Nos. 04-1704 and 04-1724

IN THE

Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION, *et al.*,
Petitioners,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

WILLIAM W. WILKINS, TAX COMM'R, OH., *et al.*,
Petitioners,

v.

CHARLOTTE CUNO, *et al.*,
Respondents.

On Writs of Certiorari to the United States Court of Appeals for the Sixth Circuit

BRIEF OF *AMICI CURIAE* FISCAL POLICY INSTITUTE, CONNECTICUT VOICES FOR CHILDREN AND GOOD JOBS FIRST IN SUPPORT OF RESPONDENTS

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BRIEF OF *AMICI CURIAE* FISCAL POLICY INSTITUTE, CONNECTICUT VOICES FOR CHILDREN AND GOOD JOBS FIRST IN SUPPORT OF RESPONDENTS

IDENTITY AND INTEREST OF *AMICUS CURIAE* [1]

The Fiscal Policy Institute is a nonprofit, nonpartisan research and education organization with offices in Latham, New York and New York, New York. Since its establishment 13 years ago, the Fiscal Policy Institute (FPI) has

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[1] This brief is filed in accordance with the global consent letters filed by petitioners and respondents with this Court. Pursuant to Supreme Court Rule 37.6, the Fiscal Policy Institute, Connecticut Voices for Children and Good Jobs First state that no counsel for any party authored this brief in whole or in part, nor did any person or entity, other than *amici*, make a monetary contribution to the preparation or submission of this brief.

worked to increase public and governmental understanding of issues related to the fairness of New York's tax system and the stability and adequacy of state and local public services.

While the states "may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads, sound public education, or low taxes" (*West Lynn Creamery v. Healy*, 512 U.S. 186, 199 n. 15 (1994)), FPI is concerned that in recent decades the states have been increasingly competing for economic activity through the use of tax incentives and credits that discriminate against interstate commerce. From a public policy perspective, FPI is concerned that these discriminatory approaches divert resources from the types of state activities (such as "maintaining good roads, sound public education, or low taxes") that are permissible under the Commerce Clause and that are much more likely to result in increases in the overall amount of economic activity in the country.

FPI believes that the decision of the Sixth Circuit in this case, if upheld by the Supreme Court, would help to deescalate the "economic war among the states" that is currently being played out in ways that are inconsistent with the Supreme Court's Commerce Clause jurisprudence.

Connecticut Voices for Children ("Voices") is a not-for-profit organization that seeks to promote the well-being of all of Connecticut's young people and their families by advocating for strategic public investments and prudent public policies. Voices advances its mission, among other ways, through high quality research and analysis.

For the last nine years, the work of Voices has included analyses of state fiscal policies, including how the state of Connecticut spends its money and how it raises its money. Voices is concerned that the state is not making the strategic investments in children and families—including education and health care—that are necessary for personal well-being as well as for Connecticut's economic future. At the same time, Voices is aware of an increasing use of business tax expenditures that deprive the state of much-needed revenues, create an unbalanced playing field that favors large, multi-state and multinational corporations over local, small businesses (which, as a category, are the acknowledged drivers of our state economy), and which are enacted into law without adequate assessment of any immediate or ongoing benefits to the state.

Good Jobs First is a non-profit, non-partisan research and education organization based in Washington, D.C. with offices in New York, New York and Chicago, Illinois. Good Jobs First seeks to promote greater accountability in state and local economic development programs and deals by tracking the adoption of reforms such as deal-specific disclosure of costs and benefits, job quality standards (wage and healthcare requirements), clawbacks (recapture provisions for deals that fall short on jobs or other promised benefits), and budgeting reforms such as Unified Development Budgets (to encourage more awareness of costly but poorly understood tax incentive expenditures).

Good Jobs First has generated research reports and a book (*The Great American Jobs Scam: Corporate Tax Dodging and the Myth of Job Creation*) that conclude that state-enabled economic development subsidies like those at issue in *Cuno*—usually justified in the name of interstate competition for jobs and tax base—have so proliferated as to create many unintended consequences that are antithetical to the goals of authentic economic development and injurious to businesses that are not able to exploit the "economic war among the states." These include: less opportunity for low-income communities most in need of reinvestment; a regressive tax burden shift; a serious national infrastructure deficit; insufficient support for workforce development; and a decline in funding for public education.

SUMMARY OF ARGUMENT

1. There is a strong public policy rationale for recognizing respondents' standing to bring suit. In spite of the Commerce Clause, almost all states have enacted, as a key weapon in their economic competition, discriminatory tax legislation that provides in-state businesses a direct competitive advantage and burdens interstate commerce. Such legislation is rarely challenged, however, because, on the whole, the tax benefits derived by multi-state corporations from the proliferation of tax incentives far outweigh the costs of any discrimination those corporations may suffer in particular instances, and a challenge to a tax incentive denied by one state might put at risk the tax breaks received in other states. As a consequence, large multi-state corporations have a huge stake in maintaining the status quo. The primary victims of the proliferation of targeted business tax incentives are other taxpayers in the state and locality who face higher tax burdens and/or reduced government services. These victims should therefore have standing to challenge the constitutionality of state business tax incentives to protect their own, directly impacted economic interests, and in doing so, the interests of the national economy as well.

2. Ohio's investment tax credit discriminates on its face against out-of-state manufacturers subject to the State's corporate income tax. As a result of the credit, manufacturers with production facilities in Ohio face a lower effective tax rate under Ohio's corporate income tax than manufacturers whose manufacturing operations are outside the State, providing a direct commercial advantage to in-state manufacturers. This difference in tax burden is due solely to the difference in the situs of the taxpayers' production facilities. Such discrimination, apparent on the face of the statute, is virtually *per se* invalid under well-established Supreme Court Commerce Clause jurisprudence.

3. The structural framework of a state corporate income tax, including Ohio's, requires that the calculation of tax liability take into account a taxpayer's activities both within and outside the state. This calculation includes, for example, deductions for wages and other expenses incurred both within and outside the state, as well as allowable depreciation for property both within and outside the state. As a consequence, when these rules regarding deductible expenses and allowable depreciation make distinctions between in-state and out-of-state property, favoring the former over the latter, they violate the Commerce Clause. Similarly, Ohio may not provide an investment tax credit for in-state manufacturing property while providing no corresponding credit for out-of-state manufacturing property without running afoul of the Commerce Clause.

4. A ruling upholding the constitutionality of Ohio's investment tax credit would undoubtedly lead to an escalation by the states in the discriminatory tax treatment of out-of-state businesses.

5. The specific intent of the Commerce Clause is to preclude the states from engaging in exactly the kind of parochial, discriminatory economic policies exemplified by Ohio's investment tax credit, which undermine the goal of a national common market. While the precise reach of the Commerce Clause is a subject of debate, the authority and responsibility of the Court to strike down discriminatory state tax schemes designed to favor in-state activity is beyond question.

6. The public welfare would be better served by the prohibition of the use of discriminatory business tax incentives than by their continued proliferation. Targeted business tax incentives are largely ineffective as a policy tool; their widespread use instead reflects such factors as political expediency, the political power and influence of large corporations, and purposeful discrimination in favor of in-state

activity. Because the states have at their disposal a broad array of public policies, including tax policies, that they may pursue to promote economic development in ways that do not run afoul of the Commerce Clause, they would not suffer any hardship if the use of the limited set of discriminatory tax incentives at issue in this case were no longer available to them.

ARGUMENT

I. There Is a Strong Public Policy Rationale For Recognizing Respondents' Standing to Bring Suit. The Primary Victims of the Proliferation of Targeted State and Local Business Tax Incentives are Taxpayers Ineligible for Preferential Tax Treatment Who Face Increased Tax Burdens and/or a Reduced Level of Government Services.

The central purpose of the Commerce Clause[2] was to establish a national economy and protect it from harm resulting from discriminatory state economic policies designed to favor in-state business interests and prejudice interstate and foreign commerce.[3]

The current economic competition among the states is reminiscent of their behavior under the Articles of Confederation. Moreover, in spite of the presence of the Commerce Clause, most states have enacted, as a key weapon in this war among the states, discriminatory tax legislation

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[2] U.S. Const. art I, § 8.

[3] See e.g. Boris I. Bittker, *On The Regulation of Interstate and Foreign Commerce,* 1-4 (1999); *Hunt v. Washington State Apple Adver. Comm'n,* 432 U.S. 333, 350 (1977); *Boston Stock Exch. v. State Tax Comm'n,* 429 U.S. 318, 328 (1977).

designed to favor in-state business activities.[4] Yet such legislation has rarely been challenged.

One reason out-of-state businesses denied a state tax incentive rarely bring suit is that a successful suit is unlikely to result in the out-of-state business receiving the tax benefit provided to in-state businesses. Instead, the taxing state is likely to repeal the benefit provided to in-state businesses. For example, if Ohio's investment tax credit is found unconstitutional, it is unlikely the State would extend the credit to qualifying out-of-state investments. Instead, since a revised credit available to all manufacturers would result in the loss of significant additional revenue and would no longer give in-state businesses a competitive advantage, Ohio would almost certainly remedy the discrimination by doing away with the credit provision. Thus, while out-of-state competitors might be able to "level the playing field" by bringing suit, they would not be able to reduce their tax liability in the taxing state. This outcome may not be of sufficient benefit to merit the time and expense of litigation.[5]

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[4] Not all of these discriminatory tax provisions are corporate income tax incentives similar in kind to Ohio's investment tax credit. For example, New York State exempts from its petroleum business tax airlines that service four or more cities in the State with direct non-stop flights between these cities (N.Y. Tax Law § 301-e (McKinney's 2006)). In addition, New York exempts from the excise tax on beer the first 200,000 barrels brewed and sold in the State each year (when first enacted in 1989, the provision exempted 100,000 barrels annually) by a distributor whose principal executive office is located within the State (N.Y. Tax Law § 424(b) (McKinney's 2006); New York Chapter Laws, L.1989 c.61).

[5] The New York State tax legislation in favor of certain in-state beer businesses noted in footnote 4, *supra*, specifically provides that: "if the exemption from tax . . . as added by section seventy-two of this act, shall be declared unconstitutional such judgment of invalidity shall not result in the extension of the exemption to out of state distributors who are brewers, but shall result only in the denial of such exemption to all distributors who are brewers." (New York Chapter Laws, L. 1989 c. 61 § 364).

More importantly, discriminatory corporate income tax incentives go largely unchallenged because the cumulative tax benefits derived by multi-state corporations from the proliferation of corporate income tax incentives far outweigh the costs of any discrimination such corporations may suffer in particular instances. A challenge to the constitutionality of an incentive denied to a corporation in one state may put at risk the tax incentives from which it benefits in other states. The existing state of affairs works to the great advantage of large multi-state corporations,[6] and they have little desire to "rock the boat." The ferocity of the corporate response to the Sixth Circuit decision in this matter is testimony to the huge stake large multi-state corporations have in maintaining the status quo.

The primary victims of the states' widespread use of targeted business tax incentives are not out-of-state corporate competitors but other taxpayers, who must pay more than their fair share to support state and local government or face reduced public services because powerful and influential corporations have sought and obtained preferential treatment. This shift in tax burden is well-documented.[7]

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[6] A study of the corporate income taxes of 20 states over the period 1990-1998 by University of Iowa economist Peter Fisher concludes that as a result of the increasing availability of tax incentives, the effective corporate tax rate on manufacturing companies in these states fell by 30% during the period. Peter Fisher, *Tax Incentives and the Disappearing State Corporate Income Tax*, 42 State Tax Notes 767 (2002).

[7] During the most recent 25-year period for which data are available (1979-2004), the corporate income tax fell from 10.2% to 5.6% of total state tax revenue in the states imposing corporate income taxes. U.S. Census Bureau, State Tax Collections (1979-2004).

The average effective state-local corporate income tax rate has been gradually declining since the mid-1980s. Congressional Research Service Report for Congress, *Average Effective Corporate Tax Rates: 1959 to 2002*, p. 6 (September 5, 2003).

In *Kelo v City of New London*,[8] this Court addressed the constitutionality of the use of the power of eminent domain by the states in the name of economic development. Both the majority and dissenting opinions in *Kelo* express concern for the potential misuse by government of its power of eminent domain, purportedly to promote economic development, to further powerful private interests at the expense of the general welfare.[9] Justice O'Connor's dissenting opinion explicitly warns that the inevitable fallout from the broad exercise of the taking power in the name of economic development will be that those with power and influence in the political process will benefit, while those with fewer resources and less influence will be victimized.[10]

The same misuse and abuse of the public trust is not just inevitable in the states' use of targeted business tax incentives—it is business as usual in many state capitols.[11] While the victims of states' misuse of the taxing power may not stand out as starkly as the victims of the government's misuse of the taking power, they are victims nonetheless.

Finally, a ruling in this matter that failed to address the important constitutional question before the Court would result in a continuing cloud of uncertainty for both state governments and multi-state businesses regarding the validity of tax statutes on the books providing targeted business tax incentives in almost every state in the union. This uncertainty, in turn, because it makes business decisions more difficult to make, could damper economic activity, an outcome that serves no one's interests.

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[8] *Kelo v City of New London*, 125 S. Ct. 2655 (2005).

[9] *Id.*, at 2661-62, 2665-68, 2674-77.

[10] *Id.*, at 2677.

[11] See *infra*, Part IV, which addresses, *inter alia*, the political power and influence of large corporations as a factor in the proliferation of targeted business tax incentives.

Consequently, respondents should not be denied standing, particularly at this late stage, to challenge Ohio's investment tax credit to protect their own, directly impacted economic interests, and in doing so, the interests of the national economy as a whole.

II. Ohio's Investment Tax Credit is Discriminatory on its Face and Burdens Interstate Commerce in Violation of the Commerce Clause.

A. Ohio's Investment Tax Credit Discriminates on its Face Against Out-of-State Manufacturers Subject to Ohio's Corporate Income Tax.

Despite the ardent assertions of petitioners to the contrary, the investment tax credit provision of Ohio's corporate income tax is clearly discriminatory on its face, imposing differential tax treatment on in-state and out-of-state economic interests that benefits the former and burdens the latter, providing a direct commercial advantage to local businesses. This Court has consistently held that such discrimination violates the Commerce Clause.[12] It does so even under the most favorable set of facts for its proponents, which presumes the credit successfully attracts new investment from outside the state. The following example illustrates:

> Assume XYZ Corp. ("XYZ") and PQR Corp. ("PQR") are identical in every respect. Both are manufacturers with facilities in State B. Both sell their products in State A. Neither has manufacturing facilities there. Both are subject to State A's corporate income tax, and both face the same annual tax liability of $1 million. State A, seeking to attract manufacturing activity, adopts an investment tax credit under its corporate income tax

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[12] *Oregon Waste Sys. v. Dept. of Envtl. Quality*, 511 U.S. 93, 99 (1994); *Boston Stock Exch.*, *supra*, 429 U.S. at 329; *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 265 (1984).

> equal to 7.5% of the cost of production machinery and equipment placed in service within the state. No more than one-seventh of the total credit amount earned may be claimed in a given year. XYZ, motivated by the incentive, abandons its manufacturing facility in State B and invests $100 million in a new facility in State A. PQR chooses to continue manufacturing its products in State B. All other variables remain constant.
>
> As a result of its investment, XYZ earns $7.5 million in tax credits, and claims one-seventh of that credit in each of the next seven years, eliminating its tax liability in each of those years.[13] PQR continues to pay $1 million each year in corporate income tax to State A, a total of $7 million. XYZ's lower tax burden provides a direct commercial advantage to XYZ over PQR in selling its products in State A. XYZ's lower tax burden is due solely to the in-state location of its manufacturing facility.

The petitioners focus their attention on refuting the allegation that Ohio's investment tax credit discriminates against

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[13] Ohio's corporate income tax business income allocation formula includes payroll and property factors. Assuming State A's formula were identical to Ohio's, XYZ's new facility in State A would increase XYZ's property and payroll factors in State A, which would in turn increase the share of XYZ's total income apportioned to State A and consequently increase XYZ's tax liability in State A (without regard to any credit). The operation of State A's apportionment formula would thus serve to offset, in some amount, the benefit of the investment tax credit claimed by XYZ. While it is correct that Ohio's corporate income tax business income allocation formula operates in this fashion, this fact has no constitutional significance. This Court has made abundantly clear in prior cases that Ohio cannot, under the facts presented, assert that its investment tax credit is a valid compensatory tax (See *Fulton v. Faulkner*, 516 U.S. 325 (1996), setting out the stringent test a facially discriminatory tax must meet to qualify as a constitutionally valid compensatory tax). Further, Ohio's use of a three-factor formula including payroll and property is a choice of its own making. Ohio is free to adopt a single-factor sales apportionment formula, under which new investment in Ohio would not, in and of itself, increase the investing corporation's Ohio income allocation percentage.

capital investment made outside Ohio. While such discrimination is indeed present, the fundamental discrimination inherent in Ohio's investment tax credit, as demonstrated above, is far more straightforward. As the example illustrates, the discrimination puts out-of-state manufacturers doing business in and subject to corporate tax in Ohio at a competitive disadvantage vis-a-vis in-state manufacturers doing business in Ohio. This Court has, as a matter of course, struck down state tax provisions that discriminate in this fashion.[14]

Petitioners argue that both XYZ and PQR had an equal opportunity to invest in State A and benefit from the investment tax credit, and therefore there is no discrimination. This argument is specious. It is irrelevant for constitutional purposes that both corporations had the opportunity to locate their facilities in State A. Businesses located in one state are always free to relocate to another. A state may not, however, discriminate against a business because it chooses to conduct its operations elsewhere.[15]

Nothing in this argument is meant to suggest that states may not entice businesses to relocate by offering tax breaks; they certainly may.[16] What states may not do to encourage in-state economic activity is to bestow a direct commercial advantage to in-state businesses by taxing them more favorably than their out-of-state counterparts based solely on the

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[14] See e.g. *Westinghouse Elec. Corp. v Tully*, 466 U.S. 388, 404 (1984); *Boston Stock Exch.*, *supra*, 429 U.S. at 329; *Oregon Waste Sys.*, *supra*, 511 U.S. at 99.

[15] See e.g. *Boston Stock Exch.*, *supra*, 429 U.S. at 334-335; *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269 (1988) (striking down an Ohio statute that provided a tax credit for sales of ethanol produced in Ohio but not in certain other states).

[16] *Boston Stock Exch.*, *supra*, 429 U.S. at 337; *Bacchus Imports*, *supra*, 468 U.S. at 271;

situs of their activities.[17] Ohio's investment tax credit does precisely this, and is therefore virtually *per se* invalid.[18]

B. Because the Calculation of State Corporate Income Taxes Takes Into Account the Business Activities of Taxpayers Carried on Both Within and Without the State, Any Provision Within These Taxes That Treats Out-of-State Business Activity Less Favorably Than In-State Business Activity Based Solely on the Location of that Activity Unconstitutionally Discriminates Against Interstate Commerce.

A Commerce Clause tax discrimination issue faced by tribunals in New York and Wisconsin highlights the discrimination inherent in Ohio's investment tax credit statute.

Under the structural framework of a state corporate income tax, including Ohio's, tax is imposed on an apportioned share of the income earned by a corporation from its business activities conducted both within and outside the state. The calculation of state income generally uses some version of federally reported income as its starting point. This federal figure reflects, among other items, deductions for allowable depreciation of property located both within and outside the taxing state.[19] Federal depreciation rules make no distinction based on the state in which property is located. As a result, state corporate income taxes generally do not impose different depreciation rules for in-state and out-of-state property.

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[17] *Boston Stock Exch.*, *supra*, 429 U.S. at 329; *Bacchus Imports*, *supra*, 468 U.S. at 273; *Westinghouse Elec. Corp.*, *supra*, 466 U.S. at 404.

[18] *Oregon Waste Sys.*, *supra*, 511 U.S. at 99; *Fulton*, *supra*, 516 U.S. at 331.

[19] Ohio Rev. Code § 5733.04

In 1981, the federal Economic Recovery Tax Act (ERTA)[20] was enacted. Among other provisions, ERTA adopted new depreciation rules. The new depreciation provisions, contained in I.R.C. §168, which allowed taxpayers to accelerate deductions under rules known as ACRS (Accelerated Cost Recovery System), were more generous than the former rules set out in I.R.C. §167. Subsequently, New York State, New York City and the State of Wisconsin, concerned with the potential loss of revenues, enacted provisions in their corporate income taxes that provided accelerated depreciation under I.R.C. § 168 for property placed in service within the taxing state while imposing the less favorable depreciation rules of I.R.C. §167 for out-of-state property.[21] New York City's statute and Wisconsin's statute were both challenged, and both were found unconstitutional.[22]

Citing *Oregon Waste Systems v. Department of Environmental Quality* and *Fulton v. Faulkner*, the New York appellate court struck down New York City's depreciation provisions as unconstitutional, concluding that these provisions were discriminatory on their face; that they had the practical effect of discriminating against taxpayers doing business in New York City who had commercial property located outside of the State of New York; and that this unequal treatment resulted solely from the situs of their activities.[23] The Wisconsin Tax Appeals Commission reached the same result, concluding that the effect of the depreciation

[20] Pub. L. 97-34, 95 Stat. 172 (1981)

[21] Former NYC Admin. Code §§ 11-602(8)(b)(11), 11-602(8)(j), 11-602(8)(a)(10); Former Wis. Stat §§ 71.04(15)(a), 71.04(15)(b), 71.26(2)(a), 71.26(3)(y).

[22] *Beatrice Cheese v. Wisconsin*, 1993 Wis. Tax LEXIS 5 (Wis. Tax App. Comm'n, 1993); *R.J. Reynolds v. City of N.Y.*, 237 A.D.2d 6 (1997) appeal dismissed 91 N.Y.2d 956 (1998).

[23] *R.J. Reynolds*, *supra*, 237 A.D.2d at 13.

provisions was "to impose a higher franchise tax burden on a business solely because some or all of its depreciable property is located outside rather than inside [the State, which] is clearly facial discrimination against interstate commerce."[24]

There is very little to distinguish the tax consequences of the depreciation provisions struck down in New York and Wisconsin from those of Ohio's investment tax credit. Those depreciation provisions granted more favorable income tax treatment to property placed in service in the taxing state than property placed in service outside the state. Ohio's investment tax credit, in the form of a credit against tax due rather than a deduction from income, achieves precisely the same result. It grants more favorable tax treatment to manufacturing property placed in service in Ohio than it does to manufacturing property placed in service outside Ohio, resulting in a lower effective tax rate for in-state manufacturers solely because of the situs of their manufacturing facilities.[25]

The discrimination inherent in the depreciation provisions adopted by New York City and Wisconsin is self-evident. The statutes explicitly provided one set of depreciation rules for in-state property and another set for out-of-state property, and treated the former more favorably than the latter. The statutes provided a double standard in favor of in-state activities for all to see. The forbidden discrimination all but jumped off the page.[26]

Ohio's investment tax credit statute, in contrast, makes no mention of out-of-state property.[27] This makes the discrimination less obvious. But, as described above, state corporate

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[24] *Beatrice Cheese*, *supra*, 1993 Wis. Tax LEXIS at 7.

[25] See e.g. *Westinghouse Elec. Corp.*, *supra*, 466 U.S. at 388.

[26] *Oregon Waste Sys.*, *supra*, 511 U.S. at 99; *Fulton*, *supra*, 516 U.S. at 331.

[27] Ohio Rev. Code § 5733.33.

income taxes are imposed on an apportioned share of the income derived from a taxpayer's activities both within and without the taxing state. Consequently, state corporate income tax provisions must address, either explicitly or implicitly, both the in-state and out-of-state activities of taxpayers. Ohio's calculation of corporate income tax includes, among other items of income and expense, deductions for wage expenses incurred both within and outside Ohio, as well as depreciation rules that apply to both in-state and out-of-state property.[28]

The credit provisions of a state corporate income tax are no different from other provisions within such tax - they must address both the in-state and out-of-state business activities of taxpayers. When they fail to do so explicitly, they do so implicitly, by their silence. In other words, appropriately restated, Ohio's investment tax credit provides as follows: qualifying in-state investment receives a 7½% (or 13%) credit; otherwise qualifying out-of-state investment, based solely on the fact it is located out-of-state, receives a 0% credit. This blatant discrimination, providing in-state businesses a commercial advantage, is patently unconstitutional.[29]

Viewed differently, if Ohio's investment tax credit scheme were constitutional, then a statute that provided a 7% credit for qualifying in-state investment and a 3% credit for qualifying out-of-state investment, certainly more favorable to out-of-state corporations than no credit at all, would be constitutional as well. Yet the impermissible discrimination inherent in this hypothetical statute is self-evident. In short,

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[28] Ohio Rev. Code § 5733.04. Petitioner DaimlerChrysler Corporation asserts in its brief (p. 24) that "Ohio does not place a financial burden on out-of-state capital investment. Rather, because Ohio's corporate franchise tax levies only against business value in Ohio, a corporation's out-of-state investment is essentially Ohio-tax-free." As the discussion above demonstrates, this assertion is untrue.

[29] *Boston Stock Exchange, supra*, 429 U.S. at 329.

Ohio's investment tax credit statute can only be read to grant, on its face, preferential treatment to in-state investment that provides a direct commercial advantage under the state's corporate income tax to in-state businesses. The credit is therefore *per se* invalid.[30]

If the Court were to rule that Ohio's investment tax credit is constitutional, would this ruling validate the use by states of more favorable depreciation rules for in-state property than out-of-state property? If it would not, what constitutional principle would distinguish the use of an income tax credit from the use of an income tax deduction? If states may in fact provide more favorable depreciation rules for in-state property, may states also provide one-year expensing of in-state property, while out-of-state property remains subject to depreciation?[31] May states allow a corporate income tax deduction equal to twice the wages paid to in-state employees, but not out-of-state employees? A ruling upholding Ohio's investment tax credit would undoubtedly encourage the states to test these waters.

The correct and better result, fully consistent with existing precedent, is that Ohio's investment tax credit is unconstitutional.

III. The Central Purpose of the Commerce Clause Is to Preclude Precisely the Kind of Parochial, Discriminatory State Economic Policies Exemplified By Ohio's Investment Tax Credit.

The immediate impetus for replacing the Articles of Confederation with the Constitution was the need for eco-

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[30] *Oregon Waste Sys.*, *supra*, 511 U.S. at 99; *Fulton*, *supra*, 516 U.S. at 331.

[31] New York Governor George E. Pataki has recently proposed legislation that would do just this. See New York State 2006-2007 Executive Budget, Article VII Revenue Bill, Part I, available at http://publications.budget.state.nt.us/fy0607artVIIbills/REVENUE.HTM.

nomic unity, unhampered by discriminatory and retaliatory state reprisals against commerce from other states and countries.[32] The Articles of Confederation had reserved to the states, not Congress, the power to regulate foreign and interstate commerce, a framework that proved unworkable as states continued their economic warfare, carried on through tariffs and duties.[33] With each state "free to adopt measures fostering its own local interests without regard to possible prejudice to nonresidents . . . a conflict of commercial regulations, destructive to the harmony of the states ensued."[34]

The states remain free under the Commerce Clause to engage in economic competition with one another by seeking to make their tax regimes more favorable for business activity than their neighboring states.[35] A state, for example, may choose to impose its corporate franchise tax at a low rate, or impose no corporate income tax at all. Alternatively, a state may provide a broad exemption from its sales and use tax for business inputs. States are also free to compete through the use of their spending powers—on public infrastructure, public education, public health and safety, and so on.

What a state may not do—what the Commerce Clause was specifically intended to preclude—is to engage in discriminatory economic policies, including tax policies, that grant a direct commercial advantage to in-state business activity and undermine the goal of a national common market.[36] Such policies include taxes that impose differential tax treatment

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[32] Wiley Rutledge, *A Declaration of Legal Faith*, 25 (1947).

[33] John E. Nowak and Ronald D. Rotunda, *Constitutional Law*, 158-60 (6th ed. 2000)

[34] *Camps New Found./Owatonna, Inc. v. Town of Harrison,* 502 U.S. 564, 571 (1997).

[35] *Boston Stock Exch., supra,* 429 U.S. at 336-337; *Bacchus Imports, supra*, 468 U.S. at 271.

[36] *Boston Stock Exch., supra,* 429 U.S. at 329, citing *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959).

on in-state and out-of-state economic interests that benefit the former and burden the latter.[37] The Ohio investment tax credit does exactly this, undermining a central purpose of the Commerce Clause and the Court's negative Commerce Clause jurisprudence.[38]

While the precise reach of the Commerce Clause is a subject of some debate, the authority and responsibility of the Court to strike down facially discriminatory state tax legislation is beyond question.[39]

IV. The Public Welfare Would be Better Served by the Prohibition of the Use of Discriminatory Tax Incentives Than By Their Continued Proliferation. Targeted Business Tax Incentives Are Ineffective as a Policy Tool. Their Widespread Use Instead Reflects Such Factors as Political Expediency, the Political Power and Influence of Large Corporations, and Purposeful State Discrimination in Favor of In-State Business Activities. A Prohibition Against the Use of a Limited Set of Discriminatory Tax Incentives Would Not Impose Any Hardship on the States. States Have at Their Disposal a Broad Array of Public Policies They May Pursue to Promote Economic Growth and to Compete for Favorable Business Activities Such as Manufacturing, Including Tax Policies.

The public welfare of the states individually and of the nation as a whole would be better served by the prohibition of the use of discriminatory tax incentives such as Ohio's investment tax credit than by their continued proliferation.

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[37] *Oregon Waste Sys.*, *supra*, 511 U.S. at 99.

[38] *Camps New Found. Owatonna, Inc.*, *supra*, 520 U.S. at 571.

[39] *Boston Stock Exchange*, *supra*, 429 U.S. at 329.

The states have at their disposal a broad array of public policies, including tax policies, they may pursue to promote economic growth generally, and, if they choose, to compete directly with other states for certain favored business activities such as manufacturing. With respect to tax policies, states may, under the Commerce Clause, tax corporate income at low rates, or not at all, exempt most business inputs from sales tax, or unconditionally exempt certain industry sectors from real property tax. States may also choose to compete through the use of their spending powers—on public infrastructure and public education, for example. All of these policies might serve to improve a state's business climate. None raises constitutional concerns.

Most states have chosen, however, to make targeted business tax incentives the central component of their economic development strategies, and their use has proliferated over the past decades.[40] This widespread and growing use of targeted business tax incentives is not, however, an indicator of their success as a public policy tool. To the contrary, several decades of research and analysis point to the conclusion that these incentives are largely ineffective.[41] The persistent

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[40] See e.g. Peter D. Enrich, *Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 Harv. L. Rev 377, 382-389 (1996). New York currently offers over two dozen different credits under its corporate franchise tax (N.Y. Tax Law § 210 (McKinney's 2006)).

[41] See e.g. Robert G. Lynch, *Rethinking Growth Strategies: How State and Local Taxes and Services Affect Economic Development*, Economic Policy Institute (2004), which reviews the findings of hundreds of studies examining the effects of state and local tax incentives and concludes that these incentives are largely unsuccessful in stimulating economic activity and creating jobs in a cost-effective manner.

Robert Ady, a prominent site location consultant, concluded:

> "[I]n the facility location process, taxes are not relatively important when compared with other cost factors such as labor, transportation and utility and occupancy costs. . . . In summary, site selection data

growth in their use is attributable instead to a variety of other factors, some relatively benign, others more insidious.

First, businesses championing targeted business tax incentives offer public officials a very attractive proposition—that the targeted business tax incentives that they are advocating will create new jobs and improve the state's economy. Elected officials are thus presented with a win-win-win opportunity under which the citizens win increased job opportunities, the targeted businesses win higher profits, and the elected officials win both business and popular support. Sometimes, the incentives are even advertised as being able to "pay for themselves," allowing the positive outcomes listed above to be accomplished without any reduction in the state revenues needed for public education and other state responsibilities-yet another "win."

If it all sounds almost too good to be true, that's because it is. It's just wishful thinking. As previously noted, a wealth of studies show that targeted business tax incentives have not worked effectively.[42] Nonetheless, many governors and state legislators are frequently seduced by this pitch for targeted business tax incentives because it offers easy answers to difficult public policy issues. In turn, they frequently make this pitch themselves.

Second, even if elected officials suspect that targeted business tax incentives may not work as promised, these officials may often be as interested in the symbolic content of their actions as in their concrete effects. By creating the appearance of being

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do not suggest any correlation between low taxes and positive economic growth, or between high taxes and slow growth. The location requirements are too many, the process too complicated, and other factors too important to justify a strong relationship." Robert Ady, *Discussion*, New England Economic Review, March/April 1997, at 77.

[42] See e.g. Lynch, *supra*, note 41.

proactive in pursuit of economic growth, they can take credit for subsequent economic successes, whatever their actual causes, and avoid most of the blame they might otherwise receive for any bad economic news that befalls the state.[43] Stated more cynically, elected officials genuinely wish to implement policies that will have a positive impact on their state's economy. But, as a close second choice, they desperately wish to take action that gives that appearance.

Third, targeted tax incentives offer state officials a particularly convenient mechanism for the delivery of benefits to private businesses in their state. Because these tax breaks involve a reduction of public revenues rather than an appropriated expenditure of public funds, they do not directly compete with other programs for scarce budget resources. In addition, the likely loss in state revenues from tax incentive legislation is generally difficult to predict, and may well be understated by its proponents, purposefully or otherwise. Indeed, many proponents of tax incentives make the argument that adopting a particular incentive will not result in *any* loss of state revenues—the incentive will "pay for itself" as a result of the increased economic activity it generates.

Further, even in those instances where a reasonable estimate of the cost of a targeted tax incentive is available, the distribution of the tax benefits within the targeted industry is almost always hidden. This lack of information facilitates the enactment of tax incentives that may deliver the lion's share of their benefits—sometimes tens of millions of dollars—to a handful of large corporations.[44] Such largesse

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[43] As one sociologist summarized the phenomenon after studying the mentality of economic development officials, "shoot anything that flies; claim anything that falls." Herbert Rubin, quoted in *Conversations With Economic Development Practitioners*, Economic Development Quarterly, at 237 (1988).

[44] New York State provides an investment tax credit (ITC) for investments in manufacturing property located in New York, accompanied

might not be politically feasible if this information were public.[45]

Additionally, once on the books, tax incentives generally remain there. They almost never require annual reauthorization, and are rarely subject to any kind of programmatic evaluation of their costs and benefits.[46] All of these attributes make targeted tax incentives a far more attractive policy tool than direct subsidies for both businesses seeking favored treatment and elected officials granting such treatment.

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by an add-on employment incentive credit (EIC) for corporations claiming an ITC whose employment has increased by at least 1%. A study published in 1985 by a legislative tax study commission constitutes the only serious evaluation of these credits undertaken since the ITC was first enacted in 1969. Some of the results are striking. For example, in 1982, five corporations claimed 35% ($47.9 million) of the total ITC claimed. Similarly, just five corporations claimed 45% ($24.2 million) of the total amount of EICs claimed. New York State Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, *The New York Investment and Employment Tax Credits* (Staff Report March 11, 1985), as cited in Richard D. Pomp, *Reforming a State Corporate Income Tax*, 51 Alb. L. Rev. 375, 632 (1987).

[45] The corporate business community has vehemently opposed measures proposed in a handful of states to make public certain information contained in the state corporate income tax returns of publicly traded corporations, such as the tax benefits received from targeted tax incentives. See e.g. Robert Tannenwald, *Corporate Tax Disclosure at the State Level: The Massachusetts Experience*, Federal Reserve Bank of Boston (2003). Robert P. Strauss, *State Disclosure of Tax Return Information: Taxpayer Privacy vs. The Public's Right to Know*, 5 State Tax Notes 24 (1993); Richard D. Pomp, *Corporate Tax Policy and the Right to Know: Enhancing Legislative and Public Access*, 6 State Tax Notes 603 (1994); Robert P. Strauss, *The Political Economy of Business Tax Return Policy*, 8 State Tax Notes 873 (1995); Richard D. Pomp, *The Political Economy of Tax Return Privacy - Revisited*, 8 State Tax Notes 2389 (1995); Robert Tannenwald, et al, *Corporate Tax Disclosure: Good or Bad for the Commonwealth*, 5 State Tax Notes 32 (1993).

[46] Sara Hinkley and Fiona Hsu, *Minding the Candy Store: State Audits of Economic Development*, Good Jobs First, September 2000.

Fourth, the states, unless checked by federal restraints, will pursue their parochial economic interests without regard to the consequences for the national economy. From a single state's perspective, the use of targeted corporate tax incentives may be perceived as an efficient strategy for pursuing its own narrow economic interests. First, they provide a (discriminatory) competitive advantage to in-state corporations over their out-of-state counterparts. In addition, because these incentives are granted for in-state activity only, they are perceived as providing a state with more economic development "bang for the buck" than other tax measures, such as a corporate tax rate reduction, which benefits both in-state and out-of-state corporations.

From a national perspective, of course, this "efficiency" is purposeful discrimination that burdens interstate commerce and hurts the national economy. Nonetheless, the states will continue to use discriminatory corporate income tax incentives to pursue their parochial economic interests unless and until they are prohibited from doing so.

Fifth, the abundance of targeted business tax incentives is to a significant degree simply a reflection of the enormous political power and influence wielded in state capitols by large corporations. The misuse of the taxing power on behalf of powerful private interests, cloaked in the mantle of economic development, is all too common. Unlike broad-based, low-rate taxes, higher-rate taxes replete with special provisions are easily engineered to favor those with power and influence. Targeted business tax incentives are thus the vehicle of choice at the state level for directing financial benefits to the most powerful and influential elements of the business community.[47] A tax incentive provision that does

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[47] In his 2001 State of the State message, New York Governor George Pataki exhorted the legislature: ". . . the [corporate] alternative minimum tax sends a very clear message to manufacturers. It says: If you invest in New York, you will be penalized. That is why we've cut that tax in half

not generate a single dollar in additional investment nor create a single new job may nonetheless result in tens of millions in tax savings for large in-state corporations. The following example is illustrative:

> Assume State A imposes a typical corporate franchise tax based on apportioned net income at a rate of 10%. XYZ Corporation ("XYZ") has its main manufacturing facility in State A. The facility is valued at $300 million and employees 500 workers. Routine capital investment

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since 1995. This year, let's finish our work and put the alternative minimum tax in the trash can where it belongs." New York's corporate alternative minimum tax (AMT), imposed at the modest rate of 2.5% in 2001, was enacted in 1987 to ensure that profitable corporations pay at least a modest amount of corporate income tax. (N.Y. Tax Law § 210(1)(c) (McKinney's 2006)). The State's primary tax on corporations is imposed at a rate of 7.5%. (N.Y. Tax Law § 210(1) (McKinney's 2006)). Under this tax, however, corporations, particularly manufacturers, are able to reduce the tax they pay by taking advantage of tax credits that reward certain activities, including investment in plant and production equipment. (N.Y. Tax Law § 210(12)(a) (McKinney's 2006)). These credits may not be used against the AMT. Indeed, that was the intent of the AMT, which was adopted after a legislative study reported that as a result of the State's generous tax credits, some of its largest manufacturers were paying just $250 in corporate tax each year, the statutory minimum. (New York State Legislative Commission on the Modernization and Simplification of Tax Administration and the Tax Law, *The New York Investment and Employment Tax Credits*, Staff Report, March 11, 1985). If the AMT were eliminated, as the Governor proposed, many corporations would be able to use their carryforward credits (over $1 billion in total) under the State's generous fifteen-year carryforward provisions to reduce their tax to the fixed dollar minimum tax every year into the foreseeable future. (New York State Department of Taxation and Finance, Office of Tax Policy Analysis, *Analysis of Article 9-A General Business Corporation Tax Credits For 1999 (2003)*; N.Y. Tax Law § 210(12)(e)(McKinney's 2006)). The AMT was not repealed in 2001 because of the State's deteriorating finances. However, Governor Pataki has called for its repeal again in 2006. (New York State Executive Budget, Article VII Revenue Bill, Section H, available at http://publications.budget.state.ny.us/fy0607artVIIbills/REVENUE.HTM).

averaging approximately $20 million a year is required to keep the facility up and running. XYZ, without tax incentives, pays $1 million annually in corporate franchise tax to State A.

XYZ and other in-state manufacturers approach State A seeking a reduction in their tax payments to State A, asserting that the state's tax structure is undermining their competitiveness and endangering the long-term economic viability of their operations in the State. State A would like to maintain XYZ and the other in-state manufacturers as large employers in the State, and would therefore like to respond positively to their request for lower taxes rather than risk the consequences of failing to do so. Not surprisingly, it would like to do so while minimizing the loss of state tax revenues.

XYZ and other manufacturers with significant plant and equipment in State A ("in-state manufacturers") propose an investment tax credit equal to 10% of the cost of depreciable property used in manufacturing placed in service in State A (but not in other states). State A adopts an investment tax credit that provides: (1) a 10% credit for qualifying manufacturing investment to the extent the amount of such investment exceeds the average investment made in the three prior tax years; and (2) a three-year carryforward provision for unused credits. The State touts the measure by asserting it will increase manufacturing investment and create jobs in the State.

In response to this legislation, XYZ alters its investment pattern, but not its overall investment level. While it continues to average $20 million per year, it adopts a four-year cycle of investment of $10 million in years one, two and three, and $50 million in year four. As a result, it earns a tax credit of $4 million (($50 million - $10 million) x 10%) in year four, eliminating its tax liability for year four and providing a $3 million credit carryforward. These carryforward credits are sufficient

> to eliminate XYZ's tax liability for years five, six and seven, during which years XYZ invests $10 million each year. In year eight, XYZ again invests $50 million, beginning the cycle of credits and carryforward credits once again. Under these facts, XYZ would eliminate its corporate tax liability in year four and every year thereafter, even though its investment in State A has not increased. Nonetheless, both XYZ and state officials cite the incentive as a key piece of the state's economic development strategy, and the State never undertakes a true programmatic evaluation of its costs and benefits that might prove otherwise.[48]

In short, while targeted tax incentives may be unsuccessful as public policy, they result in significant financial gains for the incentive-eligible businesses and in obvious political benefits for the elected officials who, in the name of economic development, promote them. In light of this powerful dynamic, whether targeted tax incentives "work" or not as public policy is often beside the point.[49]

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[48] In New York State, of the corporations claiming the ten largest amounts of investment tax credits for 1982 ($57.5 million among the ten), six had enough credits to reduce their tax to the minimum $250. Yet seven of these ten corporations could not claim the employee incentive credit, which required an increase of a mere 1% or more in New York employment. Overall, 83% of the corporations claiming an investment tax credit in 1982 did not increase their New York employment by even 1%. Pomp, *supra*, note 44, at 636.

[49] New York State has in place an Empire Zone program offering generous tax incentives that was originally designed to promote economic development in economically depressed areas. Over time, the program evolved into a more general economic development program, with tax benefits often available to businesses that are not located in depressed areas. The program is run by the Empire State Development Corporation (ESDC), headed by Charles A. Gargano. Governor Pataki has touted the Empire Zone program as "the best program in America." Yet, according to data provided by the ESDC itself, New York granted $300 million in tax benefits in 2002 to businesses that had reported the creation of 4,000

The public welfare would certainly be better served if the states abandoned targeted business tax incentives as the key component of their economic development efforts.[50] Targeted business tax incentives are largely ineffective as a policy tool; their widespread use instead reflects such factors as political expediency, the political power and influence of large corporations, and purposeful discrimination in favor of in-state activity. Because the states have at their disposal a broad array of public policies, including tax policies, that they may pursue to promote economic development in ways that do not run afoul of the Commerce Clause, they would not suffer any hardship if the use of the limited set of discriminatory tax incentives at issue in this case were no longer available to them.

This is the public policy and political context in which the constitutional challenge to Ohio's investment tax credit has been brought. This Court cannot, of course, substitute its judgment for those made by state legislatures, no matter how misinformed or self-serving. When state tax legislation violates the Commerce Clause, however, the Court should not hesitate to exercise its authority to enforce the Constitution and invalidate such legislation.

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jobs—$75,000 per job—a figure that raised concerns in the legislature regarding the effectiveness of the program. Rather than substantively addressing these concerns, however, Chairman Gargano, in testimony before a legislative committee, simply revised the calculation of tax benefit per job by dividing the $300 million revenue impact for a single tax year by the total number of employees within Empire Zones of businesses receiving tax benefits, and asserting based on this recalculation that the actual cost per job of the program was $1,170. (Marc Santora, *Zones for Business Tax Breaks Are Debated Along Party Lines*, N.Y. Times, at B5 (April 27, 2004). The State has since authorized twelve additional Empire Zones. (New York Chapter Laws, L. 2005, cc. 61, 63.)

[50] See e.g. Lynch, *supra*, note 41.

CONCLUSION

For the stated reasons above, it is respectfully urged that this Court affirm the Sixth Circuit's decision that Ohio's investment tax credit violates the Commerce Clause.

Respectfully submitted,

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