ATTACHMENT TO HELLERSTEIN TESTIMONY

CUNO AND CONGRESS: AN ANALYSIS OF PROPOSED FEDERAL LEGISLATION AUTHORIZING STATE ECONOMIC DEVELOPMENT INCENTIVES

By

Walter Hellerstein

[Forthcoming in the *Georgetown Journal of Law and Public Policy*]

CUNO AND CONGRESS: AN ANALYSIS OF PROPOSED FEDERAL LEGISLATION AUTHORIZING STATE ECONOMIC DEVELOPMENT INCENTIVES

Walter Hellerstein*

INTRODUCTION

If anything is clear about *Cuno*[1] 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 noms.* 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.

3 S. 1066, 109th Cong., 1st Sess. (2005); H.R. 2471, 109th Cong., 1st Sess. (2005). S. 1066 is reproduced as Appendix A to this paper. H.R. 2471 is identical to S. 1066.

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 SCHWEKE 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, 678-92 (1994) (concluding that industrial relocation subsidies are undesirable from an economic and political standpoint).

inappropriate burdens on interstate commerce.[5] 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*.[6] 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.

---

[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 24, 2005), reprinted in STATE TAX NOTES, May 30, 2005, at 715.

[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,"[7] Congress enjoys virtually unlimited authority to determine the validity under that clause of state economic development incentives affecting interstate commerce.[8] 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*:[9]

> 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.[10]

---

[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

[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.

[12] *See generally* Walter Hellerstein, *Federal Constitutional Limitations on Congressional Power to Legislate Regarding State Taxation of Electronic Commerce,* 53 NAT'L TAX J. 1307 (2000).

economic development incentives[13]) constitutes the broad conceptual underpinning of *Cuno*,[14] 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 . . . ."[15] Having effectively removed such incentives from judicial scrutiny under the dormant Commerce Clause by authorizing them under the "real" Commerce Clause,[16] 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.[17]

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

---

[13] New Energy Co. v. Limbach, 486 U.S. 269 (1988) (invalidating as unconstitutionally discriminatory under dormant Commerce Clause tax incentive to encourage in-state ethanol production); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (invalidating as unconstitutionally discriminatory under dormant Commerce Clause tax incentive to encourage in-state wine industry); Westinghouse Elect. Corp. v. Tully, 466 U.S. 388 (1984) (invalidating as unconstitutionally discriminatory under dormant Commerce Clause tax incentive to encourage in-state export-related activity); Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318 (1977) (invalidating as unconstitutionally discriminatory under dormant Commerce Clause tax incentive to encourage trading on in-state stock exchanges).

[14] See Hellerstein, *supra* note 5; Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789 (1996).

[15] EDA § 2.

[16] *See supra* Part I.

[17] 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 locality[20] 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 below[21]). 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).

[23] *See* Metropolitan Life Ins. Co. v. Ward, 470 U.S. 868 (1985) (invalidating under Equal Protection Clause tax imposed at higher rate on out-of-state insurance companies than on in-state insurance companies).

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 example, 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.[24] 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[25] or not "fairly related to services provided by the State"[26]—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."[27] Although the relationship between the EDA and preexisting federal statutes limiting state tax discrimination against interstate commerce might have been stated more clearly,

---

[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. 575 (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").

[26] Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 277-79, 287 (1977). *See* American River Transp. 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.

[30] 49 U.S.C. § 14501 (2000).

[31] EDA § 2. Again, it does not appear to fall within any of the limitations to the authorization. EDA § 3.

[32] 15 U.S.C. § 391 (2000). The section provides:

> 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

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.[33] Any tax incentive that falls outside the scope of the EDA[34] 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

---

> out-of-State manufacturers, 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. Snead, 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 Congress 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.

to say that Congress is legislatively adopting such doctrine. To the contrary, the EDA is 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."[35] 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.[36] I consider each of these limitations in turn.

A. Tax Incentives Dependent Upon Residence

[35] 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).

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 residence of an individual."[37] 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[38]—remains inviolate notwithstanding the EDA. Hence, in accord with *South Central Bell Telephone Co. v. Alabama*,[39] 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.[40] Similarly, in accord with *Kraft General Foods, Inc. v. Iowa Department of Revenue and Finance*,[41] 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.[42] The same principle applies to a tax

---

[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].

[39] 526 U.S. 160 (1999).

[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.

[41] 505 U.S. 71 (1992).

[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.

incentive available to corporations commercially domiciled in the state but not corporations commercially domiciled elsewhere.[43] Finally, in accord with *Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine*,[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.[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,[46] which generally bars tax discrimination against individual nonresidents.[47] As noted above,[48] Congress has no authority under the Commerce Clause to authorize the violation of other constitutional provisions, and the reference in the

---

[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 36 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. *Cf.,* 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.").

[47] *See, e.g.*, Toomer v. Witsell, 334 U.S. 385 (1948). It does not, however, bar discrimination against corporate "nonresidents," because corporations are not "citizens" within the meaning of the Privileges and Immunities Clause. Western Turf Ass'n v. Greenberg, 204 U.S. 359, 363 (1907).

[48] *See supra* note 24.

EDA to "except as otherwise provided by law" may be read to evince an intent not to 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.[49] 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.[50]

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."[51] This provision reflects the Court's holding in *Bacchus Imports, Ltd. v. Dias*[52] that a state may not provide a tax incentive to encourage the use or purchase of locally produced property.[53] Hence, the EDA is not blessing[54] 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)(2).

[52] 468 U.S. 263 (1984).

[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

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."[55] Indeed, how could DaimlerChrysler fulfill its obligation to "purchase[] new manufacturing machinery and equipment . . . installed in this state"[56] 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[57] "developed" in the state when it "installed" new manufacturing machinery and equipment" in the state?

---

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 compete with other products sold by the wholesalers and that this in substance mooted the Commerce Clause issue. The Court rejected this argument on the ground that some competition existed between the exempted and the nonexempted liquors and that the extent of the competition was irrelevant under Commerce Clause analysis. The state also claimed the exemption was designed to promote a struggling industry, but the Court found that fact unacceptable as a justification for the discriminatory tax under the Commerce Clause. *Id.*

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

[55] EDA § 3(a)(2).

[56] OHIO REV. CODE § 5733.33(B)(1) (2005).

[57] The EDA defines property as "all forms of real, tangible, and intangible property." EDA § 4(a)(5).

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 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.[58] 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

[58] One could find support for such a reading 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).

recipient of the tax incentive."[59] This limitation embodies the narrowest aspect of the 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.

---

[59] EDA § 3(a)(3).

[60] 466 U.S. 388 (1984).

[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).

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] 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

[62] EDA § 3(a)(3) (emphasis added).

[63] 2A NORMAN J. SINGER, STATUTES AND STATUTORY CONSTRUCTION § 47:37, at 392 (6th ed. 2000).

[64] *Id.*

[65] HELLERSTEIN & HELLERSTEIN, *supra* note 8, at 198.

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]

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."[67] In this provision, the EDA seeks to encapsulate the holding of *Fulton Corp. v. Faulkner*,[68] which struck down an intangible property tax on corporate stock that varied inversely with the corporation's presence in the state.[69] The underlying

[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 a tax incentive that passes muster under the Commerce Clause, despite the argument advanced by Justice Powell in dissent, *id.* at 283-84, and by Charles McLure and me elsewhere, *see* Charles E. McLure, Jr. & Walter Hellerstein, *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.

[67] EDA § 3(a)(4).

[68] 516 U.S. 325 (1996).

[69] In *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

thrust of the limitation—like the limitation described immediately above[70]—is to deny 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."[71] The broad intent of this provision is to withhold congressional approval of discriminatory taxes that do not pass muster under the complementary tax doctrine.[72] 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*

---

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." *Id.* at 333. The Court also found that the levy could not be justified under the complementary tax doctrine. *See infra* notes 71-92 and accompanying text.

[70] *See supra* Part II(C).

[71] EDA § 3(a)(5).

[72] *See generally* Walter Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 TAX LAW. 405 (1986).

Co.,[73] 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.[74] In later cases, however, the Court rejected the states' attempts to cure the apparent discrimination in their taxing statutes by reference to complementary taxes that allegedly offset the apparent discrimination.[75] 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.[76]

In *Oregon Waste Systems v. Department of Environmental Quality*,[77] for example, 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

---

[73] 300 U.S. 577 (1937).

[74] *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).

[75] *See* Armco, Inc. v. Hardesty, 467 U.S. 638 (1984) (tax on wholesaling not complemented by tax on manufacturing); Maryland v. Louisiana, 451 U.S. 725 (1981) (first-use tax on natural gas not complemented by local severance tax). Maryland v. Louisiana is discussed *infra* notes 98-100 and accompanying text.

[76] *See* S. Cent. Bell Tel. Co. v. Alabama, 526 U.S. 160 (1999) (facially discriminatory foreign franchise tax not complemented by domestic shares tax); Fulton Corp. v. Faulkner, 516 U.S. 325 (1996) (facially discriminatory tax on intangible property not complemented by corporate income tax); Associated Indus. of Mo. v. Lohman, 511 U.S. 641 (1994) (facially discriminatory use tax on interstate commerce not complemented by "overall tax burden" on local commerce); Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93 (1994) (same). *Fulton* is discussed *supra* notes 68-70 and accompanying text.

[77] 511 U.S. 93 (1994).

the disposal of their waste in the State."[78] 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 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

---

[78] *Id*. at 102.

[79] *Id.*

[80] *Id*. at 102–03

[81] *Id.* at 103.

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 are not imposed on substantially equivalent events."[83] The Court's subsequent cases involving the complementary tax doctrine,[84] 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 intrastate commerce where the tax on interstate commerce does not exceed the tax on intrastate commerce and the taxes are imposed on substantially equivalent events.[85] 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."[86] 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

---

[82] *Id.* at 104.

[83] *Id.*

[84] *See supra* note 76.

[85] EDA § 4(a)(1).

[86] EDA § 3(a)(5).

most taxes that have failed to pass muster under the Court's complementary tax doctrine (including those cited above[87]) 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 qualify as complementary taxes if the states simply relabeled them as "tax incentives" for "economic development purposes"?[88] 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

---

[87] *See supra* notes 75-76.

[88] 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).

Commerce Clause . . . ,"[89] it arguably authorizes the most obvious type of discrimination, which can easily be characterized as a "tax incentive" for "economic development purposes,"[90] 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 locations" in the state, thus favoring merchants with fixed locations in the state, but without regard to the mercchants' 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.

---

[89] EDA § 2.

[90] *See supra* notes 18-20 and accompanying text.

[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.

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 reflects the Supreme Court's decision in *New Energy Co. v. Limbach*.[94] 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."[95] 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."[96]

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

---

[93] EDA § 3(a)(6).

[94] 486 U.S. 269 (1988).

[95] *Id*. at 274.

[96] *Id*. (quoting Great Atl. & Pac. Tea Co. v. Cottrell, 424 U.S. 366, 378 (1976)).

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."[97] The purpose of the limitation is evidently to leave intact the principle underlying the Supreme Court's decision in *Maryland v. Louisiana.*[98] 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.[99]

---

[97] EDA § 3(a)(7).

[98] 451 U.S. 725 (1981).

[99] *Id.* at 756-57.

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.[100]

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 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]

[100] *See generally* Walter Hellerstein, *State Taxation in the Federal System: Perspectives on Louisiana's First Use Tax on Natural Gas*, 55 TUL. L. REV. 601 (1981).

[101] EDA § 3(a)(7).

[102] EDA § 4(a)(3).

[103] EDA § 4(a)(3).

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*, 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.

---

[104] Maryland v. Louisiana, 451 U.S. 725, 756-57 (1981).

[105] *See, e.g.*, Allied-Signal, Inc. v. Director, Div. of Taxation, 504 U.S. 768, 777-78 (1992).

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

[106] 429 U.S. 318 (1977).

[107] N.Y. TAX LAW § 270.1 (McKinney 1966).

[108] *Boston Stock Exch.*, 429 U.S. at 327 n.10.

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.

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"[109] 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"[110] because a seller's decision as to where to sell would no longer be made "*solely* on the basis of *nontax* criteria."[111] 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."[112] 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.'"[113]

---

[109] *Id.* at 330.

[110] *Id.*

[111] *Id.* at 331 (emphasis added).

[112] *Id.*

[113] *Id.* at 336.

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."[114] Insofar as the tax incentive applies to sellers of large blocks of stock, it does not appear to be excluded from the 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."[115] 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."[116] 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.

I. Enacted Congressional Legislation Approving State Tax Incentives

[114] *See supra* Part II.

[115] EDA § 3(a)(1).

[116] *Id.*

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.[117] In section 1402 of that of that Act, entitled "Energy Production Incentives," Congress provided:

> (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.[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

[117] 42 U.S.C. §§ 15801-16524 (2005).

[118] Energy Policy Act of 2005 § 1402, 42 U.S.C. § 16491 (2005).

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.[119] 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.

APPENDIX A

[S. 1066 – Not Reproduced]