plea to you.
Senator Thomas. Thank you.

Mr. Renzas, what ramifications, if any, do State laws like the one at issue here have on the international trade arena, in your judgment?

Mr. Renzas. Well, obviously the ability of States to provide incentives currently, as they are doing right now, gives them an opportunity to compete against some of these countries that are offering very lucrative incentives for American manufacturing jobs, and other types of jobs. We have one right now, for example, a $500 million investment, high technology, that is looking at Canada and the United States. It is down to the point where there are two finalist locations, one in the United States and one in Canada. It is a German company.

They stated, if this location in the United States is not able to provide enough incentives, they will go to Canada. That will be high-technology jobs in a very lucrative industry that will be moving to another country as a result of this.

So, yes, it is very important. To the extent that you can give States—or the U.S. Government can provide those kinds of incentives to stem the tide of those jobs elsewhere, it is a very, very important issue.

Senator Thomas. It gets to be a little sticky as to whether that is done to compete with Canada or to compete with Colorado, is it not?

Mr. Renzas. That is going to be the issue that Congress is going to have to deal with.

Senator Thomas. Mr. Duncan, or whoever, how many States offer investment tax credits similar to the one in question in the Cuno case, do you know?

Mr. Duncan. I do not have an exact number, but I think you can guarantee yourself it is at least 35.

Senator Thomas. Is that right, around that? Are there States or localities who publicly sided with the plaintiffs against the tax incentive, and, if so, what is the division among the States, Mr. Renzas? Do you know?

Mr. Renzas. I do not know which States have sided against the tax incentives. I am not aware of that. Most States are reluctant to take that position because it is really going to hurt their economic development competitiveness right now.

Senator Thomas. Mr. Duncan, do you have a thought on that?

Mr. Duncan. I would turn to the counsel in the case.

Senator Thomas. All right.

Professor Enrich. There was an amicus brief on behalf of the State of Ohio that was signed by 34 States, almost to all States, who did have similar issues that they were appropriately seeking to defend.

Senator Thomas. I see. All right. Thank you.

Senator Bingaman. Let me ask, Dr. Fisher, based on your analysis of the economics, if you were to assume that tax incentives can impact on the decision to locate a plant or to maintain an operation, to some extent, to what extent does the possibility of Federal tax incentives compare to the possibility of State and local tax incentives?
My impression is, and I think one of you testified to the effect that, there is a substantially greater capability at the Federal level to provide financial incentives through the tax code than there is at the State and local levels, so you have State and local governments essentially giving away the fairly modest taxing authority that they have to get these jobs to locate there, where the Federal Government could do much more if it were so inclined. Do you have any thoughts on that?

Dr. Fisher. I think, if you take the corporate income tax, I think the Federal is, on average, probably about six times the State. The top Federal rate is still 35 percent and the average State rate, I think, is around 6 percent. So, clearly, there is a great deal more leverage internationally with adoption of incentives as part of the Federal tax than State and corporate income tax.

Senator Bingaman. All right. That is all I have, Mr. Chairman.

Senator Thomas. I cannot help but think, as you talk, that this is sort of a challenge to the Federal Government, to make their taxes competitive with the rest of the world if we are going to have people come to this country.

Gentlemen, thank you so very much. I think this is a most interesting issue, certainly one in which both the courts and the Congress is involved. You have brought us some very important issues and information, and we thank you so much for it. Some might have some further questions for you in the next 24 hours, and I hope you will respond to them. Thank you.

The hearing is adjourned.

[Whereupon, at 10:29 a.m., the hearing was concluded.]
Testimony of Walter Hellerstein

Before the

Subcommittee on International Trade

of the

Committee on Finance
United States Senate

Hearing on

“Cuno and Competitiveness: Where to Draw the Line”

March 16, 2006
I am Walter Hellerstein, the Francis Shackelford Professor of Taxation at the University of Georgia School of Law. I have devoted most of my professional life to the study and practice of state taxation and, in particular, to state taxation of interstate commerce and the federal constitutional restraints on such taxation.

I am honored by the Chairman’s invitation to testify today. I welcome the opportunity to share with the Subcommittee my views on whether Congress should draw a line between appropriate economic development incentives and inappropriate state tax discrimination and, if so, how Congress should draw that line. I do not appear here on behalf of any client, public or private, and the views I am expressing here today reflect my independent professional judgment.¹

My testimony can be succinctly summarized in two sentences. First, I believe Congress should draw a line between appropriate economic development incentives and inappropriate state tax discrimination. Second, I believe Congress should act with extraordinary care in drawing that line.

I. 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,² and things have not gotten much better.³ 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 earlier this year before a House Subcommittee looking into the Cuno problem,⁴ perhaps the one point on which virtually all observers would agree is

¹ In the interest of full disclosure, it should be noted that I am of counsel to Sutherland Asbill & Brennan LLP; Sutherland is counsel to the Council On State Taxation (COST), which is actively supporting a congressional resolution of the state tax incentive issue raised by Cuno v. DaimlerChrysler. As I have just stated, however, the following testimony represents my independent professional judgment, and it does not necessarily represent the views of any institution or organization with which I am affiliated.


that “the law in this area is indeterminate,” and that, “[i]f less charitably put, it is a mess, albeit a mess that keeps many lawyers and law professors busy.”

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? But Cuno is just the tip of the iceberg. 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 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.

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6 Id. at 10.

7 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 that 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.


10 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.

11 Id. at 329 (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)).
Right now, for example, in Wisconsin, the state 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,\(^\text{11}\) a question that the Wisconsin Court of Appeals certified to the state 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.”\(^\text{12}\) 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.\(^\text{13}\) I could have chosen a similar example from virtually any other state.

The problem created by this uncertainty for taxpayers and taxing authorities alike is self-evident. Taxpayers who have reasonably relied on these economic development incentives in the past have no assurance that these provisions will survive 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

\(^{11}\) *Northwest Airlines, Inc v. Wisconsin Dep’t of Revenue*, 281 Wis. 2d 117, 697 N.W.2d 475 (2005).


\(^{13}\) 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 … employs 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 jobs.

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 $300,000 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.
light of the constitutional requirement that those who have been the victim of unconstitutional state tax discrimination are entitled to "meaningful backward-looking relief." 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 testify 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.

That solution will not come from the U.S. Supreme Court or from other courts that are bound to follow its guidance. As Justice 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.15

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 earlier this 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."16


16 Hellerstein, supra note 4, at 13.
II. 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. New York’s “economic development incentive” was “discriminatory” to the wine industry that was sold to sellers of alcoholic beverages produced in other states, a view with which the U.S. Supreme Court concurred. New York’s “economic development incentive” for business involved in export shipment from New York was a “discriminatory tax” to those making export shipments from other states, a view with which the U.S. Supreme Court concurred. 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. 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,” or, 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. Two weeks ago today 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.” 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.

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 Senator Voinovich and Representative Tiberi\(^\text{22}\) 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.

Attached to this testimony is my analysis of this proposed legislation from a technical standpoint. Specifically, it describes how it would modify the constitutional landscape reflected in \textit{Cuno}. Insofar as I suggest changes in the proposed statute, it is my intention to improve upon legislation that I support in principle and, with the changes suggested, would support in practice as a technically sound implementation of what I perceive to be the proposed legislation’s apparent intent.

* * *

Once again, I thank the Chairman for inviting me to testify before this Subcommittee, and I will be happy to respond to any questions or to provide any other assistance that the Chairman or other Members of the Subcommittee may find helpful.

\(^{22}\) See S. 1066, 109\textsuperscript{th} Cong., 1\textsuperscript{st} Sess. (2005); H.R. 2471, 109\textsuperscript{th} Cong., 1\textsuperscript{st} Sess. (2005).
CUNO AND CONGRESS: AN ANALYSIS OF PROPOSED FEDERAL LEGISLATION AUTHORIZING STATE ECONOMIC DEVELOPMENT INCENTIVES

Walter Hellerstein*

INTRODUCTION

If anything is clear about Cuno¹ and the controversy the opinion has spawned, it is that Congress has the last word on the matter. Whether Congress will speak to the issues Cuno has raised is currently an open question, although in one narrow respect Congress already has.² Broader legislation, however, has been introduced into Congress as the “Economic Development Act of 2005,”³ and debate over the efficacy and wisdom of this proposal is as intense as the debate over the defensibility of Cuno itself.⁴ My purpose here is not to join that debate, although I am already on record as supporting in principle broad legislation that will draw a clear line between appropriate state tax incentives and

* Francis Shackelford Professor of Taxation, University of Georgia Law School, Athens, Georgia. I would like to thank Dan Coenen, Jeffrey Friedman, and James C. Smith for their helpful comments on an earlier draft of this article. All errors or omissions are my own.

¹ Cuno v. DaimlerChrysler, Inc., 386 F.3d 738 (6th Cir. 2004), petitions for cert. granted sub nom. DaimlerChrysler Corp. v. Cuno (No. 04-1704) and Wilkins v. Cuno (No. 04-1724) (Sept. 27, 2005).

² See infra notes 117-118 and accompanying text.


⁴ See, e.g., Chris Atkins, Ohio Investment Credit Decision: A Pyrrhic Victory for Economic Neutrality, ST. TAX NOTES at 772 (June 6, 2005); David Brunori, The Politics of State Taxation: Helping the States to Hurt Themselves, ST. TAX NOTES at 752 (June 6, 2005); Michael Mazerov, The Ohio Investment Credit Decision: Modest but Helpful “Arms Control” in the Economic War Between the States, ST. TAX NOTES at 849 (Mar. 21, 2005); Edward A. Zelinsky, Ohio Incentives Decision Revisited, 37 ST. TAX NOTES 859 (Sept. 19, 2005). This is a debate that long predates Cuno and the proposed Cuno-inspired legislation. See, e.g., WILLIAM SCHWEBER ET AL., BIDDING FOR BUSINESS 35 (1994) (noting the weight of scholarly opinion against using development incentives to attract new industry); William J. Barrett IV, Note, Problems with State Aid To New or Expanding Businesses, 58 S. CAL. L. REV. 1019, 1024-25 (1985) (citing FORTUNE study showing practical importance of business incentives); Mark Taylor, Note, A Proposal to Prohibit Industrial Relocation Subsidies, 72 TEX. L. REV. 669, 678-93 (1994) (concluding that industrial relocation subsidies are undesirable from an economic and political standpoint).
inappropriate burdens on interstate commerce. Rather my narrow purpose here is to
analyze the now-pending legislation from a technical standpoint and, specifically, to
describe how it would modify the constitutional landscape reflected in Cuno. Insofar as I
suggest changes in the proposed statute, it is my intention to improve upon legislation
that I support in principle and, with the changes suggested, would support in practice as a
technically sound implementation of the proposed legislation’s apparent intent.

Part I of the paper briefly elaborates on the initial proposition advanced above,
namely, that Congress has unquestionable authority to make whatever rules it deems
appropriate regarding the states’ ability to provide tax incentives affecting interstate
commerce. Part II provides an overview of the proposed Economic Development Act of
2005 and its relationship to existing constitutional restraints on state tax incentives. Part
III examines in more detail the impact of the proposed legislation on the Court’s dormant
Commerce Clause doctrine barring taxes that discriminate against interstate commerce.

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5 As I stated before Congress: “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.” 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. (May

6 In the interest of full disclosure, it should be noted that I am of counsel to Sutherland Asbill & Brennan
LLP; Sutherland is counsel to the Council On State Taxation (COST); and COST, with my participation,
assisted in drafting the proposed Economic Development Act of 2005, which COST actively supports. The
views expressed in this paper, however, are entirely my own and do not necessarily represent the views of
Sutherland or its clients.
I. CONGRESS'S POWER TO DETERMINE THE VALIDITY OF STATE ECONOMIC DEVELOPMENT INCENTIVES

Under the affirmative power that the Commerce Clause bestows upon Congress "to regulate commerce . . . among the several States," Congress enjoys virtually unlimited authority to determine the validity under that clause of state economic development incentives affecting interstate commerce. Congress may exercise its affirmative Commerce Clause power in one of two ways. First, Congress may restrict the taxing power the states otherwise would enjoy under the dormant Commerce Clause by imposing additional limitations on state taxing authority. Second, Congress may expand the taxing power the states otherwise would enjoy under existing dormant Commerce Clause restraints by removing those restraints. The Court emphasized both aspects of Congress's power in Prudential Insurance Co. v. Benjamin.

The power of Congress over commerce . . . is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade. Its plenary scope enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons. That power does not run down a one-way street or one of narrowly fixed dimensions. Congress may keep the way open, confine it broadly or closely, or close it entirely, subject only to the restrictions placed upon its authority by other constitutional provisions and the requirement that it shall not invade the domains of action reserved exclusively for the states.

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7 U.S. CONST. art. I, § 8, cl. 3.
8 There are other federal and state constitutional provisions that may provide the basis for a constitutional challenge to state tax incentives, e.g., the Equal Protection Clause of both federal and state constitutions and the constitutional provisions in many states that require taxes to be levied for public purposes. See generally JEROME R. HELLERSTEIN & WALTER HELLERSTEIN, STATE AND LOCAL TAXATION 24-29 (8th ed. 2005) [hereinafter HELLERSTEIN & HELLERSTEIN]. These challenges, which generally have been unsuccessful, are beyond the scope of this paper.
9 328 U. S. 408 (1946).
10 Id. at 434.
In *Prudential*, the Court sustained a South Carolina insurance premiums tax imposed solely on foreign insurance companies—a levy that clearly would have been struck down under the Commerce Clause if Congress had not consented to such legislation in the McCarran-Ferguson Act.\(^{11}\)

In short, in the final analysis it is up to Congress—not to the courts in construing the dormant Commerce Clause—to determine what constitutes a burden on interstate commerce.\(^{12}\)

II. **THE PROPOSED ECONOMIC DEVELOPMENT ACT OF 2005: OVERVIEW**

The proposed Economic Development Act of 2005 (hereafter the “EDA”) is relatively simple in its overall structure and design. Generally speaking, the EDA provides congressional authorization for states to provide tax incentives that might otherwise be unconstitutionally discriminatory under the Court’s dormant Commerce Clause doctrine while at the same time leaving undisturbed the balance of the Court’s dormant Commerce Clause doctrine barring discriminatory taxes. Mere statement of the broad thrust of the legislation underscores the delicacy of the task at hand. Because the Court’s doctrine barring discriminatory taxes (including those that were explicitly designed by state legislatures as

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\(^{11}\) The McCarran-Ferguson Act, 15 U.S.C. § 1011 (2000), provides:

> Congress . . . declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that the silence of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

economic development incentives\(^1\)) constitutes the broad conceptual underpinning of *Cuno*,\(^4\) and because the EDA is intended at a minimum to overturn *Cuno*, Congress must act with surgical precision if it is to perform the operation without killing the patient.

The basic approach of the EDA is first to exercise Congress’s Commerce Clause power to authorize “any State to provide to any person for economic development purposes tax incentives that otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause . . . .”\(^5\) Having effectively removed such incentives from judicial scrutiny under the dormant Commerce Clause by authorizing them under the “real” Commerce Clause,\(^6\) the EDA in the next breath carves out of the authorization a laundry list of state tax incentives that (broadly speaking) describes taxes the Court has struck down in the past as discriminatory under its dormant Commerce Clause doctrine.\(^7\)

The initial authorization of state tax incentives is quite broad. In light of the expansive definitions of “tax incentive” and “economic development purposes,” it is doubtful that any state legislature would have difficulty satisfying the EDA’s standard for

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\(^5\) EDA § 2.

\(^6\) See supra Part I.

\(^7\) EDA § 3.
the type of incentive that falls within the scope of the authorization. A “tax incentive” is any provision that reduces a State tax burden or provides a tax benefit as a result of any activity by a person that is enumerated or recognized by a State tax jurisdiction as a qualified activity for economic development purposes.18 “Economic development purposes” are “all legally permitted activities for attracting, retaining, or expanding business activity, jobs, or investment in a State.”19 In short, a qualifying state tax incentive is anything a state or locality20 says it is, as long as the state or locality says it is enacting the provision to attract, retain, or expand business activity, jobs, or investment in the state.

Despite the breadth of the initial authorization, it does contain several limiting factors, wholly apart from the explicit exceptions to the authorization (which are addressed in detail below21). The authorization is restricted to incentives that “otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause.”22 Hence a tax incentive that might be the cause or source of discrimination against interstate commerce under some provision other than the Commerce Clause—for example, a tax incentive that discriminated without rational basis against out-of-state companies—will still be unconstitutional notwithstanding the EDA.23 Similarly, a tax incentive that violated

18 EDA § 4(a)(9).
19 EDA § 4(a)(2). The concept of “tax benefit” is likewise quite broad. It means “all permanent and temporary tax savings, including applicable carrybacks and carryforwards, regardless of the taxable period in which the benefit is claimed, received, recognized, realized, or earned.” EDA § 4(a)(8).
20 For purposes of the EDA, a “State” means “each of the several States (or subdivision thereof), the District of Columbia, and any territory or possession of the United States.” EDA § 4(a)(6).
21 See infra Part III.
22 EDA § 2 (emphasis added).
some constitutional provision other than the Commerce Clause (even though it might be the
source of discrimination against interstate commerce under the Commerce Clause)—for
effect, a tax incentive to encourage the economic development of small newspapers in the
state—would still be unconstitutional under the First Amendment notwithstanding the
EDA. Finally, any tax incentive that might violate the dormant Commerce Clause for
some reason other than the tax being a source of discrimination against interstate
commerce—for example, a tax that is unfairly apportioned or not “fairly related to services
provided by the State”—falls outside the EDA’s authorization. Although one may
question the practical significance of these limitations, they demonstrate that the EDA’s
attention is focused only on dormant Commerce Clause limits on state tax discrimination,
not on the entire universe of federal constitutional or statutory restraints on state taxation.

One additional limitation on the EDA’s broad authorization of tax incentives is
contained in the final clause of the authorization, to wit, “except as otherwise provided by
law.” Although the relationship between the EDA and preexisting federal statutes limiting
state tax discrimination against interstate commerce might have been stated more clearly,

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24 For example, a tax incentive designed to encourage the development of small newspapers in the state by
exempting from tax the first $100,000 of purchases of paper and ink would presumably still be invalid
under the First Amendment, see Minneapolis Star & Tribune Co. v. Minnesota Department of Revenue,
460 U.S. 573 (1983), even though it would be “authorized” under the EDA (because it does not fall within
any of the limitations to the authorization under EDA § 3). The EDA cannot authorize a violation of the
First Amendment.

25 Although some taxes that are unfairly apportioned may also be viewed as discriminatory, clearly not all
such taxes would fall into that category. See, e.g., Norfolk & Western Ry. v. State Tax Comm’n, 390 U.S.
317, 326 (1968) (invalidating application of rail-mileage apportionment formula to interstate railroad’s
rolling stock under Commerce and Due Process Clauses because it “led to a grossly distorted result”).

Co. v. Bower, 813 N.E.2d 1090 (Ill. App. 2004) (invalidating under “fairly related” test use tax on fuel and
supplies purchased by taxpayer for use in tugboats pushing barges along the Mississippi, Illinois, and Ohio
Rivers, even though tax satisfied other three prongs of Court’s dormant Commerce Clause test).

27 EDA § 2.
the apparent purpose of this phrase is to assure that preexisting bars on state tax
discrimination are not “trumped” by the EDA’s authorization of a limited subset of
discriminatory tax provisions. In other words, it presumably would not be permissible under
the EDA for a state or locality to provide a reduced property tax assessment for most
commercial and industrial property in the state, except property owned by interstate
transportation companies, for the purpose of “attracting, retaining, or expanding” non-
transportation-related “business activity, jobs, or investment in a State,” 28 even though such
a provision might be characterized as a tax incentive that “would be the cause or source of
discrimination against interstate commerce under the Commerce Clause.” 29 The provision
would nevertheless be impermissible because it would violate the preexisting bar in the
Railroad Revitalization and Regulatory Reform Act of 1975 (the “4R Act”) prohibiting tax
discrimination against interstate railroads. 30 Nor would the EDA authorize a state’s
provision of an investment tax credit for in-state facilities designed to generate electricity for
local (but not out-of-state) sale, even though that might be characterized as a tax incentive
that “would be the cause or source of discrimination against interstate commerce under the
Commerce Clause,” 31 because it would violate the preexisting federal bar against
discriminatory taxes on the generation or transmission of electricity. 32

28 EDA § 4(a)(2).
29 EDA § 2. Moreover, it does not appear to fall within any of the limitations to the authorization. EDA § 3.
31 EDA § 2. Again, it does not appear to fall within any of the limitations to the authorization. EDA § 3.

No State, or political subdivision thereof, may impose or assess a tax on or with respect to the
generation or transmission of electricity which discriminates against out-of-State manufacturers,
A final general observation regarding the EDA is that it does not prohibit any tax incentive. It simply authorizes certain tax incentives that might otherwise be unconstitutional under existing dormant Commerce Clause doctrine.

Any tax incentive that falls outside the scope of the EDA is subject to dormant Commerce Clause restraints that exist in the face of congressional silence.

III. PRESERVING THE COURT'S DORMANT COMMERCE CLAUSE DOCTRINE BARRING STATE TAXES DISCRIMINATING AGAINST INTERSTATE COMMERCE: THE EXPLICIT EXCEPTIONS TO THE AUTHORIZATION OF TAX INCENTIVES

Having broadly insulated state tax incentives from dormant Commerce Clause scrutiny under its "authorization" provision, the EDA reverses field in the "limitations" provision and substantially cuts back on the broad authorization. In substance, the limitations are an effort to assure that most of the Supreme Court's dormant Commerce Clause doctrine barring discriminatory taxation is left undisturbed by the EDA. This is not to say that Congress is legislatively adopting such doctrine. To the contrary, the EDA is

producers, wholesalers, retailers, or consumers of that electricity. For purposes of this section a tax is discriminatory if it results, either directly or indirectly, in a greater tax burden on electricity which is generated and transmitted in interstate commerce than on electricity which is generated and transmitted in intrastate commerce.

Id.; see also Arizona Public Service Co. v. Sneed, 441 U.S. 141 (1979) (construing statute).

\[33\] Technically, the EDA authorizes certain tax incentives that "otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause," without regard to whether such discrimination is permissible or impermissible. EDA §2. Assuming that some forms of discrimination against interstate commerce are permissible (for example, if there are no nondiscriminatory alternatives to the discriminatory legislation, see New Energy Co. v. Limbach, 486 U.S. 269, 278-80 (1988)), the EDA is beside the point because such tax incentives would pass muster under the dormant Commerce Clause apart from the congressional authorization.

\[34\] Either because the tax incentive is not an incentive that "otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause," EDA §2, or because it falls within one of the carve-outs to the authorization. EDA §3. See infra Part III.
clear that “nothing” in the “limitations” provision “shall be construed to create any inference with respect to the validity or invalidity under the Commerce Clause . . . of any tax incentive described in this section.” Nevertheless, by carving out a significant class of discriminatory state taxing measures from the EDA’s authorization, the Act substantially narrows the universe of discriminatory tax incentives that Congress is blessing. Although the language of the bill is sometimes difficult to parse, its overall intended purpose is readily discernible.

The “limitations” section of the bill provides that seven specific types of tax incentives are not subject to the protection of the act, that is, the “authorization” section does not apply to these incentives. I consider each of these limitations in turn.

A. Tax Incentives Dependent Upon Residence

The EDA’s authorization of tax incentives does not apply to any state tax incentive that “is dependent upon State or country of incorporation, commercial domicile, or

33 EDA § 3(b). Despite this language, one could plausibly argue that “[t]he lady doth protest too much . . . .” WILLIAM SHAKESPEARE, HAMLET, ACT III, Scene 2, line 222 (Penguin paperback ed. 1957). If Congress did not think the limitations described tax incentives inimical to our national common market, why did it exclude them from the authorization? And despite Congress’s injunction not to draw “any inference with respect to the validity or invalidity under the Commerce Clause . . . of any tax incentive described in this section,” EDA § 3(b), how can a conscientious court ignore the fact that Congress has seen fit not to approve a tax incentive of a specific type? These conceptual problems, however, pale by comparison to those that would confront Justices Scalia and Thomas by the EDA’s implicit recognition of the negative Commerce Clause under the affirmative Commerce Clause. By recognizing the possible “invalidity under the Commerce Clause” of a “tax incentive described in this section,” when such invalidity is not prescribed by congressional legislation, does this not necessarily constitute Congress’s recognition under the affirmative Commerce Clause of the existence of the negative Commerce Clause and therefore pull the rug out from under the Scalia-Thomas enterprise to persuade the Court to repudiate the Court’s negative Commerce Clauses doctrine as illegitimate? In short, would Congress not have spoken under the “real” Commerce Clause that there is a dormant Commerce Clause? Yes, Virginia, there is a Santa Claus.

36 EDA § 3(a).
residence of an individual." This limitation makes it clear that one of the bedrock principles of the Court’s Commerce Clause jurisprudence—that states may not favor local over out-of-state taxpayers—remains inviolate notwithstanding the EDA. Hence, in accord with South Central Bell Telephone Co. v. Alabama, the EDA does not authorize a state to provide a tax incentive to corporations incorporated in the state but not to corporations incorporated outside the state. Similarly, in accord with Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance, the EDA does not authorize a state to provide a tax incentive available to corporations incorporated in the United States but not to corporations incorporated in foreign countries. The same principle applies to a tax incentive available to corporations commercially domiciled in the state but not corporations

37 EDA § 3(a)(1). This provision might have been drafted more clearly to eliminate the ambiguity of the relationship of the last prepositional phrase “of an individual” to the rest of the clause. Plainly, an individual does not have a place of incorporation, but he or she may have a “commercial domicile.” See infra note 43. Query whether the last phrase could be read as excluding from the limitation an incentive based on the commercial domicile, as distinguished from the residence, of an individual.

38 See 1 HELLERSTEIN & HELLERSTEIN, supra note 8, at 4 13[2][j].


40 In South Central Bell, the Court held that Alabama’s franchise tax discriminated against interstate commerce in violation of the Commerce Clause because it favored Alabama over non-Alabama corporations. For domestic corporations, the franchise tax was measured by the par or stated value of their capital stock, but for foreign corporations it was measured by the actual capital they employed in the state. The taxing scheme plainly favored domestic over foreign corporations, because “Alabama law gives domestic corporations the ability to reduce their franchise tax liability simply by reducing the par value of their stock, while it denies foreign corporations that same ability.” Id. at 169.


42 In Kraft, the Court held that Iowa’s corporate income tax discriminated against foreign commerce in violation of the Commerce Clause because it favored domestic (U.S.) corporations over foreign (non-U.S.) corporations. Iowa’s corporate income tax included dividends from foreign subsidiaries, but not from domestic subsidiaries, in a taxpayer’s apportionable tax base. Although there was a rational legislative purpose behind Iowa’s discrimination, which was based on Iowa’s conformity to the federal corporate income tax scheme, the Court held that “[t]he Iowa statute cannot withstand . . . scrutiny, for it facially discriminates against foreign commerce and therefore violates the Foreign Commerce Clause.” Id. at 82.
commercially domiciled elsewhere. \(^\text{43}\) Finally, in accord with *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine,* \(^\text{44}\) the EDA does not authorize a tax incentive that depends on the residence of an individual, for example, a tax incentive to a corporation contingent on the hiring of state residents. \(^\text{45}\)

One might argue that the reference to "residence of an individual" as one of the impermissible bases for an "authorized" tax incentive is unnecessary in light of the Privileges and Immunities Clause, \(^\text{46}\) which generally bars tax discrimination against individual nonresidents. \(^\text{47}\) As noted above, \(^\text{48}\) Congress has no authority under the Commerce Clause to authorize the violation of other constitutional provisions, and the reference in the EDA to "except as otherwise provided by law" may be read to evince an intent not to

\[^{43}\] A corporation's "commercial domicile" is "the principal place from which the trade or business of the taxpayer is directed or managed." *Uniform Division of Income For Tax Purposes Act* § 1(b), 7A U.L.A. 148 (2002). The concept of commercial domicile in substance defines a taxpayer's residence in terms of its seat of management rather than its legal domicile (e.g., place of incorporation). See generally 1 Hellerstein & Hellerstein, *supra* note 38, at 9.03[2].

\[^{44}\] 520 U.S. 564 (1997).

\[^{45}\] In *Camps Newfound*, the Court held that a Maine property tax exemption for charitable institutions discriminated against interstate commerce in violation of the Commerce Clause because it excluded charitable institutions that are "in fact conducted or operated principally for persons who are not residents of Maine." Id. at 568 (quoting 26 ME. REV. STAT. ANN. § 652(1)(A) (Supp. 1996)). It is not clear to what extent this (and other provisions of the EDA) would be subject to an analysis based on the "practical effect" of an incentive. *C. J. Best & Co. v. Maxwell*, 311 U.S. 454, 455-56 (1940) ("[I]n each case it is our duty to determine whether the statute under attack . . . will in its practical operation work discrimination against interstate commerce"). For example, the "practical effect" of an incentive offered to a firm located in the middle of a large state, conditioned on its hiring of 100 additional employees, arguably is dependent upon the residence of an individual. Perhaps the answer to this argument lies in the "rule of construction" that "[i]t is the sense of Congress that the authorization provided in section 2 should be construed broadly and the limitations in section 3 should be construed narrowly." EDA § 4(b).

\[^{46}\] U.S. CONST. art IV, § 2, cl. 1 ("The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.").


\[^{48}\] See *supra* note 24.
override such other provisions, assuming such intent were relevant. However, there may be a small class of provisions discriminating against nonresident individuals that do not violate the Privileges and Immunities Clause but that arguably would violate the Court’s dormant Commerce Clause doctrine. Moreover, by excluding individual-residence-based tax incentives from its authorization, the EDA assures that corporations, as well as nonresident individuals, will have a constitutional predicate for challenging such incentives as discriminatory.  

B. Tax Incentives Dependent Upon Use of Property Produced In-State

The EDA’s authorization of tax incentives does not apply to any state tax incentive that “requires the recipient of the tax incentive to acquire, lease, license, use, or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State.” This provision reflects the Court’s holding in Bacchus Imports, Ltd. v. Dias that a state may not provide a tax incentive to encourage the use or purchase of locally produced property. Hence, the EDA is not blessing a tax incentive, for example, 

49 Cf. Baldwin v. Fish & Game Commission, 436 U.S. 371, 388 (1978) (sustaining higher elk-hunting license fees on non-residents than residents because Privileges and Immunities Clause is inapplicable to “privileges and immunities” that are not “basic to the maintenance or well being of the Union”). It is by no means clear, however, that courts would hold that such a license scheme discriminated against interstate commerce.

50 See supra note 47 and notes 44-45 and accompanying text.

51 EDA § 3(a)(C).


53 In Bacchus, the Court held that Hawaii’s liquor excise tax discriminated against interstate commerce in violation of the Commerce Clause because it favored locally produced alcoholic beverages over alcoholic beverages produced outside the state. Bacchus involved an exemption for locally produced alcoholic beverages from an excise tax on the wholesale sale of liquors. The state sought to avoid the force of the Court’s precedents prohibiting such local favoritism by arguing that the locally produced beverages did not
that provides a tax credit to automobile manufacturers that invest in new facilities or equipment in the state (a provision that, standing alone, would fall within the EDA’s authorization), if the credit were available only to automobile companies that furnished their automobiles with tires or mufflers produced in the state.

There is some risk that this provision extends to the tax incentive at issue in Cuno itself because, as practical matter, a tax credit for new investment in the state will almost invariably lead taxpayers to “acquire, lease, license, use, or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State.” Indeed, how could DaimlerChrysler fulfill its obligation to “purchase[] new manufacturing machinery and equipment . . . installed in this state” but not “acquire, lease, license, use, or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State”? Did not DaimlerChrysler necessarily have to “provide services” to real property “developed” in the state when it “installed” new manufacturing machinery and equipment “in the state”?

The answer to these questions presumably is that such acquisition, lease, license, use, etc. is not explicitly “required” to qualify for the incentive. Unless such an incentive

54 But nor is it condemning. See supra note 35 and accompanying text.

55 EDA § 3(a)(2).


57 The EDA defines property as “all forms of real, tangible, and intangible property.” EDA § 4(a)(5).
literally required the use of in-state property, it arguably falls on the right side of the congressional authorization, despite the fact that it may be difficult, as a practical matter, to satisfy the requirements of the incentive-granting provision without acquiring, leasing, licensing, etc. property produced, manufactured, etc. in the State.  

Whether this reading of the statute will prove persuasive, thereby implementing congressional intent to separate the baby from the bathwater, cannot be predicted with certainty on the basis of the proposed statutory language. However, any doubt on this score can be substantially eliminated simply by inserting the words “by the terms of the incentive” after “required.” If this modest change in the statutory language were made, it would assure that the incentive would fall within the congressional authorization if the literal terms of the statute did not require the acquisition, lease, license, use, etc. of property produced, manufactured, generated, etc. in the state, regardless of whether such acquisition, license, use, etc. were, as a practical matter, required.

C. Tax Incentives Reduced as a Direct Result of the Taxpayer’s Increase in Out-of-State Activity

The EDA’s authorization of tax incentives does not apply to any state tax incentive that “is reduced or eliminated as a direct result of an increase in out-of-state activity by the recipient of the tax incentive.”  

This limitation embodies the narrowest aspect of the

31 One could find support for such a reading in the “rule of construction” that “[i]t is the sense of Congress that the authorization provided in section 2 should be construed broadly and the limitations in section 3 should be construed narrowly.” EDA § 4(b).

39 EDA § 3(a)(3).
Court's holding in *Westinghouse Electric Corp. v. Tully* 60 to the effect that a state tax incentive penalizing an increase in out-of-state activity discriminates against interstate commerce. 61 In effect, the authorization does not apply to any tax incentive that would require a taxpayer to maintain a certain percentage of its work force or invest a certain percentage of its property in the state, because percentage-based rules necessarily disadvantage the taxpayer based on an increase in out-of-state activity. Thus the EDA would not authorize a "headquarters" tax credit for companies that maintained at least fifty percent of their executive work force in the state, because the hiring of additional out-of-state executives could push the in-state executive work force below fifty percent, if one held the number of in-state executives constant. By contrast, a headquarters tax credit granted for any company that employed a fixed number of executives in the state would not fall within this limitation and would appear to be authorized by the EDA.

The exclusion from the EDA's authorization of tax incentives that are reduced by an increase in a taxpayer's out-of-state activities is limited to those that are reduced as "as a direct result of an increase in out-of-State activity by the recipient of the tax incentive." 62

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61 In *Westinghouse*, the Court held that New York's tax credit for income earned by Domestic International Sales Corporations (DISCs) discriminated against interstate commerce in violation of the Commerce Clause because, among other things, the credit decreased with the increase in out-of-state activity. 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 treatment to DISCs. Former IRC §§ 991-97. New York's corporate franchise tax included DISC income in the tax base by combining the income of the DISC and its parent. 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. The credit was limited, however, to the percentage of DISC receipts from export shipments from New York. In striking down the credit, the court described this aspect of the tax incentive as "the most pernicious effect of the credit scheme."

*Westinghouse*, 466 U.S. at 401 n.9. As the Court explained, "not only does the New York tax scheme 'provide a positive incentive for increased business activity in New York State,' but it also penalizes increases in the DISC's shipping activities in other States." *Id.* at 400-01 (citation omitted).

62 EDA § 3(a)(3) (emphasis added).
Unless the term “direct” has no meaning (in violation of the well-known canons of
construction that a “legislative body is presumed not to have used superfluous words,”63 and
that “[c]ourts are bound to accord meaning, if possible, to every word in a statute”64), it
presumably means that there is no exclusion from the EDA’s authorization of tax incentives
that are reduced as an “indirect” result of a taxpayer’s out-of-state activity. The trick, of
course, is to distinguish between “direct” and “indirect” results. Although the direct-indirect
distinction may not be the sharpest pencil for drawing meaningful lines,65 the EDA is
evidently attempting to distinguish between first-order effects and second-order effects.
First-order effects would include, for example, a percentage reduction in a tax credit
precisely equal to a percentage increase of out-of-state activity, and corresponding
percentage decrease in in-state activity, as in Westinghouse. Second-order effects might
include, for example, a reduction in a tax credit that was based on an absolute amount of in-
state activity (and, hence, did not suffer from the defect in Westinghouse), but that
nevertheless could not exceed the taxpayer’s income apportioned to the state. If the credit
were reduced not because of any “penalty” tied to the creditworthy activity itself, but rather
to the overall level of the taxpayer’s in-state activity (and its income apportionment
percentage), perhaps this would constitute an incentive that had been reduced as an
“indirect”—rather than a “direct”—result of an increase in the taxpayer’s out-of-state
activity.66

64 Id.
65 HELLERSTEIN & HELLERSTEIN, supra note 8, at 198.
66 In this connection, it may be worth observing that there is nothing in the EDA to disturb the Court’s
holding in Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978), that the single-factor sales formula is
D. Tax Incentives Reduced as a Result of a Third-Party’s Increase
In Out-of-State Activity or Lack of Presence in the State

The EDA’s authorization of tax incentives does not apply to any state tax incentive that “is reduced or eliminated as a result of an increase in out-of-State activity by a person other than the recipient of the tax incentive or as a result of such other person not having a taxable presence in the State.”\textsuperscript{67} In this provision, the EDA seeks to encapsulate the holding of \textit{Fulton Corp. v. Faulkner},\textsuperscript{68} which struck down an intangible property tax on corporate stock that varied inversely with the corporation’s presence in the state.\textsuperscript{69} The underlying thrust of the limitation—like the limitation described immediately above\textsuperscript{70}—is to deny

\begin{itemize}
\item a tax incentive that passes muster under the Commerce Clause, despite the argument advanced by Justice Powell in dissent, \textit{id}. at 283-84, and by Charles McLure and me elsewhere, see Charles E. McLure, Jr. \& Walter Hellerstein, \textit{Does Sales-only Apportionment of Corporate Income Violate International Trade Rules?}, 96 TAX NOTES at 1513 (Sept. 9, 2002), that the single-factor sales formula is a discriminatory export subsidy.
\end{itemize}

\begin{itemize}
\item EDA § 3(a)(4).
\item 516 U.S. 325 (1996).
\item In \textit{Fulton}, North Carolina imposed an intangible property tax on, among other things, shares of stock owned by resident individuals and corporations and on shares of stock having a business situs in the state. The tax was imposed at the rate of 0.25 percent of the fair market value of the stock. The value of the stock assessed under the tax, however, was reduced by a percentage equal to the percentage of the corporation’s income subject to tax in North Carolina. This percentage was determined by the familiar three-factor income apportionment formula of property, payroll, and sales. Under this taxing regime, the stock of a corporation doing all of its business in North Carolina would be subject to no North Carolina intangible property tax; the stock of a corporation doing fifty percent of its business in North Carolina would be subject to an intangible property tax on fifty percent of the stock’s value; and the stock of a corporation doing no business in North Carolina would be subject to an intangible tax on its full value. “There is no doubt,” the Court observed, “that the intangibles tax facially discriminates against interstate commerce,” because “[a] regime that taxes stock only to the degree that its issuing corporation participates in interstate commerce favors domestic corporations over their foreign competitors in raising capital among North Carolina residents and tends, at least, to discourage domestic corporations from plying their trades in interstate commerce.” \textit{id}. at 333. The Court also found that the levy could not be justified under the complementary tax doctrine. See \textit{infra} notes 71-92 and accompanying text.
\end{itemize}

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\item See supra Part II(C).
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congressional approval to an incentive that penalizes activity in other states. The principal
difference between the two provisions is that the first is directed at an incentive that
penalizes an increase in the taxpayer’s out-of-state activity and the second is directed to an
incentive that penalizes an increase in the out-of-state activity of someone other than the
taxpayer (for example, a corporation in which the taxpayer invests).

E. Tax Incentives That Result in the Loss of a Compensating Tax System

The EDA excludes from the scope of its authorization a tax incentive that “results
in loss of a compensating tax system, because the tax on interstate commerce exceeds the
tax on intrastate commerce.”\(^1\) The broad intent of this provision is to withhold
congressional approval of discriminatory taxes that do not pass muster under the
complementary tax doctrine.\(^2\) Under this doctrine, the Court has sometimes held that a
state tax that appears to discriminate against interstate commerce is nevertheless
constitutionally permissible because of a complementary exaction that offsets the
apparent discrimination. For example, in the 1937 case of *Henneford v. Silas Mason
Co.*,\(^3\) the Court sustained a “use” tax that was discriminatory on its face, since it applied
only to goods purchased outside the state, because it was complemented by a sales tax on
in-state purchases.\(^4\) In later cases, however, the Court rejected the states’ attempts to

\(^1\) EDA § 3(a)(5).

\(^2\) *See generally* Walter Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax

\(^3\) 300 U.S. 577 (1937).

\(^4\) *See also* Hinson v. Lott, 75 U.S. (8 Wall.) 148 (1868) (tax on importation of liquor into state
  complemented by tax on in-state distillers).
cure the apparent discrimination in their taxing statutes by reference to complementary
taxes that allegedly offset the apparent discrimination. The Court’s most recent
encounters with the complementary or compensatory tax doctrine continue its modern
trend of evaluating states’ complementary tax arguments with considerable skepticism.

In Oregon Waste Systems v. Department of Environmental Quality, Oregon imposed a fee for the in-state disposal of waste that was generated outside the state at the rate of $2.25 per ton while imposing a fee of only $0.85 per ton for the disposal of waste generated within Oregon. Oregon’s principal defense of the facially
discriminatory tax on out-of-state waste was that it was “a ‘compensatory tax’ necessary
to make shippers of such waste pay their ‘fair share’ of the costs imposed on Oregon by the disposal of their waste in the State.” In rejecting this argument, the Court carefully
delineated its current understanding of the scope of the complementary tax doctrine.

The Court first noted that the complementary tax doctrine was not a “doctrine unto itself” but “merely a specific way of justifying a facially discriminatory tax as
achieving a legitimate local purpose that cannot be achieved through nondiscriminatory


77 511 U.S. 93 (1994).

78 Id. at 102.
means.”79 Under the doctrine, the Court observed, “a facially discriminatory tax that
imposes on interstate commerce the rough equivalent of an identifiable and ‘substantially
similar’ tax on intrastate commerce does not offend the negative Commerce Clause.”80

Extracting from its earlier cases, the Court articulated a three-prong inquiry for
determining whether the complementary tax doctrine applies:

1. The state must identify the intrastate tax burden for which the state is
   attempting to compensate.

2. The tax on interstate commerce must be shown to roughly approximate—but
   not exceed—the amount of the tax on intrastate commerce.

3. The events on which the interstate and intrastate taxes are imposed must
   be “substantially equivalent,” i.e., they must be sufficiently similar in
   substance to serve as mutually exclusive proxies for each other.81

Applying these criteria to Oregon’s taxing scheme, the Court had little difficulty
concluding that the complementary tax doctrine could not be invoked to salvage
Oregon’s discriminatory levy on out-of-state waste. First, the state had failed to identify a
specific charge on intrastate commerce equal to or exceeding the charge on interstate
commerce. This failure by itself was “fatal” to the state’s claim.82 Second, in response to
the state’s contention that intrastate commerce “through general taxation” bore taxes
equivalent to the levy on interstate commerce, the Court declared that, even assuming the
burdens were equivalent, the argument “fails because the in-state and out-of-state levies

79 Id.
80 Id. at 102–03
81 Id. at 103.
82 Id. at 104.
are not imposed on substantially equivalent events. The Court's subsequent cases
involving the complementary tax doctrine, each of which closely tracks the analysis the
Court articulated in Oregon Waste, similarly reject complementary tax defenses.

The EDA tracks the Court's complementary tax doctrine in defining a
"compensating tax system" as "complementary taxes imposed on both interstate and
intra-state commerce where the tax on interstate commerce does not exceed the tax on
intrastate commerce and the taxes are imposed on substantially equivalent events." The
EDA then declares in the "limitations" section that it is not authorizing a tax incentive that
"results in loss of a compensating tax system, because the tax on interstate commerce
exceeds the tax on intrastate commerce." But the meaning of this language is not clear.
Does it mean that there must be a preexisting "compensating tax system" in place that is
"lost" because of the subsequent imposition of a greater tax on interstate commerce than
local commerce? If so, the provision is so narrow that it may well have no effect because
most taxes that have failed to pass muster under the Court's complementary tax doctrine
(including those cited above) did not involve preexisting "compensating tax systems" that
were somehow "lost" by the introduction of an offending rate or differential between
interstate and intrastate commerce. Does the language mean that the EDA would in fact
authorize all of the discriminatory levies the Court has struck down in the past as failing to

83 Id.
84 See supra note 76.
85 EDA § 4(a)(1).
86 EDA § 3(a)(5).
87 See supra notes 75-76.
qualify as complementary taxes if the states simply relabeled them as “tax incentives” for “economic development purposes”? Or is there a “close but no cigar” standard for determining whether two levies should be treated as potentially compensating (and therefore within the exclusion for a tax incentive that “results in loss of a compensating tax system”)?

This section could be substantially clarified by limiting its impact to a situation in which an allegedly discriminatory tax incentive defended as part of a compensatory tax regime fails the U.S. Supreme Court’s compensatory tax test. For example, an alleged tax incentive for in-state retailers that exempted certain purchases from sales tax, while subjecting similar purchases from out-of-state merchants to use tax, would not fall within the congressional authorization. The EDA would more effectively achieve its goal if the compensatory tax language were modified along the lines suggested.

The foregoing analysis also raises a fundamental question about the scope (and, perhaps, unintended consequences) of the EDA. Because the EDA authorizes “any State to provide to any person for economic development purposes tax incentives that otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause . . .”, it arguably authorizes the most obvious type of discrimination, which can easily be characterized as a “tax incentive” for “economic development purposes,” so long as it does not fall within one of the explicit carve-outs. For example, what about a “tax incentive” that rewarded merchants’ maintenance of “permanent

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81 Support for such a reading of EDA can be found in the “rule of construction” that “[i]t is the sense of Congress that that the authorization provided in section 2 should be construed broadly and the limitations in section 3 should be construed narrowly.” EDA § 4(b).

89 EDA § 2.

90 See supra notes 18-20 and accompanying text.
locations” in the state, thus favoring merchants with fixed locations in the state, but without regard to the merchants’ state of incorporation, commercial domicile, or residence? Such an incentive would appear to fall comfortably within the authorizing language of the EDA,\(^{91}\) and does not appear to be excluded by any of the carve-outs, yet it would run roughshod over scores of Supreme Court decisions striking down such favoritism for local over out-of-state merchants as unconstitutionally discriminatory under the Commerce Clause.\(^{92}\) If this is not the EDA’s intent, it is important that the proposed statutory language be modified to reflect the EDA’s intent more accurately. As noted above, Congress must act precisely if the EDA is to achieve its goal of authorizing appropriate tax incentives without undermining the dormant Commerce Clause doctrine forbidding discriminatory state taxes.

F. Tax Incentives That Require Other Taxing Jurisdictions to Offer Reciprocal Benefits

The EDA’s authorization of tax incentives does not apply to any state tax incentive that “requires that other taxing jurisdictions offer reciprocal tax benefits.”\(^{93}\) The exclusion

\(^{91}\) Any suggestion that this would fall within the exclusion from the authorization for any incentive that “requires the recipient of the tax incentive to acquire, lease, license, use, or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State,” EDA § 3(a)(2), would arguably prove too much, because it would be equally fatal to the tax incentive at issue in Cuno itself. See supra notes 55-58 and accompanying text. As explained above, see id., one may contend that unless such an incentive explicitly requires the use of in-state property, it falls on the right side of the congressional authorization. The mere fact that those who have a permanent location in the state or invest in new facilities in the state are likely “to acquire, lease, license, use, or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State” cannot take the incentive outside the scope of the EDA’s authorization without rendering the EDA largely meaningless.

\(^{92}\) See Hellerstein & Hellerstein, supra note 8, at 262-63.

\(^{93}\) EDA § 3(a)(6).
reflects the Supreme Court’s decision in *New Energy Co. v. Limbach.* In *New Energy,* the Court struck down an Ohio fuel tax credit granted to fuel dealers who used 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 certain other States.” In response to the claim that Ohio was really promoting interstate commerce by encouraging other states to enact similar tax advantages that would spur the interstate sale of gasohol, the Court responded that a state “may not use the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement.”

G. Tax Incentives That Require the Offset Against Another Tax On Local Activities

An example of language that is particularly deserving of more attention is the EDA’s exclusion from the scope of its authorization of a tax incentive that “requires that a tax incentive earned with respect to one tax can only be used to reduce a tax burden for or provide a tax benefit against any other tax that is not imposed on apportioned interstate activities.” The purpose of the limitation is evidently to leave intact the principle

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95 *Id.* at 274.
96 *Id.* (quoting *Great Atl. & Pac. Tea Co. v. Cottrell,* 424 U.S. 366, 378 (1976)).
97 EDA § 3(a)(7).
underlying the Supreme Court's decision in *Maryland v. Louisiana*. In *Maryland v. Louisiana*, Louisiana imposed a tax on the "first use" within the state of any natural gas. The tax applied to the substantial amount of gas extracted from the Outer Continental Shelf (OCS) off the Louisiana coast and subsequently "used" in Louisiana. The tax appeared to be nondiscriminatory, because it applied to all gas used in the state. However, various credits and exclusions from the tax, available only to those engaged in in-state economic activity, effectively immunized local interests from the tax. Among other things, the statute provided a credit against the state's "severance" tax on the extraction of oil or gas within Louisiana for those who had already paid a "first use" tax on gas brought into the state. In holding that the credit for severance taxes discriminated against interstate commerce in violation of the Commerce Clause, the Court declared:

> On its face, this credit favors those who both own OCS gas and engage in Louisiana production. The obvious economic effect of this Severance Tax Credit is to encourage natural gas owners involved in the production of OCS gas to invest in mineral exploration and development within Louisiana rather than to invest in further OCS development or in production in other States.  

The states could not create a tax scheme designed to encourage energy producers to undertake specified activity within the state rather than in other states by providing a credit for an otherwise nondiscriminatory tax against a tax on a local activity.  

Although the goal of the provision may be to preserve the Court's decision in *Maryland v. Louisiana*, the EDA may not in fact accomplish its intended goal. To be

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99 Id. at 756-57.

sure, it would appear to exclude the precise credit at issue in *Maryland v. Louisiana* from the EDA authorization, because the credit could be characterized as a “tax incentive earned with respect to one tax”—the “first use” tax—that was “used to reduce a tax burden . . . against” another tax—the severance tax—that “is not imposed on apportioned interstate activities.”101 However, it is not at all clear that the provision would preserve the broader principle underlying *Maryland v. Louisiana*, namely, that states may not limit a tax incentive to relief from tax liability attributable to other taxes on “local” activity.

This problem becomes clear when one examines the definition of “imposed on apportioned interstate activities.”102

The term “imposed on apportioned interstate activities” means, with respect to a tax, a tax levied on values that can arise out of interstate or foreign transactions or operations, including taxes on income, sales, use, gross receipts, net worth, and value added taxable bases. Such term shall not include taxes levied on property, transactions, or operations that are taxable only if they exist or occur exclusively inside the State, including any real property and severance taxes.103

Under this definition, Louisiana could reenact the “first use” tax and provide an authorized “tax incentive” that provided a credit against local sales tax liability. The sales tax, according to the foregoing definition, is a tax “imposed on apportioned interstate activities.” Yet the effect of permitting a credit against local sales tax liability is indistinguishable from the effect of permitting a credit against local severance tax liability. To repeat the language of the Supreme Court in *Maryland v. Louisiana*,

101 EDA § 3(a)(7).
102 EDA § 4(a)(3).
103 EDA § 4(a)(3).
appropriately modified (in brackets) to account for the fact that a sales tax credit, rather
than a severance tax credit, is at issue:

On its face, this credit favors those who both own OCS gas and engage in
Louisiana [purchases]. The obvious economic effect of this [Sales] Tax Credit is
to encourage natural gas owners involved in the production of OCS gas to [make
purchases] within Louisiana rather than [make purchases] in other States.104

The same analysis would apply to any of the other taxes the EDA defines as “imposed on
apportioned interstate activities.”

The problem with the provision is a conceptual one: all taxes must be “fairly
apportioned” to local activities to pass muster under the Commerce and Due Process
Clauses.105 Hence even a tax on “apportioned interstate activities” is, in the end, a tax on
“local” activity. Maryland v. Louisiana was concerned with the evil of reducing a
nondiscriminatory tax by another tax on local activity because it created pressure to
undertake local activity in the state rather than in other states. That same pressure exists
regardless of the form of the “local” activity that generates the tax liability. In short, the
EDA appears to preserve Maryland v. Louisiana in form but not in substance.

There is no easy solution to this problem, and there is no obvious reason to retain
Maryland v. Louisiana if the goal is to overturn Cuno. Why should it matter if the local
activity itself generates a tax break or the tax break is earned only if one engages in
certain other local activity that falls within the EDA’s authorization? The principle
underlying Maryland v. Louisiana does not depend on the existence of two taxes, the
payment of one that generates relief from the other. The key is that the taxpayer gets

relief for engaging in in-state activity. But that is precisely what the Cuno incentive is designed to authorize. Hence, in my view, the EDA would be improved if the provision seeking to preserve Maryland v. Louisiana were eliminated.

H. Precedents Overruled by the EDA

The one Supreme Court discriminatory tax precedent that appears, at least in part, to be a casualty of the EDA is Boston Stock Exchange v. State Tax Commission.106 In that case, the Court considered a New York stock transfer tax that included an incentive designed to assist the New York brokerage industry. The transfer tax applied to “all sales, or agreements to sell, or memoranda of sales and all deliveries or transfers of shares or certificates of stock” in New York.107 Because the “bulk of stock transfers . . . funnels through New York,”108 New York’s stock transfer tax applied to the lion’s share of stock transfers, regardless of where the stock sale occurred. In order to encourage (1) nonresident stock sellers and (2) sellers of large blocks of stock to effectuate their sales through New York exchanges (rather than out-of-state exchanges), New York amended the statute to offer each of these two categories of sellers a tax break. In lieu of the tax that had previously applied uniformly to the transfer of securities through a New York stock transfer agent without regard to the situs of the sale, New York provided a reduced stock transfer tax for these sellers if they made their sales through New York exchanges.


108 Boston Stock Exchange, 429 U.S. at 327 n.10.
The Court found that this reduction in tax liability, designed to encourage in-state business activity, offended the Commerce Clause's nondiscrimination principle. Prior to the statute's amendment, the New York transfer tax was "neutral as to in-state and out-of-state sales" because, regardless of where the sale occurred, the same tax applied to all securities transferred through a New York transfer agent. The amendment, however, "upset this equilibrium" because a seller's decision as to where to sell would no longer be made "solely on the basis of nontax criteria." Instead, a seller would be induced to trade through a New York exchange to reduce his or her transfer tax liability. By providing a tax incentive for sellers to effectuate their sales through New York rather than out-of-state exchanges, the state had, in the Court's eyes, "foreclose[d] tax-neutral decisions." Moreover, it had done so through the coercive use of its taxing authority. As the Court noted, "the State is using its power to tax an in-state operation as a means of 'requiring other business operations to be performed in the home State.'"

The tax incentive the Supreme Court struck down in Boston Stock Exchange appears to fall, at least in part, within the EDA's authorization. It plainly falls within the scope of a "tax incentive" for "economic development purposes." Insofar as the tax incentive applies to sellers of large blocks of stock, it does not appear to be excluded from the

109 Id. at 330.
110 Id.
111 Id. at 331 (emphasis added).
112 Id.
113 Id. at 335.
114 See supra Part II.
EDA's authorization. The EDA's limitations generally do not preclude tax incentives directed to particular classes of sellers when the identity of the class is not further restricted, for example, by reference to the seller's residence or use of in-state property.

Insofar as the tax incentive at issue in *Boston Stock Exchange* is limited to nonresident sellers, however, it would appear to fall within the limitation that an authorized tax incentive not be "dependent upon State or country of incorporation, commercial domicile, or residence of an individual." To be sure, this exclusion may be wholly unintended—the EDA's apparent concern is not about favoritism to nonresidents but favoritism to residents. Nevertheless, a plain reading of the language of the EDA suggests that it would not insulate the provision (insofar as it was limited to nonresidents) from Commerce Clause attack, because it is "dependent upon . . . residence of an individual." If this is an issue of concern, it is easily remedied by providing explicitly that the EDA's authorization does not apply to any incentive that is dependent upon the "in-state" residence of the individual, etc.

1. Enacted Congressional Legislation Approving State Tax Incentives

It is worth observing that Congress has, in fact, already "spoken" on the subject of the constitutionality of state tax incentives under the Commerce Clause in a narrow provision buried deep in the Energy Policy Act of 2005. In section 1402 of that of that Act, entitled "Energy Production Incentives," Congress provided:

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115 EDA § 3(a)(1).
116 *Id.*
(a) In General – A State may provide to any entity –

(1) a credit against any tax or fee owed to the State under a State law, or

(2) any other tax incentive,
determined by the State to be appropriate, in the amount calculated under and in accordance with a formula determined by the State, for production described in subsection (b) in the State by the entity that receives such credit or incentive.

(b) Eligible entities – Subsection (a) shall apply with respect to the production in the State of electricity from coal mined in the State and used in a facility, if such production meets all applicable Federal and State laws and if such facility uses scrubbers or other forms of clean coal technology.

(c) Effect on Interstate Commerce – Any action taken by a State in accordance with this section with respect to a tax or fee payable, or incentive applicable, for any period beginning after the date of the enactment of this Act shall –

(1) be considered to be a reasonable regulation of commerce; and

(2) not be considered to impose an undue burden on interstate commerce or to otherwise impair, restrain, [or] discriminate against interstate commerce.\(^\text{118}\)

The authorization of "a credit . . . or . . . any other tax incentive determined by the State to be appropriate, in the amount calculated under and in accordance with a formula determined by the State" is breathtakingly broad, and it plainly permits states to provide tax incentives that would violate settled dormant Commerce Clause doctrine. The saving grace of the legislation, at least for those who think that there is anything in the Court’s dormant Commerce Clause worth preserving, is that the scope of the authorization is extremely narrow. It is limited essentially to taxpayers engaged in production of electricity from coal mined in the state employing scrubbers or other forms of clean coal technology.

CONCLUSION

The EDA has undertaken an enormously challenging task in attempting to authorize tax incentives encouraging in-state economic development while at the same time leaving undisturbed almost all of the Court’s dormant Commerce Clause doctrine barring discriminatory taxes. The problem, of course, is that the line between an acceptable tax incentive and a discriminatory tax can be exceptionally thin. Indeed, if the Court’s precedents teach us nothing else, it is that one taxpayer’s economic development incentive can be another’s discriminatory tax. As I suggested at the outset of this paper, because the Court’s doctrine barring discriminatory taxes constitutes the broad conceptual underpinning of Cuno, and because the EDA is intended at a minimum to overturn Cuno, Congress must act with surgical precision if it is to perform the operation without killing the patient. The EDA has outlined the diagnosis and cure, but the patient needs some additional work if the operation is to be a complete success.

[119] See supra notes 13-14 and accompanying text.