No. 01-3960

IN THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

CHARLOTTE CUNO, et al.,,

Plaintiffs - Appellants,

v.

DAIMLERCHRYSLER, INC., *et al.*,

Defendants - Appellees.

On Appeal from the United States District Court
for the Northern District of Ohio

APPELLANTS' MEMORANDUM IN OPPOSITION TO PETITIONS FOR REHEARING *EN BANC*

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INTRODUCTION

On November 4, 2004, the Clerk of this Court invited Plaintiffs (who are Appellants herein) to file a memorandum in response to Defendants' (Appellees') Petitions seeking a rehearing *en banc* of the panel's unanimous decision originally issued on Sept. 2, 2004 and subsequently amended and reissued on October 19, 2004. This memorandum is offered in response to that invitation.

While Plaintiffs readily acknowledge that the Court's decision in this case, finding Ohio's Investment Tax Credit (ITC) in violation of the Commerce Clause, will have a substantial financial impact on a number of Ohio business taxpayers and will have significant implications for the validity of similar tax credits offered by a number of other states, the decision does not raise the sorts of exceptional concerns about the uniformity or validity of the Court's holdings that warrant the extraordinary and burdensome process of *en banc* rehearing. Indeed, the Court's decision results from a straightforward application to the Ohio ITC of an extensive body of Supreme Court precedent, which has consistently found unconstitutional a wide range of state tax measures that offer preferential tax treatment for in-state economic activity. Petitioners are unable to point to any conflicts between this decision and other decisions of this Court or of the other federal courts. Their assertions that the case was wrongly decided either rehearse arguments that were

carefully considered and rightly rejected in the panel's opinion or which rely on broad mischaracterizations of the panel's careful and focused analysis. Moreover, many of petitioners' and amici's dire predictions of the possible practical consequences of the ruling likewise rely on broad overstatements of the decision's content and cannot withstand critical scrutiny. Rehearing *en banc* is unnecessary and unwarranted.

ARGUMENT

Rehearing *en banc* is "an extraordinary measure," U.S. Ct. of App. 6th Cir. Rule 35(b), which "is not favored and ordinarily will not be ordered" except where "necessary to secure or maintain uniformity of the court's decisions" or to address "a question of exceptional importance," Fed. R. App. Proc. Rule 35(a), such as "an issue on which the panel decision conflicts with the authoritative decisions" of other Courts of Appeals. Fed. R. App. Proc. Rule 35(b)(1)(B). While the present case raises important issues of state tax policy with significant impacts on the affected business taxpayers, there is no indication of a conflict between this decision and other decisions of this Court or of any other federal court. Petitioners' claims of potentially dire harms to the economy or to the states in the Sixth Circuit are unsupported and unsupportable. Nor do they offer substantial reasons to suspect that the panel's decision rests on an error that requires review

and correction by the burdensome process of *en banc* review.

I. While the panel's decision will have substantial impacts on Ohio business taxpayers and significant ramifications for the validity of certain tax incentives offered by other states, petitioners-defendants broadly overstate the implications of the decision.

Plaintiffs do not question that the Court's decision in this case, by invalidating Ohio's ITC, will cost defendant DaimlerChrysler Corp., and other similarly-situated Ohio business taxpayers, many millions of dollars in lost savings on their Ohio franchise taxes. *See* "State of Ohio's Petition for Rehearing with Suggestion for Rehearing *En Banc*" (hereafter "State Petition") at 4 (estimating annual cost of Ohio ITC at $73 million). Nor do they question that the Court's decision raises serious questions about the constitutionality of the similarly structured ITCs offered by many other states, both within and outside the Sixth Circuit. The Court's decision marks a significant step toward the application of well-established Commerce Clause restrictions to rein in a set of state tax policies that provide many hundreds of millions of dollars annually in tax benefits to in-state business taxpayers, and that have, hitherto, largely avoided judicial scrutiny. To this degree, plaintiffs acknowledge that the Court's decision is an important development.

Petitioners and amici, however, in their efforts to establish the decision's

exceptional importance, wildly exaggerate the plausible consequences of the Court's ruling. Their assertions that the decision will have "disastrous consequences for Ohio's ability to compete with its sister States for new business," State Petition at 1, or that it "places all of the states in this Circuit at a grave disadvantage in seeking to attract jobs and economic development," DaimlerChrysler Petition at 7, rest on a series of ungrounded assumptions.

First, their claims assume that state ITCs play a central role in shaping business decisions about where to locate their activities. *See, e.g.,* State Petition at 4-5 (claiming investments made "in reliance on" Ohio's ITC). But years of econometric studies of the actual efficacy of state business tax incentives have failed to provide evidence that would support that assumption.[1] Instead, the evidence suggests that such incentives have, at best, modest effects on business decision-making, both because the magnitudes of these incentives are typically

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[1] For just a few examples from a massive literature, *see* California Legislative Analyst's Office, *An Overview of California's Manufacturers' Investment Credit* at 11 (2002) ("In general, the empirical evidence suggests that while taxes do influence economic activity, state-level investment tax credits have little impact on business decisions relative to other factors."); Richard F. Dye, J. Fred Giertz, and Therese J. McGuire, *An Analysis of Illinois State Business Tax Provisions* at para. 76 (reprinted in STATE TAX TODAY (Lexis), 2003 STT 101-18) (finding it impossible to estimate an impact of the Illinois ITC); ROBERT LYNCH, RETHINKING GROWTH STRATEGIES: HOW STATE AND LOCAL TAXES AND SERVICES AFFECT ECONOMIC DEVELOPMENT (Economic Policy Institute 2004) (summarizing numerous studies finding state and local tax incentives largely ineffective).

swamped by other cost factors and because alternative locations typically offer countervailing packages of incentives.[2] Contrary to the State's assertion that "nearly all 50 states have an ITC," State Petition at 3, many states have not chosen to adopt generally available ITCs like Ohio's, *see, e.g.,* John C. Healy and Michael S. Schadewald, 2004 Multistate Corporate Tax Guide on CD ROM (Aspen) ("State-by-State Summary of Investment, Jobs, and Research Credits") (showing that less than half the states offer generalized ITCs); Amicus Brief of Michigan, Kentucky and Tennessee at 2-3 n. 4 (explaining Kentucky's far narrower incentive), and California, for example, has recently allowed its ITC to lapse because of its ineffectiveness in maintaining manufacturing jobs in the state. *See* California Franchise Tax Board Notice 2003-10 (Dec. 8, 2003) (announcing repeal of California's Manufacturers Investment Credit, effective Jan. 1, 2004 "due to a reduction in manufacturing sector jobs").

Moreover, to the extent that state incentives are an effective economic development tool, the Court's decision only affects one class of the incentives that

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[2] The suggestion that the elimination of ITCs will hinder states' ability to compete with overseas locations for business facilities, *see, e.g.,* DaimlerChrysler Petition at 8, is even more speculative, in light of the far larger variations in non-tax costs that influence choices between domestic and foreign locations. Petitioners offer no evidence to suggest that state tax credits are of a magnitude likely to actually influence such decisions.

states can, and typically do, offer to businesses. Despite Petitioners' apocalyptic suggestions to the contrary, there is nothing in the Court's ruling that would imperil many of the ways that states presently adjust tax policies to create an attractive environment for business, such as narrowing the base of their property or sales taxes or lowering generally applicable tax rates. Indeed, the Court's decision to uphold Ohio's abatement of business personal property taxes for new facilities provides a vivid example of the wide range of tax incentives that remain unconstrained by the ruling here. And the decision has no bearing on the ability of states to use loans or other non-tax subsidies as economic development tools. *See* Slip Op. at 5 (distinguishing subsidies from tax credits).

Finally, Petitioners' suggestion that the Court's ruling places Ohio, or perhaps all of the states in the Sixth Circuit, at a competitive disadvantage, because it only affects their ability to offer ITCs and not their competitors', reflects an exceedingly odd view of the evolution of constitutional case law. On this view, every one of the multitude of prior cases finding a state tax practice unconstitutionally discriminatory would be suspect, because each, initially, only affected the specific state whose practice was challenged, thus depriving it of a tool that its competitor states retained. In reality, of course, the Court's decision here casts a cloud over the substantially similar ITCs offered by many other states,

both inside and outside the Sixth Circuit, and both businesses and states are actively assessing the vulnerability of those similar provisions to Commerce Clause challenges modeled on the present case. And, to the extent that the State of Ohio is actually disadvantaged in competing for business investment by another state's use of an ITC, the State would unquestionably be a proper party to bring a suit challenging the constitutionality of that other state's credit. *See, e.g., Wyoming v. Oklahoma*, 502 U.S. 437 (1992) (allowing suit by Wyoming to challenge Oklahoma's discriminatory incentives favoring in-state coal production).

In short, while the Court's decision certainly represents a significant new restriction on current state uses of investment tax credits as tools of economic development, there is no reason to anticipate the dramatic effects on the location of new economic activity – or on the ability of states to influence such location – that are hypothesized in Petitioners' arguments.

II. The panel's unanimous decision is firmly grounded in an extensive body of Commerce Clause precedent, does not conflict with any decision from this Circuit or elsewhere, and does not raise the serious concerns about error that would warrant *en banc* review.

Petitioners assert that the Court's opinion addressing the Ohio ITC is contrary to applicable Supreme Court precedent and misconstrues the Court's

Commerce Clause jurisprudence. But, as in their Briefs before the panel, Petitioners' contentions rely on mischaracterizations of the arguments relied on in the panel's unanimous decision and on an exceedingly selective reading of the relevant case law. These contentions were thoroughly addressed in Plaintiffs' two briefs before the panel, at greater length than this Memorandum permits. And they were carefully considered and appropriately rejected by the panel. They provide no evidence either of a conflict between the panel's decision and the existing case law or of any error in the panel's analysis.

In reality, the panel's decision comports not only with the three Supreme Court decisions which are the focus of the panel's analysis, *see* Slip Op. at 4-5 (discussing *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977); *Maryland v. Louisiana*, 451 U.S. 725 (1981); and *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984), but with an extensive and univocal collection of Supreme Court cases that have consistently invalidated a wide array of state and local tax measures that discriminated between in-state and out-of-state economic activity in ways that provided "a direct commercial advantage to local business." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 268 (1984); *see* Brief of Appellants (before the panel) at 17-19 (citing more than a dozen recent Supreme Court cases invalidating discriminatory tax provisions). In fact, Petitioners are unable to

identify a single case from the Supreme Court, or from any federal court for that matter, that has upheld a tax provision that provided preferential tax treatment conditioned upon in-state economic activity, as Ohio's investment tax credit indisputably does.

Instead, Petitioners focus, as they did in their briefs and oral arguments before the panel, on scattered *dicta* in the Supreme Court's cases – cases which uniformly invalidated the tax provisions that they actually addressed – that acknowledge the legitimacy of states seeking "to encourage the growth and development of intrastate commerce and industry." *See* State Petition at 6 (quoting *Boston Stock Exch.*, 429 U.S. at 336); *see also* DaimlerChrysler Petition at 12. But these *dicta* offer nothing to support tax provisions that single out in-state economic activity for preferential treatment. In fact, these *dicta* have consistently been careful to distinguish the legitimacy of the state's purposes from the acceptability of the means selected to further them, *see, e.g., Bacchus Imports*, 468 U.S. at 271, and to clarify that the permissible means do not include measures that discriminate in their treatment of in-state and out-of-state activity, *see, e.g., Boston Stock*, 429 U.S. at 329. The specific sorts of state competition for industry that the Court's *dicta* have countenanced, such as uniformly applicable reductions of state taxes and government support for services needed by business, *see, e.g.,*

West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199 n.15 (1994), include only provisions that do not differentiate benefits or burdens based on a business's location.[3]

Similarly, Petitioners seek to characterize the Supreme Court's anti-discrimination cases as narrowly confined to "preventing economic protectionism" that shelters existing in-state businesses from out-of-state competition, and thus as not applicable to measures that encourage companies to locate new business activity in the state. *See* State Petition at 6-7; DaimlerChrysler Petition at 10-11. Certainly, some of the Court's (and the Circuit's) Commerce Clause cases have involved such protectionism, and the Court's language in those cases repeatedly condemns such protectionism. But many other of the Supreme Court's cases

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[3] The State and the City go so far as to use these *dicta* to assert that the panel's decision is "contrary to Supreme Court dormant commerce clause precedent." State's Supplemental Memorandum at 1-2; *see* City's Supplemental Memorandum at 1 ("conflict with precedent"). These assertions are apparent references to the dicta in *Westinghouse Electric*, 466 U.S. at 406 n.12, which Petitioners characterize as "at least tacitly bless[ing]" tax credits like those invalidated by the panel's decision. State's Petition at 6; *see* City's Petition at 2. But a reading of the relevant footnote in *Westinghouse Electric* reveals that the Court was taking no position on any such question, but was instead merely describing the position articulated by the New York Tax Commission, which analogized the provision challenged there to a wide range of other possible supports for export commerce, including job-incentive and investment tax credits. The Court offered no opinion on which, if any, of such analogous measures would pass constitutional muster.

invalidate provisions whose purpose and effect is not to protect existing business from competition but to attract new activity or investment to the state, and the Court's concept of discrimination clearly applies to both sorts of cases. *See, e.g., Maryland v. Louisiana*, 451 U.S. at 756-57 (invalidating Louisiana tax credit because its "obvious economic effect" was to "encourage natural gas owners . . . to invest in mineral exploration and development within Louisiana rather than invest in other states"); *Fulton Corp. v. Faulkner*, 516 U.S. 325, 333 (1996) (invalidating North Carolina provision because it "tends . . . to discourage domestic corporations from plying their trades in interstate commerce"); *Boston Stock Exch.*, 429 U.S. at 335-36 (invalidating New York tax break for in-state security sales because it encouraged out-of-state investors to make trades on New York's exchanges); *Halliburton Oil Well Cementing Co. v. Reily*, 373 U.S. 64, 72 (1963) (invalidating a state use tax provision for "encourag[ing] an out-of-state operator to become a resident in order to compete on equal terms").

At the same time that Petitioners attempt to suggest a conflict by painting an inaccurately narrow picture of Supreme Court precedent, they likewise attempt to paint an inaccurately broad picture of the panel's ruling. Specifically, Petitioners seek to discredit the panel's decision by characterizing it as a "simplistic approach," DaimlerChrysler Petition at 10, that would invalidate any measure that

"encourages further investment in-state at the expense of development in other states." *Id.* (quoting initial Slip Op. at 10); *see* State Petition at 7 (same claim).

Petitioners are, no doubt, correct that such a sweeping prohibition would conflict with the Supreme Court's repeated explanations of its dormant Commerce Clause decisions. But Petitioners can only characterize the panel's decision in this over-broad manner by isolating a single sentence in the decision and ignoring the decisions's primary and recurrent focus on the question of whether the challenged provision discriminates in the burdens and benefits it places on in-state and out-of-state activity. *See* Amended Slip Op. at 3, 4, 5. Indeed, the absurdity of Petitioner's mis-characterization of the panel's analysis is laid bare by the panel's subsequent discussion upholding the other challenged tax benefit in this very case, on the ground that the property tax exemption, while encouraging in-state investment, did not impermissibly discriminate against interstate commerce. *See id.* at 6. While Plaintiffs question (as is discussed below) the specific reasoning that leads the panel to conclude that the property tax exemption in this case was not discriminatory, the panel's analysis of both issues reflects a clear recognition of the limited scope of the Supreme Court's anti-discrimination jurisprudence.

Unable to identify any conflicts between the panel's decision and the wide array of Supreme Court Commerce Clause case law or with any decisions of this,

or any other, Circuit, Petitioners argue that the panel's ruling is inconsistent with a 1992 decision in the Michigan state courts, *Caterpillar, Inc. v. Department of Treasury*, 488 N.W.2d 182 (Mich. 1992). Leaving aside the fact that conflicts with state court decisions are not among the recognized grounds for *en banc* rehearings, the *Caterpillar* decision involved a tax regime, and a tax benefit, dramatically different from those in the present case, rendering the case entirely inapposite. As was discussed at greater length in the briefing before the panel, *see* Reply Brief of Appellants at 18-20, the tax involved in *Caterpillar* was Michigan's unique Single Business Tax, a form of value-added tax under which a business's tax liability is measured, not by its net income, but by its total business activity, including its costs for payroll and for acquisition of capital equipment, apportioned to reflect the portion of that activity attributable to Michigan. The challenged provision in *Caterpillar* was a "capital acquisition deduction" which adjusted the tax base to exclude the costs for capital acquisitions tied to Michigan business activity. Since the single business tax base, as the Michigan court recognized, was designed to include only the share of capital acquisitions which were attributable to its in-state activity, a deduction that was likewise restricted to capital acquisitions attributable to Michigan does not discriminate, but simply serves to exclude all capital acquisitions (wherever located) from the tax base.

Thus, the Michigan provision, which provides no competitive advantage for in-state investment activity, is far more akin to a universally available property tax exemption for all in-state business property than it is to an investment tax credit, which reduces a tax on net income in a manner that provides advantages exclusively for in-state investment.[4]

Lastly, in their initial Petitions for rehearing, the State of Ohio and the City of Toledo also raised a question concerning the Plaintiffs' standing to pursue this litigation in the federal courts, a question that had not been raised by anyone at any earlier stage of the proceedings before this Court. In their subsequent Supplemental Memoranda filed after the issuance of the panel's amended opinion, neither the State nor the City makes any further reference to this topic in their recitations of the grounds for granting a rehearing *en banc*. Perhaps they have dropped their claim of a lack of standing because that contention rested on the premise that plaintiff Kim's Auto and Truck Service, Inc. ("Kim's") lost its

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[4] A far closer parallel to Ohio's investment tax credit is found in states which have offered accelerated depreciation deductions, available exclusively in connection with in-state property, in calculating taxable income for their state corporate income taxes. These provisions, which have the same economic effect as an investment tax credit restricted to in-state property, have been uniformly found to violate the Commerce Clause, consonant with the panel's decision here. *See R.J. Reynolds Tobacco Co. v. City Dept. of Finance*, 667 N.Y.S.2d 4 (App. Div. 1997); *Beatrice Cheese, Inc. v. Wisconsin Dept. of Revenue*, Nos. 91-I-100 to -102, 1993 WL 57202, at *3 (Wisc. Tax App. Comm'n Feb. 24, 1993).

standing when its challenge to the City's eminent domain taking of its land for inclusion in the Jeep plant's site had been concluded. *See* State Petition at 9-10. This premise assumed that Kim's petition for *certiorari* in the eminent domain case would be routinely denied. *See id.* at 11-13 n.2. However, to date, the Supreme Court has not acted on Kim's petition for certiorari, perhaps because it is waiting to act on the petition until after it decides *Kelo v. City of New London*, cert. granted, 125 S. Ct. 27 (Sept. 28, 2004), a case which presents the same constitutional issues raised in Kim's petition.

In any case, the various plaintiffs, including Kim's, have multiple grounds for standing in this case. In particular, many of the plaintiffs have standing in their status as municipal and state taxpayers, injured by Toledo's and Ohio's losses of revenues due to the challenged tax breaks. As this Court has recognized, "'municipal taxpayer standing' is different from 'federal taxpayer standing," *Gwinn Area Community Schools v. Michigan*, 741 F.2d 840, 844 (6th Cir. 1984), and the federal courts have consistently recognized the expenditure of local funds or the loss of local revenues as a cognizable ground for standing. *See, e.g., Taub v. Commonwealth of Kentucky*, 842 F.2d 912, 917 (6th Cir. 1988); *State of New York v. City of New York*, 972 F.2d 464, 470-71 (2d Cir. 1992); *cf. Johnson v. Economic Development Corp.*, 241 F.3d 501, 508 (6th Cir. 2001) (applying same

standards to state taxpayer standing as to municipal taxpayer standing).

In the present case, plaintiffs, many of whom are citizens and taxpayers of both the City of Toledo and the State of Ohio, challenge an incentive agreement among the city, state and DaimlerChrysler that included both an exemption from municipal property taxes and a credit that reduced corporate franchise tax revenues. The property tax exemption unquestionably affected the Toledo plaintiffs in their status as municipal taxpayers. And, indeed, the investment tax credit did so as well, because under Ohio law, a specified portion of corporate franchise tax revenues is expressly dedicated as a municipal revenue. *See* Ohio Rev. Code § 5733.12(A) (crediting specified fractions of franchise tax revenues to the Local Government Fund and the Local Government Revenue Assistance Fund for direct distribution to local governments). Thus, like the taxpayer plaintiffs in *Gwinn Area Community Schools*, who had standing in their municipal taxpayer role to challenge a state statute affecting the amount of state funds distributed to local school districts, *see* 741 F.2d at 844, the Toledo taxpayer plaintiffs here likewise have municipal taxpayer standing to challenge a state tax provision that diminishes the funds that are distributed to their locality.

III. If the Court decides to rehear the case *en banc*, such rehearing should reach the full range of Commerce Clause issues raised by the case, including the panel's decision upholding the constitutionality of the property

tax abatement granted to DaimlerChrysler.

While Plaintiffs do not believe that this case meets the stringent criteria for *en banc* review, if the Court should nonetheless decide to rehear the case *en banc*, that rehearing should extend to the full range of Commerce Clause issues raised by the DaimlerChrysler tax incentive package challenged by the Plaintiffs. In particular, the Court should consider not only the constitutionality of Ohio's investment tax credit, but the constitutionality of its conditional property tax exemptions as well. Unlike the panel's analysis of Ohio's investment tax credit, its analysis of the property tax exemption provision is open to serious claims of conflict both with Supreme Court precedent and with the only decision of a sister Circuit to address the issue. *Compare* Amended Slip Op. at 6 (finding conditional property tax exemptions unproblematic if the conditions "are related to the use . . . of the property itself" and if they "do not discriminate based on an independent form of commerce") *with Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564 (1997) (invalidating Maine property tax exemption because of condition requiring that exempted charitable property be primarily used for benefit of in-state residents) and *Pelican Chapter, Associated Builders & Contractors, Inc. v. Edwards*, 128 F.3d 910 (1997) (invalidating Louisiana property tax exemption because of condition requiring that owner give preference to in-state

workers and suppliers in construction and operation of the exempted facility). The two components of the panel's Commerce Clause analysis draw on the same body of case law and constitutional jurisprudence, and they address two intimately related elements of Ohio's policy of preferential tax breaks used to attract business investments, like the DaimlerChrysler facility involved in this case. If the Court is to consider either aspect of this package in an *en banc* rehearing, then, as a matter of fairness and completeness, it should consider the two together.

CONCLUSION

As explained herein, there is no reason in this case why a rehearing or the extraordinary measure of rehearing *en banc* should be granted with regard to the panel's decision concerning the unconstitutionality of Ohio's investment tax credit. Moreover, should the Court order a rehearing *en banc*, that rehearing should encompass the full range of Commerce Clause issues addressed in the panel's decision, relating not only to the investment tax credit but to the conditional property tax exemption as well.

WHEREFORE, Plaintiffs pray the Court *deny* Petitioners' requests for rehearing *en banc.*

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CERTIFICATION

I hereby certify that a copy of the foregoing "Appellants' Memorandum in Opposition to Petitions for Rehearing *en banc*" was sent via email message and regular U.S. Mail, postage prepaid, to the following this 17th day of November, 2004:

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