S. HRG. 109–691

# *CUNO* AND COMPETITIVENESS: WHERE TO DRAW THE LINE

## HEARING

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE

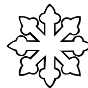
OF THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDRED NINTH CONGRESS

SECOND SESSION

MARCH 16, 2006



Printed for the use of the Committee on Finance

U.S. GOVERNMENT PRINTING OFFICE

30–836—PDF WASHINGTON : 2006

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2250 Mail: Stop SSOP, Washington, DC 20402–0001

## COMMITTEE ON FINANCE

CHARLES E. GRASSLEY, Iowa, *Chairman*

ORRIN G. HATCH, Utah
TRENT LOTT, Mississippi
OLYMPIA J. SNOWE, Maine
JON KYL, Arizona
CRAIG THOMAS, Wyoming
RICK SANTORUM, Pennsylvania
BILL FRIST, Tennessee
GORDON SMITH, Oregon
JIM BUNNING, Kentucky
MIKE CRAPO, Idaho

MAX BAUCUS, Montana
JOHN D. ROCKEFELLER IV, West Virginia
KENT CONRAD, North Dakota
JAMES M. JEFFORDS (I), Vermont
JEFF BINGAMAN, New Mexico
JOHN F. KERRY, Massachusetts
BLANCHE L. LINCOLN, Arkansas
RON WYDEN, Oregon
CHARLES E. SCHUMER, New York

KOLAN DAVIS, *Staff Director and Chief Counsel*
RUSSELL SULLIVAN, *Democratic Staff Director*

---

## SUBCOMMITTEE ON INTERNATIONAL TRADE

CRAIG THOMAS, Wyoming, *Chairman*

MIKE CRAPO, Idaho
TRENT LOTT, Mississippi
GORDON SMITH, Oregon
JIM BUNNING, Kentucky
ORRIN G. HATCH, Utah
OLYMPIA J. SNOWE, Maine
BILL FRIST, Tennessee

JEFF BINGAMAN, New Mexico
MAX BAUCUS, Montana
JOHN D. ROCKEFELLER IV, West Virginia
KENT CONRAD, North Dakota
RON WYDEN, Oregon
CHARLES E. SCHUMER, New York

# CONTENTS

## OPENING STATEMENT


| | Page |
|---|---|
| Thomas, Hon. Craig, a U.S. Senator from Wyoming, chairman, Subcommittee on International Trade | 1 |


## CONGRESSIONAL WITNESS


| | |
|---|---|
| Voinovich, Hon. George V., a U.S. Senator from Ohio | 2 |


## PUBLIC WITNESSES


| | |
|---|---|
| Enrich, Peter D., professor of law, Northeastern University School of Law, Boston, MA | 5 |
| Duncan, Harley, executive director, Federation of Tax Administrators, Washington, DC | 7 |
| Hellerstein, Walter, Francis Shackelford distinguished professor of taxation law, University of Georgia School of Law, Athens, GA | 9 |
| Fisher, Dr. Peter, professor, graduate program in urban and regional planning, University of Iowa, Iowa City, IA | 11 |
| Renzas, James H., president and chief executive officer, Location Management Services, Mission Viejo, CA | 13 |


## ALPHABETICAL LISTING AND APPENDIX MATERIAL


| | |
|---|---|
| Bunning, Hon. Jim: | |
| Prepared statement | 21 |
| Duncan, Harley: | |
| Testimony | 7 |
| Prepared statement | 22 |
| Enrich, Peter D.: | |
| Testimony | 5 |
| Prepared statement | 28 |
| Fisher, Dr. Peter: | |
| Testimony | 11 |
| Prepared statement with attachment | 37 |
| Responses to questions from subcommittee members | 81 |
| Frist, Hon. Bill: | |
| Prepared statement | 83 |
| Hellerstein, Walter: | |
| Testimony | 9 |
| Prepared statement with attachment | 84 |
| Renzas, James H.: | |
| Testimony | 13 |
| Prepared statement | 124 |
| Thomas, Hon. Craig: | |
| Opening statement | 1 |
| Prepared statement | 128 |
| Voinovich, Hon. George V.: | |
| Testimony | 2 |
| Prepared statement with attachment | 129 |


## COMMUNICATION


| | |
|---|---|
| Tax Foundation | 135 |

# *CUNO* AND COMPETITIVENESS: WHERE TO DRAW THE LINE

---

**THURSDAY, MARCH 16, 2006**

U.S. SENATE,
SUBCOMMITTEE ON INTERNATIONAL TRADE,
COMMITTEE ON FINANCE,
*Washington, DC.*

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Craig Thomas (chairman of the subcommittee) presiding.

Also present: Senator Bingaman.

**OPENING STATEMENT OF HON. CRAIG THOMAS, A U.S. SENATOR FROM WYOMING, CHAIRMAN, SUBCOMMITTEE ON INTERNATIONAL TRADE, COMMITTEE ON FINANCE**

Senator THOMAS. We will call to order the *Cuno* case hearing. We are going to be pressed for other things today, so we will get started right on time. I hope there will be other members to join us.

Thank you for being here. We appreciate the opportunity for you to appear before the Senate Finance International Trade Subcommittee to share your thoughts concerning the *Cuno* case and its impact on domestic and international competitiveness, and I look forward to your comments.

The actions that have given rise to this issue to be discussed today began in 1998. DaimlerChrysler entered into agreements with Toledo, Ohio and two school districts to construct a new vehicle assembly plant in exchange for approximately $280 million in tax incentives.

Under two separate provisions in the Ohio law, DaimlerChrysler was to receive a 10-year 100-percent property tax exemption and investment credit tax of 3.5 percent against the State's corporate franchise tax for building the new facility in an economically depressed area in Ohio.

A group of Ohio and Michigan taxpayers sued, alleging that these tax benefits discriminated against those deciding to do business outside of Ohio, in violation of the Commerce Clause of the U.S. Constitution and the Equal Protection Clause of the Ohio constitution.

The Federal court agreed on the issue of the investment tax credit, and the Supreme Court heard arguments on the constitutionality of the investment credit on March 1.

While I am hesitant for the Congress to intervene in the matter that is being litigated, I understand there is widespread interest in the issue presented. In addition, the Supreme Court itself acknowl-

edged that the issue of the investment tax credit is one that may best be dealt with in the political arena.

The issues raised by the *Cuno* case are far-reaching, from encouraging healthy competition for investment between various domestic and international jurisdictions, to ensuring that States do not engage in activity that discriminates against interstate business.

We must take care to guard a State's ability to establish its own laws and exercise appropriate taxing jurisdiction. At the same time, however, we must ensure that there is a clear line delineating where competition ends and discrimination begins.

I am very pleased to have a number of outstanding witnesses here today to provide testimony on these issues. All witnesses will be limited to 5 minutes for their introductory remarks, and your written statements will be entered into the record without objection.

I would also like to acknowledge the interest of the Majority Leader in this issue. While he is unable to attend today, he has submitted a statement for the record. I remind other members that they may submit statements and questions for the record as well.

[The prepared statement of Senator Frist appears in the appendix.]

I look forward to hearing the comments of the witnesses.

I turn, now, to Senator Bingaman.

Senator BINGAMAN. Mr. Chairman, I did not have an opening statement. I think the issue of the hearing is extremely interesting and one we need to understand better, and I appreciate you having the hearing. I appreciate Senator Voinovich taking the lead on this issue and look forward to his testimony.

Senator THOMAS. Thank you, Senator.

So, now we turn to Senator George Voinovich, sponsor of the Economic Development Act that would clarify the ability of States to provide tax incentives to attract investment.

Senator, welcome.

**STATEMENT OF HON. GEORGE V. VOINOVICH, A U.S. SENATOR FROM OHIO**

Senator VOINOVICH. Thank you. Thanks very much for holding this hearing today. I appreciate your understanding the problem because of your experience as a member of the legislature in your State.

Senator Bingaman, I am very happy that you showed up this morning. There are lots of things going on.

We are here to testify at this hearing to discuss the U.S. Court of Appeals for the Sixth Circuit's decision in *Cuno v. DaimlerChrysler* and its effect on competitiveness. I welcome this hearing, and I believe it is an important step in enacting the Economic Development Act of 2005, which I introduced.

First, I want to make this clear. While I was Governor, the Investment Tax Credit at issue in *Cuno* was essential to Ohio's economic success. During my administration, the legislature enacted the Investment Tax Credit, as well as other incentives to help attract new business and expand existing businesses in Ohio. It worked.

After the Investment Tax Credit program was enacted, Ohio surged ahead of others in new business development and existing business expansion. Since the Investment Tax Credit was enacted, over 20,000 businesses have been able to claim a total of $2 billion in credits, leveraging $34 billion in investment.

The Ohio Investment Tax Credit had concrete effects on business decisions. For example, during a House Judiciary Subcommittee hearing on *Cuno,* Michelle Kurt, currently vice president of Corporate Tax for Lincoln Electric, a 111-year-old Cleveland-based manufacturing company, testified: "Without this tax credit, our investments in Ohio would certainly have been less. Since 1995, when the Ohio manufacturing credit began, Lincoln Electric's capital expenditures in Ohio have exceeded one-quarter of a billion dollars. In many of the investment analyses we prepared, taxes are a significant, and in some cases a deciding, factor on where to locate our capital."

Given that tax incentives are an important tool of economic development, and in the wake of the *Cuno* decision, I introduced the EDA. The bill has bipartisan support. It is co-sponsored by all the Senators in the Sixth Circuit.

It is also supported by the National Governors Association, the National Association of Counties, the U.S. Conference of Mayors, the National League of Cities, the International Brotherhood of Teamsters, and the National Association of Manufacturers. That is the big seven, all of them, in favor of this legislation.

In *Cuno,* the Sixth Circuit held that Ohio's Investment Tax Credit was discriminatory because it granted preferential tax treatment to in-State investments and, thus, violated the so-called "Dormant Commerce Clause" of the U.S. Constitution.

As you know, the Commerce Clause grants Congress the power to regulate interstate commerce. On the flip side, the Dormant Commerce Clause restricts States from unduly burdening interstate commerce in the absence of Congressional action. Congress is very much involved in dealing with these issues that the Court deals with in terms of what is alleged to be interfering with commerce.

Applying the Dormant Commerce Clause can be challenging. In *Cuno,* the Federal trial court and the Federal appellate court disagreed as to the appropriate application of that clause. The disagreement between these courts reflects the differences between two general, but conflicting legal principles the Supreme Court has developed regarding State taxes.

The first principle is that a State may not impose a tax that discriminates against interstate commerce by providing a direct commercial advantage to a local business.

The second principle is that a State may use its tax system to encourage interstate commerce and may compete with other States for interstate commerce, so long as the State does not discriminatorily tax the products manufactured or the business operations performed in any other State.

My understanding is that the Court has never completely reconciled these two principles. That is why we need this legislation. On March 1, 2006, the Supreme Court heard oral arguments in *Cuno,* and a decision is expected later this year.

Now, here is the real challenge. If the Court chooses to uphold or reverse *Cuno,* its decision likely will be narrowly tailored. There is no guarantee the Court will reconcile these conflicting legal principles. If the Court dismisses the case for lack of standing by the plaintiffs, as some think they may, then States and businesses will be left without clear guidance as to the validity of State tax incentive programs.

Whatever decision the Court reaches, Congress is in the position to clarify the legality of tax incentives used for economic development by exercising its Commerce Clause powers and enacting the EDA.

If Congress enacts the EDA, it would end the legal ambiguity surrounding such incentives once and for all. Everybody will know where they stand. Without the EDA, other challenges to long-standing incentive programs in other States will occur.

These are not speculative possibilities. There are lawsuits similar to the one brought in *Cuno* pending in a number of other States. In other words, this is a rash that is moving all the way throughout the country. The uncertainty resulting from *Cuno* causes State and local governments and businesses to not be able to rely upon negotiated agreements with mutual benefits.

This uncertainty will trigger large expenditures of public and private monies to determine what incentives or subsidies will pass legal muster. By enacting the EDA, Congress will prevent this confusion and waste of resources required by endless litigation, which is why this bill has gained such widespread support.

The EDA was drafted with the input from the best tax and constitutional lawyers to ensure that the bill would be carefully crafted to protect the most common and benign forms of tax incentives, but not to authorize those tax incentives that truly discriminate against interstate commerce. I will be submitting for the record the list of cases that we feel that this would not touch.

[The information appears in the appendix on page 133.]

Senator VOINOVICH. Moreover, the EDA does not require that States offer tax incentives. The policy considerations and fiscal impact of tax incentives are complex questions that are driven by the facts and circumstances of each State.

The EDA simply recognizes that 50 States, not the courts, are in the best position to evaluate these decisions. States are the laboratories of democracy and innovation.

The Economic Development Programs in States create jobs and prosperity by allowing each State to tailor packages to encourage new growth through tax incentives for job training, job creation, and investment in new plants and equipment.

As we all know, companies considering investment opportunities are comparing not just different States in the United States—this is a very important part of this—but also countries around the globe.

As Michelle Kurt of Lincoln Electric stated, "Many other international locations offer exceptional tax incentives: low wages and no litigation costs. For a company like Lincoln Electric, our preference is to create jobs inside the United States. However, the economic factors presented by many other jurisdictions can make an

investment decision to locate outside the United States overwhelming."

In other words, this is not now between the States. We are competing now with countries all over the world that want our businesses. As a former Governor who had to compete against Japan, Canada, China, India, and Europe for business expansion, as well as new business projects, I know just how important a role tax incentives play in attracting new businesses, as well as in retaining existing businesses.

As Ms. Kurt's statement demonstrates, and I can verify from my experience as Governor, our international competitors are certainly not going to stop using tax or other incentives to attract our businesses. We should not impede the States' ability to do the same.

To compete in the global economy, States need to be able to use tax incentive policies as one tool for economic development. By enacting the EDA, the winners will be working men and women and their families, who will benefit from new business investment and existing business expansion.

I certainly appreciate the opportunity to testify before you today and hope that you give real serious consideration to this matter, because I want you to know that, even if the Court decides this case, there is still going to be uncertainty in the country, and it needs to be clarified.

[The prepared statement of Senator Voinovich appears in the appendix.]

Senator THOMAS. Thank you very much, Senator. We appreciate your being here.

Senator VOINOVICH. Thank you.

Senator THOMAS. We have an interesting panel that will follow you with some additional ideas.

Senator VOINOVICH. Thank you. Again, thank you for the hearing.

Senator THOMAS. All right. Let us have our second panel, please. Mr. Peter Enrich, professor of law, Northeastern University School of Law in Boston; Mr. Harley Duncan, executive director, Federation of Tax Administrators, Washington, DC; Mr. Walter Hellerstein, Francis Shackelford distinguished professor of taxation law, University of Georgia School of Law, Athens, GA; Dr. Peter Fisher, professor, graduate program in urban and regional planning, The University of Iowa, Iowa City, IA; and Mr. James Renzas, president and chief executive officer, Location Management Services, Mission Viejo, CA.

A very impressive panel, gentlemen. We thank you so much. As I indicated, if you can summarize your statement in about 5 minutes, then we will include your complete statement in the record. Then perhaps we will have some questions.

So if we could begin with you, Mr. Enrich, we will start, sir.

## STATEMENT OF PETER D. ENRICH, PROFESSOR OF LAW, NORTHEASTERN UNIVERSITY SCHOOL OF LAW, BOSTON, MA

Professor ENRICH. Good morning. I want to thank you, Chairman Thomas, and of course the subcommittee, for the invitation to testify at this hearing. It is an honor and a privilege.

In my statement this morning, I would like to highlight two points that are developed at greater length in my written testimony. First, the accelerating proliferation of State tax breaks to influence business location harms the national interest, and it does so in precisely the ways the Commerce Clause was designed to protect against.

Second, the legislation presently before the subcommittee is severely flawed as an attempt to draw a boundary between harmful tax discrimination against out-of-State business and acceptable State economic development measures.

On the first point, I will be very brief. The States are caught in a vicious cycle of offering ever-larger tax breaks to large, mobile businesses. But this is a zero-sum game that the States cannot win. The tax breaks do not create jobs or investment; at best, they merely shuffle them from place to place.

But this game carries very high costs, costs in the form of a dramatic shift of tax burdens onto individuals and small businesses, and costs in the form of depleted revenues for the things that really matter to a strong economy, like education and infrastructure.

The constitution responded to an earlier example of this same harmful competition among the States for business, at that time in the form of tariff wars, by placing responsibility for interstate commerce with the Federal Government, not the States.

The framers understood that the States' rational self-interest would inevitably trigger these vicious cycles unless the States were precluded from this kind of competition.

Now, as then, the imperatives of international competitiveness do not change the situation. To suggest that State tax breaks, which at best serve as tie-breakers in interstate competition, can significantly affect international location decisions defies plausibility, not to mention the prospect that these State tax breaks violate our trade treaty commitments.

Turning to my second point, the proponents of the legislation before you claimed that it preserves the status quo, protecting against discriminatory tax measures, while allowing pro-economic development policies.

But, in fact, its sets off on a novel and deeply flawed new course. The proponents say legislation is needed because the courts' Dormant Commerce Clause jurisprudence is "a quagmire," a term that the Court itself has used.

But while some areas of the Commerce Clause case law are hounded by inconstancy and inconsistency, the area in question here today, the prohibition against discrimination against interstate commerce, is not.

I cannot do better than to quote the Court's own words: "From the quagmire, there emerge some firm peaks of decision which remain unquestioned. Among these is the fundamental principle: no State, consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce by providing a direct commercial advantage to local business.

"The prohibition against discriminatory treatment of interstate commerce," the Court goes on to say, "follows inexorably from the basic purpose of the clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-

State businesses would invite a multiplication of preferential trade areas, destructive of the free trade which the clause protects."

Senator Voinovich's bill would turn the Supreme Court's approach on its head. Where the Court begins with a prohibition on discriminatory tax measures, the bill begins with a blanket authorization of tax incentives that discriminate against interstate commerce, so long as they are said to be intended to foster economic development.

The bill then seeks to preserve the existing restrictions on discrimination by excepting from its blanket authorization seven specific kinds of tax provisions, reflecting specific measures previously struck down by the courts.

But this approach is fatally flawed in two respects. First, it assumes that the boundaries of discrimination can be frozen in time, that the courts have already recognized all of the kinds of tariff-like tax measures that human ingenuity can devise.

Second, it fails to provide any kind of principle that distinguishes the forbidden practices from the permitted ones, relying instead on an ad hoc list. One symptom of these fundamental flaws, which I spell out in my written testimony, is that the bill would authorize a wide range of measures of kinds the courts have forbidden, while it likely fails to authorize the very measures—the State investment tax credits—that it was designed to protect.

Because of its flawed structure, the bill provides neither clarity, nor protection against the engineering of an array of new tariff-like measures that would be immunized from scrutiny. In fact, the bill is an open-ended invitation to such engineering.

In short, I would urge the committee that if Congress is to consider legislation in this area, it do so sensitive to the fundamental purposes behind the Commerce Clause and that it be cautious about superseding the Court's careful and cogent approach, unless it is able to offer a similarly coherent and administrable alternative standard.

The bill before you clearly fails to provide such an alternative, and its failings suggest the great difficulties confronting any attempt to devise legislation along similar lines.

Thank you.

Senator THOMAS. Thank you.

[The prepared statement of Professor Enrich appears in the appendix.]

Senator THOMAS. Mr. Duncan?

**STATEMENT OF HARLEY DUNCAN, EXECUTIVE DIRECTOR, FEDERATION OF TAX ADMINISTRATORS, WASHINGTON, DC**

Mr. DUNCAN. Thank you very much, Mr. Chairman. My name is Harley Duncan. I am the executive director of the Federation of Tax Administrators, which is an association of the principle tax administration agencies in each of the 50 States, DC, and New York City.

Our organization adopted a policy resolution in June of last year in support of the Economic Development Act of 2005, S. 1066. The goal of our resolution and the goal of the legislation, we believe, ought to be that if the *Cuno* decision is not set aside by the Court, that Congress should act to authorize State tax incentives for eco-

nomic development purposes, with the effort being to return to the state of affairs as they existed prior to the *Cuno* decision.

I would like to emphasize three points this morning. The first is that, if *Cuno* is not overturned, it is extremely important that Congress act. Every State has adopted a variety of incentives in their tax structure to promote development and encourage business location and investment in their State. They take the form of investment tax credits, job creation credits, sales tax exemptions, credits for investment in venture capital funds, and the like.

There are a number of arrangements in place with existing businesses in each State. If each of those were outlawed or prohibited by the *Cuno* decision and there needed to be retroactive relief, the disruption of corporate balance sheets would be detrimental and extremely significant.

You will hear, and have heard, testimony that questions the effectiveness or efficiency of tax incentives. We really believe that the question of, do they work, is misplaced before the Congress.

The question of whether they work is one that is best decided by State and local officials, considering their own structure, their unique circumstances within their State and their locality. It really is a matter that State and local elected officials should consider in terms of what types of incentives they want to offer, and the conditions under which they wish to offer them.

I would also make a comment on the race to the bottom, as Professor Enrich characterized it, in terms of States not being able to help themselves and continuing to grant incentives that cause the corporate tax to waste away. I think that sells State and local elected officials quite short.

If you look at the pattern and the activity in State legislatures over the past 3 years, the bulk of the tax activity that has occurred has all been aimed at trying to shore up the corporate income tax, make it a viable piece in State revenue structures, and to avoid and to mitigate some of the instances and effects of what the States have considered inappropriate tax planning or income shifting.

So, I think the State and local elected officials and State legislatures have a sense of what the corporate tax is supposed to do and what they can do to preserve it, and they have done that.

The second point I would make to you is that, obviously, Congress cannot make an open-ended grant to use State tax incentives for economic development purposes. There must be, of course, guidelines that prevent impermissible discrimination.

As I said, our goal was to return to the status quo ante, prior to, *Cuno*. We believe that S. 1066, the bill by Senator Voinovich and others, strikes a reasonable balance in this regard.

As Mr. Enrich pointed out, it first authorizes incentives for economic development purposes and then sets a series of restrictions on the types of incentives that are not to be authorized by the Act.

Whether that list is complete and perfect, of course, is one that needs to be explored, and further work can be done. But we think it is in the right direction. It is not a fundamentally flawed approach and is one that deserves the support of the Senate.

Finally, the third point I would like to make is that there is language in section 3B of the bill that is extremely important to the

States, and we think is important to the effective functioning of the Economic Development Act.

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

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

Thank you, Mr. Chairman.

Senator THOMAS. Thank you, sir. Appreciate it.

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

Senator THOMAS. Mr. Hellerstein?

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

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

Senator THOMAS. Good for you!

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

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

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

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

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

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

The uncertainty created by this, which has been alluded to by Senator Voinovich, is very serious, both, from a taxpayer standpoint, in terms of what they have relied on in the past and what they may rely on in the future.

In terms of States, if States lose these cases, under Supreme Court doctrine they have to provide meaningful backward-looking relief. That could mean coughing up hundreds and millions of dollars to those who were discriminated against. In the future, budgetary considerations are quite uncertain.

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

"We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. The problem calls for a solution by devising a Congressional policy."

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

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

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

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

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

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

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

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

Thank you very much.

Senator THOMAS. Thank you, sir.

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

Senator THOMAS. Dr. Fisher?

**STATEMENT OF DR. PETER FISHER, PROFESSOR, GRADUATE PROGRAM IN URBAN AND REGIONAL PLANNING, UNIVERSITY OF IOWA, IOWA CITY, IA**

Dr. FISHER. Thank you. I am honored to be afforded this opportunity to present my views today on State economic development tax incentives.

While I am a professor of planning, I have a doctorate in economics, and I have spent about the last 10 years conducting research on State tax incentives and economic development policy.

I want to focus my remarks on the issue of whether or not it is good national economic policy, as it has been suggested by many, to encourage States to engage in competition with one another for business activity through the offering of tax incentives.

I argue that such competition is counterproductive, both for the States engaging in such activity and for the national economy. I would, therefore, conclude that Federal legislation sanctioning or encouraging the use of tax credits and similar incentives by State governments is not in the national interest.

I have five points that I would like to make. First, tax incentive competition is, at best, a zero-sum game. State tax incentives are designed to change the location of economic activity by inducing the firm to locate and/or move a facility to the State offering the incentive rather than another State.

To the extent that such incentives are effective, they merely move economic activity from one State to another. There is no national interest in encouraging economic activity to move in response to such incentives, since no net gain in economic activity for the Nation arises.

Second, tax incentive competition affirms economic efficiency. It is likely that the State tax incentive competition is, in fact, not a zero-sum game, but a negative-sum game. That is, it produces a net loss for the national economy.

In the absence of incentives, firms choose locations based on economic rationality; that is, the location that minimizes the cost of production and distribution would be selected. Labor supply and productivity, labor costs, access to markets and suppliers, cost of utility services; these are the major determinants of location.

Tax incentives, however, are designed to alter the location choices of business and, in so doing, to override those kinds of market considerations. To the extent that they are effective in altering choices, they will produce a pattern of economic activity that requires greater use of real resources and, hence, reduces national economic efficiency.

Point three. Tax incentive competition undermines economic growth. Our Federal system places on State and local governments much of the responsibility—in fact, probably most of the responsibility—for providing the public services that businesses directly use and depend on: education for entrance into the labor force, police and fire protection, provision of streets and highways, and water and sewer systems.

Investment in these services provides the foundations for economic activity. By diverting tax revenues, tax incentive competition undermines the ability of State and local governments to finance those services and thereby degrades the quality of basic services that the Nation needs to support economic growth.

Four. Tax incentive competition does not benefit the States. I have concluded from a review of the extensive research on incentives within the U.S. that they are a marginally effective, and very expensive, tool for attracting business from one State to another.

State and local taxes falling on business represent only about 1.2 percent of the total cost of doing business, so that incentives that reduce this fraction a little provide very little leverage over the location decision.

For the vast majority of investment and location choices, tax incentives will be swamped by differences in other economic factors. The typical incentive package offered routinely by a State to attract manufacturing investment, for example, can be expected to be the decisive factor in the location decisions of firms in only about 1 in 10 instances. The other 9 out of 10 times, the incentives are simply a waste of money because the firm would have made that decision anyway based on sound economic reasons.

My last point. Interstate tax incentive competition is an inappropriate vehicle for enhancing the competitiveness of the U.S. in the global economy. It might be argued that interstate tax incentive competition drives down the level of taxes on business activity and makes the U.S. as a whole more competitive.

This is a poor argument in defense of State incentives. First of all, State taxes are small relative to Federal. Second, State taxes are small relative to the enormous variation in transportation costs, labor costs, and labor productivity across Nations.

Thus, even very large State tax incentives will not cause much variation in the overall tax bill facing the firm, and will not be enough to offset even small differences in the other factors that are more important in determining the profitability of U.S. versus overseas locations.

More importantly, it hardly makes sense for Congress to delegate to the 50 States the task of ensuring that economic activity remains in the U.S. If this is a compelling national interest, surely it calls for measures at the national level.

Incentives are a weakly effective and costly tool, even for altering the location decisions of firms from one State to another. As a tool for offsetting the much more substantial differences in costs between U.S. and overseas locations, they must be even less effective and more costly.

In conclusion, States have available to them a variety of strategies for enhancing economic growth that are more cost-effective and that do not require a beggar-thy-neighbor strategy.

Investments in infrastructure, education, and workforce development are important not only to a State's economic growth potential, but to the ability of the U.S. to compete in the global economy.

Encouraging States to compete with one another through tax incentives deprives them of the resources to fund the investments that we as a Nation must depend on as we confront the challenges of globalization.

We cannot afford a national economic strategy that relies on each of the 50 States to figure out for themselves how to stem the outflow of production and jobs from the U.S. This is surely a self-defeating strategy in the long term.

Senator THOMAS. Thank you very much, sir.

[The prepared statement of Dr. Fisher appears in the appendix.]

Senator THOMAS. Finally, Mr. Renzas?

**STATEMENT OF JAMES H. RENZAS, PRESIDENT AND CHIEF EXECUTIVE OFFICER, LOCATION MANAGEMENT SERVICES, MISSION VIEJO, CA**

Mr. RENZAS. Mr. Chairman and members of the subcommittee, I am honored to have been invited to testify before this distinguished body on an important issue affecting the future of this great country.

Today you have heard from a number of brilliant and distinguished experts in the field of State taxation and economic development. These experts have a variety of backgrounds and are highly educated, and immersed in the body of research surrounding the effects of taxation and State economic policy on the creation of new jobs and investment.

As CEO of Location Management Services, I am unique in the respect that, rather than conduct research and theorize on what makes companies choose certain locations for new corporate facilities, I have actually done it hundreds of times over in my career.

That said, I would like to discuss my life helping companies select the most appropriate locations for new investment and job creation from the standpoint of one who has been on the inside with senior management and the board directors when comparing the pros and cons of potential investment locations.

Location Management Services recently partnered with the National Association of Manufacturers to offer its members corporate site-selection services in the United States through the Site Selection Network.

This network provides confidential site-selection consulting services to NAM members who are looking to establish new corporate manufacturing facilities, distribution centers, corporate headquarters operations, and back-office support centers.

In the last 2 weeks, I have conducted field work in the States of North Carolina and Georgia to help a U.S. manufacturer select the final location for a half-million square-foot manufacturing plant, which will ultimately employ over 1,000 American workers.

As part of that field work, I have interviewed numerous manufacturers in five semi-finalist counties throughout the States to assess the availability of labor skills, employment costs, benefit policies, and government cooperation. I have learned a great deal about what these U.S. manufacturers are facing in an increasingly competitive world market.

Some of these companies have dropped product lines as their markets have been adversely impacted by dramatically lower prices resulting from the movement of their competition from the United States to offshore locations like China, India, and the Philippines.

One textile company I interviewed in North Carolina last week downsized its workforce from over 300 manufacturing employees to

just 65 manufacturing employees today as global competition and pricing has eroded its profit margins.

Another consumer products company simply discontinued manufacturing in the United States and moved operations to Mexico, where wage rates are a fraction of the wage rates in North Carolina.

This relocation resulted in the displacement of over 800 manufacturing workers who have almost no hope of finding a replacement job paying anywhere near what they formerly made in the manufacturing sector.

As we analyze these locations for labor force availability and skills, most employers have commented favorably on the commitment, skills, and work ethic of the American worker.

Yet, given the competitive pricing advantage that offshore locations have in labor, materials, health care, real estate, and environmental compliance, many of our manufacturing companies cannot afford to continue employing these workers.

In the last 4 years, the United States has lost close to 1.3 million manufacturing jobs, resulting in the displacement of honest, hardworking American workers throughout this country, including the States that you represent.

I am sure you are all well-aware of the recent announcements of General Motors, Ford, Delphi, and many others in the automotive industry who have chosen to close plants and lay off thousands of manufacturing workers in order to remain competitive.

These workers went to work every day, paid their taxes, did good work, and did nothing to deserve this fate. Yet, thousands will pay the price in the form of lost jobs, broken families, and lost savings in the name of global competitiveness. Some have postulated that incentives make no impact on the final decision of companies as to where they will place their corporate facilities.

Having been a consultant to hundreds of companies seeking new locations for corporate facilities, however, I can tell you unequivocally that once the basic site selection criteria have been satisfied, incentives often do make a difference in the selection of the finalist location, and second place does not count in site selection.

Some witnesses have calculated that State and local taxes comprise roughly 1 percent of business costs, and there could not be sufficient enough incentive to influence the location decision one way or the other. Yet, when one looks at the impact that incentives have on geographically variable operating costs, that is, the business cost that can vary from one location to another, such as property taxes, real estate costs, labor costs, Worker's Compensation costs, et cetera, the impact of State and local incentives can often be equal to 10 to 20 percent of the capital investment.

A cost reduction of this nature is often enough to get the attention of the chief financial officer and the board of directors, who are instrumental in the selection of the finalist site.

Incentives are but one tool that States currently use to help level the playing field and attract jobs and investment. If you look at what other countries like China, India, and Ireland offer new companies by way of incentives, you will find that the incentive packages are often much more generous than any U.S. State.

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

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

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

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

Thank you very much.

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

Senator THOMAS. Thank you. That is a very impressive panel. We thank you so much.

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

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

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

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

Senator THOMAS. So you maintain it is ineffective.

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

Senator THOMAS. I understand.

Dr. FISHER. And very expensive.

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

Professor ENRICH. Senator, again, you are asking the legal expert the economic question. In the course of my scholarship and in the course of my work as a State official, I have had the occasion to look at a lot of evidence about the size of differences the tax incentives do make to business bottom lines.

I do not hold myself out as an economist or an expert, but the overwhelming evidence is that tax incentives offered at the State level are not terribly effective.

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

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

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

Senator THOMAS. All right.

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

Senator THOMAS. Thank you.

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

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

Senator THOMAS. All right. Thank you.

Senator Bingaman?

Senator BINGAMAN. Thank you all for your testimony.

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

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

Now, I do think, myself, I have seen examples in my State where companies were solicited to move to Ireland, or to Singapore, or whatever, and there are very substantial financial incentives offered to them to do that.

We have then, for example, the Albuquerque Economic Development Organization trying to figure out, how can it compete with the government of Ireland or the government of Singapore, or wherever it happens to be. Frankly, it is not a very fair competition.

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

provided by other countries, we should be doing that at the Federal level.

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

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

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

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

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

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

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

Dr. FISHER. I would.

Senator BINGAMAN. Go ahead, please.

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

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

The question is, what is the most cost-effective use of limited resources? I would argue that investments in education, particularly

at this juncture, are a much more cost-effective use of our scarce resources than competing with one another on the taxes.

Senator BINGAMAN. Thank you, Mr. Chairman.

Senator THOMAS. Thank you, sir.

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

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

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

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

Senator THOMAS. Thank you.

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

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

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

Professor ENRICH. Not just to fill the holes.

Senator THOMAS. Even if overturned.

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

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

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

I just want to return for a moment, without keeping you from your vote, to what Senator Bingaman was suggesting. I think it is very important to keep in mind that there are two issues here.

The one that Senator Bingaman spoke about as a bigger problem, which I think is not within my area of expertise, is terribly important, but we should not let the problems with that issue, I think, stop Congress from resolving the sort of narrow or legal problem of clearing up this uncertainty. Even assuming we can keep the law as it is, at least let us make it clearer. That is my plea to you.

Senator THOMAS. Thank you.

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

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

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

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

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

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

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

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

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

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

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

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

Senator THOMAS. All right.

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

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

Senator?

Senator BINGAMAN. Let me ask, Dr. Fisher, based on your analysis of the economics, if you were to assume that tax incentives can impact on the decision to locate a plant or to maintain an operation, to some extent, to what extent does the possibility of Federal tax incentives compare to the possibility of State and local tax incentives?

My impression is, and I think one of you testified to the effect that, there is a substantially greater capability at the Federal level to provide financial incentives through the tax code than there is at the State and local levels, so you have State and local governments essentially giving away the fairly modest taxing authority that they have to get these jobs to locate there, where the Federal Government could do much more if it were so inclined. Do you have any thoughts on that?

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

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

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

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

The hearing is adjourned.

[Whereupon, at 10:29 a.m., the hearing was concluded.]

# APPENDIX

## Additional Material Submitted for the Record

---

**Statement of Senator Jim Bunning**
**Senate Committee on Finance**
**Subcommittee on International Trade**
**"Cuno and Competitiveness: Where To Draw the Line"**
**16 March 2006**

Thank you, Mr. Chairman.

I have been looking forward to today's hearing for quite a while, and I thank Chairman Thomas for his leadership in making it happen.

Senator Frist and I, and the rest of the delegation from the Sixth Circuit, have been working under the leadership of Senator Voinovich to address this issue, which arose from a Sixth Circuit decision.

I have had a number of conversations with State and local officials in Kentucky, who have expressed their concern to me about the impact that this decision could have on the commonwealth.

I am extremely interested in the testimony we will hear today.

Obviously, the outcome of the recent arguments in the Supreme Court in the Ohio case will have an impact on when or even whether Congress should act in this area.

I am hopeful that today we will be able to examine how various potential outcomes of the Supreme Court case could affect the desirability of us acting in this area.

I also hope that we will spend time examining the legislation that Senator Voinovich and the rest of the senators from the Sixth Circuit have put forward and hear suggestions from our experts on possible improvements to that bill.

I look forward to hearing today's testimony.

Thank you.

**Statement of**
**Harley Duncan, Federation of Tax Administrators**
**Before the**
**International Trade Subcommittee – Senate Committee on Finance**
**March 16, 2006**

Mr. Chairman and Members of the Committee:

My name is Harley Duncan. I am Executive Director of the Federation of Tax Administrators. The Federation is an association of the principal state tax administration agencies in the 50 states, D.C., and New York City. Thank you for the opportunity to appear before you today to discuss the *Cuno* decision and S. 1066, the Economic Development Act of 2005.

The policy of our organization regarding this matter is contained in a resolution adopted by our members at the June 2005 Annual Meeting in San Antonio. That policy supports S. 1066 and offers the auspices of our organization to work with the states and Congress to arrive at federal legislation that would protect state and local governments' interest in offering tax incentives. The sponsors of the bill worked with FTA and its members to improve the clarity and precision of the bill and to address concerns about the effects the bill might have on existing state and local tax incentives. We believe that the bill represents a good-faith effort to balance the states' interests in offering incentives and avoiding harmful discrimination against interstate commerce. My statement will focus on three points: the need for Congress to act in this area; the need to avoid discrimination against interstate commerce; and the importance of certain language in the bill.

**The need for S. 1066.** As you know, in its 2004 decision in *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (2004), the U.S. Court of Appeals for the Sixth Circuit determined that an investment tax credit offered by the City of Toledo, Ohio and other Ohio jurisdictions violated the Commerce Clause of the federal constitution. The city and other political subdivisions had entered into a development agreement with an automobile

manufacturer, by which the manufacturer would receive $280 million in local property and state corporate franchise tax benefits, to induce the manufacturer to stay in the city. The federal district court had upheld the constitutionality of the incentives, on the basis that, while an increase in Ohio activity could increase the tax benefits for the manufacturer, the benefits were not decreased as a result of an increase in activity outside of Ohio. The appellate court, however, rejected the position that tax incentives were permissible as long as they did not penalize out-of-state economic activity. The appellate court instead determined that U.S. Supreme Court decisions had not distinguished between laws that benefit in-state activity and laws that burden out-of-state activity, and that, "economically speaking, the effect of a tax benefit or burden is the same." The court ruled that the investment tax credit discriminated against interstate commerce in violation of the Commerce Clause (while the constitutionality of a property-tax credit was upheld). The U.S. Supreme Court agreed to review that decision, and oral argument of the case was heard by the Court on March 1, 2006.

While we at FTA have not attempted to catalog all of the tax incentives offered by state and local governments, we can say with some confidence that there are many such incentives that would be difficult to distinguish in any material way from the incentives involved in *Cuno*. Consequently, if that decision is allowed to stand, those incentives would be vulnerable to attacks based on the *Cuno* decision. There are already actions challenging tax incentives pending in North Carolina and Minnesota, and there is every reason to believe that, if Sixth Circuit position holds, there will be more such actions filed. Such challenges would call into question the constitutional validity of the multitude of existing arrangements that many businesses have relied upon in making decisions regarding the locations of their plants and other properties. The negative impact on corporate balance sheets and shareholder value would be extremely detrimental. In addition, the challenges would disrupt or negate a substantial component of each state's development program.

Beyond the issue of the constitutionality of tax incentives, some commentators and litigants have questioned the effectiveness and wisdom of offering such incentives. We

do not believe that is the question before this Committee. It is clear that each state believes tax incentives are an important part of its economic development effort as witnessed by the number of programs in place. We believe the issue of whether and what types of incentives are effective and in what circumstances they should be offered are issues that are best resolved by state and local elected officials operating in their normal legislative and administrative processes. The ability to structure one's tax system is one of the most basic and integral aspects of state sovereignty and should be subject to the control of state and local elected officials. Therefore, if the *Cuno* decision is not overturned, we believe it is important that Congress act to preserve the ability of states and localities to offer tax incentives for economic development purposes.

**Avoiding impermissible discrimination against interstate commerce.** It is clear that the Commerce Clause gives Congress the authority to act in matters involving interstate commerce. In fact, the Supreme Court has encouraged Congress to do so, for example, in the matter of determining what would constitute sufficient nexus with a state to allow that state to require an out-of-state seller to collect the state's use tax. In *Quill Corp. v. North Dakota*, 112 S.Ct. 1904, 1916 (1992), after rejecting the state's position that the time had come to renounce a test for nexus that had been established in an earlier decision, the Court stated, "This aspect of our decision is made easier by the fact that the underlying issue is not only one that Congress may be better qualified to resolve, but also one that Congress has the ultimate power to resolve." (Footnote omitted.)

Similarly, if the U.S. Supreme Court does not overturn the *Cuno* decision on the merits (as opposed to deciding the case on the standing issue, which appears to be a distinct possibility), Congress should address the issue of the constitutionality of state tax incentive. In doing so, however we believe it will be necessary not only to authorize the use of certain types of tax incentives, but to also provide guidance as to what types of incentives would not be acceptable in that they would constitute impermissible discrimination against interstate commerce. In our view, the goal of federal legislation in this area should be to reestablish the lay of the land as it was commonly understood prior to *Cuno*. We believe S. 1066 effectively accomplishes this task.

As you know, the U.S. Supreme Court has ruled that a variety of state tax preferences have violated the Commerce Clause by impermissibly discriminating against interstate commerce. Those decisions involved preferences in the form of, for example, a West Virginia gross receipts tax that exempted in-state manufacturers, *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984); a New York gross receipts tax that allowed a credit for sales of products shipped from New York but not from other locations, *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984); an excise tax exemption only for alcoholic beverages produced in Hawaii, *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984); and, a New York tax scheme that imposed a higher tax on transfers of stock occurring outside the state than was imposed on transfers involving a sale within New York, *Boston Stock Exchange v. State Tax Commissioner*, 429 U.S. 318 (1977). These and other cases provide guidance as to what types of incentives are acceptable and unacceptable, and are the decisions that, to a large extent, have been encapsulated in the list of types of incentives that are not authorized by S. 1066, in Section 3(a) of the bill. Therefore, while S. 1066 provides a general authorization for state tax incentives in Section 2, it balances that authorization with a statement of what types of incentives are not authorized.

In reaching its decision in *Boston Stock Exchange*, the Court described the state of the law as follows:

> Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade society. We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other state.

429 U.S. 336, 337. S. 1066 strikes the balance contemplated by the Supreme Court, between the encouragement of intrastate business and the prohibition against discrimination against interstate commerce.

The importance of certain language in the bill. As described, S .1066 is an attempt to balance a general authorization of tax incentives for economic development with restrictions that would prevent impermissible discrimination by removing from that authorization incentives that fit within the drafters' characterizations of several U.S. Supreme Court decisions striking down incentives. That is not a process that can produce precision for at least two reasons: (a0 U.S. Supreme Court rulings are often not suited to brief encapsulations; and (b) one cannot know with certitude which state tax incentives would fall within the ambit of each of those provisions. That would leave open the question of what would happen to a tax incentive that, by falling within the ambit of a provision describing an incentive that is not authorized by the bill. That is, would such an incentive be considered in violation of the Commerce Clause, because Congress had addressed, or occupied, the area of state tax incentives and had explicitly not authorized that incentive? As you can imagine, this is a critical question. That question is addressed by Section 3(b) of the bill.

While Section 3(a) sets out the "Tax Incentives Not Subject to Protection Under This Act," Section 3(b) states:

> No Inference. – Nothing in this section shall be construed to create any inference with respect to the validity or invalidity under the Commerce Clause of the United States Constitution of any tax incentive described in this section.

As we read this section – and have been assured by the drafters of its meaning – Section 3(b) provides that, if a tax incentive falls within the ambit of Section 3(a), so that it is not authorized by Section 2 of the bill, it cannot be inferred by the courts that that incentive is invalid under the Commerce Clause. That is, such an incentive is merely not authorized by the bill, but is not in any way prohibited or invalidated by the bill. Therefore, if a court were to determine that an incentive fell within the ambit of Section 3(a), so that it was not protected by the bill, the court would then undertake its own analysis of whether

the bill was valid under the Commerce Clause, with this bill being silent as to that question.

Section 3(b) is critical to the states. As noted above, given the lack of precision inherent in any attempt to encapsulate a U.S. Supreme Court decision in a handful of words, there is no way for state and local governments to know just which of their tax incentives might fall within the ambit of Section 3(a). Therefore, state and local governments need to know that, if one of their incentives does fall within the ambit of Section 3(a), so that it is not specifically authorized by this bill, that incentive will not be deemed invalid, but rather, will be analyzed for constitutionality by the courts in accordance with current Commerce Clause standards. The inclusion of Section 3(b) in the bill is critical to the ability of the bill to restore the use of tax incentives as they existed prior to *Cuno*.

**Conclusion.** If the Supreme Court does not overturn *Cuno* on the merits, state and local governments will need guidance on how they can implement policies of attracting businesses to their jurisdictions without discriminating against interstate commerce in violation of the Commerce Clause, and, as indicated above, Congress is uniquely situated, and empowered by the federal constitution, to do that. We believe that S. 1066 represents an appropriate balance between authorizing state tax incentives for economic development and preventing impermissible discrimination. It should be effective in meeting our goal of restoring the state of affairs prior to *Cuno*.

**Testimony of Peter D. Enrich**

**on**

***Cuno* and Competitiveness:**
**Where to Draw the Line**

**Before the**

**Subcommittee on International Trade**

**Of the**

**Committee on Finance**
**United States Senate**

**March 16, 2006**

I am honored by the invitation to appear before the Subcommittee, and I welcome this opportunity to share my views on possible legislation addressing the proper limits on the states' use of location-based tax incentives as a means to compete for business investment.

I am presently a professor of law at Northeastern University School of Law in Boston, where my research and scholarship focus on issues of state and local taxation and state and local government law. I received my undergraduate degree *summa cum laude* from Yale, did doctoral studies in philosophy at Princeton, and received my law degree *magna cum laude* from Harvard Law School. Before teaching law, I worked for Massachusetts state government for seven years, serving as general counsel for the Commonwealth's Executive Office of Administration and Finance under both Democratic and Republican governors. It is in that setting that I first came to focus on the problematic nature of the competition among the states to offer ever more aggressive tax incentives to mobile businesses and on the important role of constitutional limitations on such incentives.

In my fifteen years as a law professor, the topic of the constitutionality of state and local business tax incentives has been one of my primary areas of scholarly interest, and I have written a number of articles on the topic.[1] As a result, I was invited to serve, on a *pro bono* basis, as lead counsel for the plaintiffs in *Cuno v. DaimlerChrysler*, which challenges the constitutionality of the two tax breaks which comprise the bulk of the incentive package offered to DaimlerChrysler in return for its decision to locate a Jeep assembly plant in Toledo, Ohio. However, I do not appear here today on behalf of any client, and the views I am expressing reflect my independent professional judgment.

In my testimony today, I want to focus on two points: First, the accelerating proliferation of state and local business tax incentives that are conditioned on business location and that discriminate in favor of in-state activity is contrary to the national interest and should not be encouraged by federal legislation. Second, legislative efforts, like S. 1066, that seek to authorize certain location-based tax incentives, such as investment tax credits, while not authorizing other location-based incentives of kinds previously invalidated by the courts, are doomed to failure, because the line they attempt to draw is arbitrary and insubstantial. Because the first of these points is the focus of Prof. Peter Fisher's testimony, with which I am in complete agreement, I will devote the majority of my time to the second point.

## I. THE PROLIFERATION OF STATE TAX INCENTIVES FOR BUSINESS LOCATION DECISIONS IS HARMFUL BOTH TO THE STATES AND TO THE NATIONAL INTEREST.

In recent decades, the states have found themselves in an accelerating competition to offer ever more generous tax breaks to businesses that site their facilities in the state. From a national perspective, the effect of these incentives on economic activity has been, at best, a zero-

[1] *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 (1996); Peter D. Enrich, *The Rise – and Perhaps the Fall – of Buisness Tax Incentives*, in THE FUTURE OF STATE TAXATION 73 (David Brunori ed., 1998); Peter D. Enrich, *Business Tax Incentives: A Status Report*, 34 URB. LAW. 415 (2002).

sum game, and, in fact, has likely been a net loss due to the inefficiencies that result from distortions of economic decision-making. Meanwhile, the effect of these incentives on the ability of the states to derive revenues from the taxation of mobile business sectors has been substantial. The result is increased tax burdens on individual taxpayers and small businesses and reduced resources for state services, such as education and infrastructure, that are real contributors to economic vitality. Even if tax incentives may, on occasion, provide some local benefits in the form of increased economic activity in a particular state, from a national perspective there are no net economic benefits, and very real and substantial societal losses. These observations are spelled out and documented in detail in the testimony of Prof. Fisher and in the supporting materials he references. A few points, however, warrant brief additional discussion.

First, decades of empirical evidence show that state and local tax breaks have, at most, a very small, marginal influence on levels of economic activity. State and local taxes are simply too small a component of business costs for tax breaks to significantly influence the economics of business location decisions, as compared to such factors as the availability and costs of skilled workers, access to supplies and markets, utility costs, and regulatory requirements. And any possible effects of tax incentives in an economic calculus are typically mitigated by the fact that competing locations offer competing packages of tax incentives that further reduce the scale of any differences in tax burdens.

But, even to the extent that tax incentives are a factor that influences some business location decisions, such influence does not provide benefits to national economic well-being. No one seriously suggests that state or local tax breaks are of a sufficient size to affect overall levels of economic activity; their purpose is to affect *where* new investment is located, not *how much* new investment takes place. While national economic welfare may be affected – positively or negatively – by where in the country new economic activity locates, there is no reason to anticipate that the incentive competition among the states will steer economic activity where it is most needed, and no evidence that it has done so. There is no national interest in encouraging an incentive competition among the states which merely shuffles jobs and investment from one state or community to another.

The costs of the incentive competition, by contrast, are real and substantial. The best available estimate of the cost to state and local governments of the incentives that they offer to influence business location was close to $50 billion in 1996,[2] and the continuing proliferation of incentives over the past decade means that the current number is far higher. These incentives have deeply eroded the portions of state and local tax revenues that are supplied by business taxpayers. Between 1979 and 1999, the share of state income tax revenues paid by businesses declined from 29 percent to 15 percent,[3] and by 1998 state tax incentives were responsible for reducing corporate tax liabilities by 30 percent.[4] Thus, the effect of the incentive competition among the states is to shift tax burdens from the large, mobile businesses that receive the bulk of

---

[2] *See* KENNETH THOMAS, COMPETING FOR CAPITAL 158-59 (2000). Note that this estimate includes both tax and non-tax incentives, with tax incentives constituting the majority.
[3] *See* Robert Tomsho, *In Toledo, a Tension Between School Funds and Business Breaks*, WALL ST. J., July 18 2001, at A1.
[4] *See* Peter Fisher, *Tax Incentives and the Disappearing State Corporate Income Tax,* ST. TAX N., March 4, 2002, at 767-774.

the incentives to individual taxpayers and small, immobile businesses and to reduce the resources available to state and local governments. It is far from clear why it might be in the national interest to reinforce these trends.

Recently, proponents of state and local tax incentives, apparently recognizing the difficulties of defending a zero-sum competition with such high costs, have begun to suggest that the real benefit of the incentive competition is its impact on international competitiveness, and particularly on the ability to attract businesses that otherwise would have located outside the United States. But this after-the-fact rationalization for incentive programs that were enacted on the basis of inter-state, not international, competition, is entirely lacking in any empirical support. And given the voluminous evidence that state and local tax incentives are too small to have more than a marginal effect on inter-state location decisions, the notion that they could substantially impact international choices, where the differences in all of the bigger factors – such as wage levels, skill levels, and transportation costs – are so much larger, simply defies plausibility.

In any case, under our federal system, the responsibility for issues of international trade has rested, since the ratification of the Constitution, with the federal government, not with the states, and for good reason. If Congress wants to provide incentives for businesses to locate their facilities at home and not abroad, there are far more powerful and efficient tools available to it than to rely on state and local tax policies designed largely for an entirely different purpose.

Moreover, for Congress to rely on state tax incentives as a tool to influence international investment decisions is likely to conflict with the United States' treaty commitments under GATT and NAFTA. The federal government's obligations under GATT restrict, not only the federal government's, but also the states' ability to grant subsidies to domestic economic activity.[5] Indeed, state tax incentives similar to the provision challenged in *Cuno* have already been challenged as violations of the United States' treaty obligations under the GATT Agreement on Subsidies and Countervailing Measures.[6] Similarly, state tax incentives that provide specially favorable treatment to in-state businesses may violate the provisions of NAFTA's chapter 11, which requires that foreign companies be accorded treatment no less favorable than the most favorable treatment accorded to a local business.[7]

---

[5] The GATT Agreement on Subsidies and Countervailing Measures ("SCM") specifically applies to tax incentives granted by any level of government (see SCM, art. 1.1 (a)(1)(ii)), where access to the incentive is limited either to certain enterprises or to enterprises in a certain geographical region (see SCM, art. 2.1(a), 2.2). The restrictions on such incentives imposed by articles 3, 5 and 6 of the SCM Agreement are likely to apply to many of the forms of business tax incentives routinely offered by states and localities.

[6] For example, the European Community in June 2005 filed a demand for a WTO adjudicatory panel on US subsidies for Boeing's civil aircraft production, including the subsidies provided through the state and local tax incentive programs of Washington, Kansas, and Illinois. *See* Request for the Establishment of a Panel by the European Communities, *United States – Measures Affecting Trade in Large Civil Aircraft*, WT/DS317/2 (June 3, 2005). *See also* Arthur Rogers, *EC Will Investigate Kansas Tax Breaks Aimed at Luring British Production Plant*, BNA Daily Tax Report, April 15, 2005.

[7] *See, e.g.,* art. 1102. Under NAFTA art. 105, the United States expressly commits to take all necessary measures to ensure observance of NAFTA's provisions by the states, and, for violations of chapter 11, the United States is subject to private actions for damages by injured foreign businesses.

**II. EFFORTS TO DRAW A STATUTORY BOUNDARY BETWEEN AUTHORIZED AND UNAUTHORIZED LOCATION-BASED STATE TAX INCENTIVES ARE FUNDAMENTALLY FLAWED BECAUSE THEY REST ON AN INSUBSTANTIAL DISTINCTION.**

For the past century and a half, the courts have played the primary role in setting the limits to state taxation that disturbs the free flow of interstate commerce. The proponents of legislation to authorize state tax incentives that encourage in-state business locations do not question the wisdom of the long history of judicial decisions forbidding a wide variety of state tax measures that were found to discriminate against out-of-state business activity. Instead, they propose to draw a statutory line that leaves intact the bulk of the Supreme Court's recent cases striking down numerous discriminatory state tax practices, while at the same time authorizing investment tax credits and other incentives for in-state development not yet addressed by the Court. But the careful effort to implement this strategy in S. 1066 is deeply flawed; it would authorize a wide range of measures of sorts long recognized as discriminatory, and it may well fail to authorize many of the measures it is intended to permit. These flaws are not results of careless drafting, but rather of the inherently problematic approach of a strategy that attempts to draw a bright line between measures which are not functionally distinguishable.

The proponents of legislation designed to protect state tax incentives from judicial scrutiny could have followed a different course. Instead of complex line-drawing, they could have simply proposed a broad Congressional authorization of state tax measures serving economic development purposes. There is precedent for such a broad-brush approach, in the McCarran-Ferguson Act,[8] which responded to judicial decisions restricting state taxation and regulation of the insurance industry by granting to the states plenary power over the insurance industry notwithstanding possible Commerce Clause concerns.

Instead, proponents have chosen a far narrower and far more complex approach, presumably out of a recognition of the importance of preserving some judicial restrictions on the freedom of the states to use their tax systems to give advantages to in-state economic activity over its out-of-state competition. After all, a central purpose of the Commerce Clause has always been to avoid the revival of the tariff barriers which impeded the growth of a national common market in the years before adoption of the Constitution. An overly broad authorization of state tax measures to further in-state economic development could easily undermine this fundamental national purpose and invite the re-emergence of tariff-like barriers between the states. And, indeed, the very businesses that are most interested in ensuring the continued availability of economic development incentives have historically been the parties most commonly seeking Commerce Clause protection against discriminatory treatment of out-of-state activities.

The proposed legislation, thus, takes a two-step approach. First, it provides a very broad authorization for state tax incentives for economic development purposes, regardless of any discriminatory impact on interstate commerce.[9] But second, it then limits that broad permission

---

[8] 15 U.S.C. § 1011 *et seq. See, e.g., Western & Southern Life Ins. Co. v. State Bd. of Equalization*, 451 U.S. 648, 652-55 (1981).

[9] *See* S. 1066, § 2 (authorizing "any State to provide to any person for economic development purposes tax

by identifying seven categories of tax incentives, of sorts previously found unconstitutional by the courts, which are excluded from the statute's authorization.[10]

The question then is whether this two-step strategy works to draw a line between, on the one side, tariff-like measures which pose a problematic threat to the free flow of interstate economic activity and which remain prohibited and, on the other side, economic development incentives, like investment tax credits, which, in the eyes of the proponents, are harmless (and perhaps beneficial) and which are authorized by the legislation. The short answer, explained below, is that S. 1066 fails in its effort to draw such a line, and that further efforts to refine its approach will not yield greater success.

The failings of S. 1066 can be seen in both the under-inclusiveness and the over-inclusiveness of its list, in section 3, of types of measures not covered by the bill's blanket authorization of economic development incentives. Because of section 3's under-inclusiveness, a wide range of measures of kinds long recognized as impermissibly discriminatory would be permitted, including some measures functionally equivalent to tariffs. Because of its over-inclusiveness, even provisions like investment tax credits, which the bill intends to authorize, would remain under a legal cloud. These observations about S. 1066 are not novel; they have been explicated in detail by several critics, including Professor Hellerstein.[11] I will not attempt to duplicate their discussions, but simply offer a few examples here.

First, consider the under-inclusiveness of the proposed exceptions. S. 1066 would allow the states to adopt a variety of measures that violate accepted expectations about the level playing field to be provided to out-of-state businesses. For instance, as Professor Hellerstein observes, states would be free to impose higher tax burdens on sellers that do not have a permanent business location in the state than on those that do, although such discrimination has long been recognized as impermissible by the courts.[12]

And S. 1066 would similarly authorize a range of measures that, like tariffs, would impose higher tax burdens on out-of-state services, products or activities than on their in-state competitors. For instance, while the bill would not authorize a measure that expressly exempted from the state's alcohol excise those fruit wines produced from in-state fruits,[13] it would allow a measure that achieved the same result by providing an exemption limited to wines produced from particular varieties of fruit that, in fact, were grown exclusively in the state.[14] Likewise, the bill, while it would not permit a tax that was applied exclusively to milk produced out of state,

---

incentives that otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause . . . , except as otherwise provided by law").

[10] *See id.*, § 3.

[11] *See* Walter Hellerstein, Cuno *and Congress: An Analysis of Proposed Federal Legislation Authorizing State Economic Development Incentives* (2005) (a copy of which is included as an appendix to this testimony); Michael Mazerov, *Should Congress Authorize States to Continue Giving Tax Breaks to Businesses?* (revised June 30, 2005) (available at *http://www.cbpp.org/2_18_05sfp.pdf*).

[12] *See* Hellerstein, *supra* n. 11, at 16.

[13] *See* S. 1066, § 3(b) (excluding a measure that "requires the recipient of the tax incentive to . . . use . . . property produced . . . in the State").

[14] The courts have declined to draw such a distinction, striking down such provisions, whether the preference for in-state produce was explicit, as in *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984), or implicit, as in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990).

would authorize a state to achieve the same effect by imposing a uniform tax on milk and then allowing a credit based on how many dairy cows a taxpayer owned in the state.[15] Or, for one more example discussed in Professor Hellerstein's paper,[16] a major component of New York's discriminatory tax on stock transfers conducted through out-of-state stock exchanges, which was invalidated by the Supreme Court in the *Boston Stock Exchange* case,[17] would be authorized by the bill, while its other discriminatory component could be salvaged by a modest change that would do nothing to diminish its discriminatory impact.

Conversely, the very same exclusionary language that fails to reach a number of widely recognized examples of discriminatory treatment that the Commerce Clause has long forbidden, appears likely to reach provisions like investment tax credits and thereby to leave them subject to judicial invalidation, despite the drafters' evident contrary intent. As Professor Hellerstein has observed,[18] S. 1066's section 3(a)(2), which excludes from the bill's protection any measures that require the taxpayer "to acquire, lease, license, use or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State" appears applicable to an investment tax credit program that allows credits only to the extent that the taxpayer places new machinery or equipment in service at a facility of the taxpayer's located in the state. Even if such a credit does not require that the qualifying property be manufactured or acquired in the state, it certainly does require that it be "use[d]" (i.e., that it be placed in service) in the state and that it be "assemble[d]" in the state in order to be used there.[19] And, likewise, such a credit certainly requires the taxpayer to "develop" in-state property that it either owns, leases or uses when it improves that property by the installation of the qualifying new machinery or equipment. Thus, the bill as drafted does not succeed in sheltering the very provision – the investment tax credit challenged in the *Cuno* case – that it was designed to protect.

At the very least, these difficulties with the design of S. 1066 undercut any suggestion that a statutory enactment could provide businesses and states with greater certainty about the range of permissible tax incentives or could reduce the need for litigation to settle unresolved questions. To some extent, of course, the under-inclusiveness and over-inclusiveness of S. 1066's provisions may reflect defects in the precision or clarity of its drafting.[20] And unquestionably, many specific shortcomings, once identified, could be remedied by additions, deletions, clarifications, and redefinitions in the terms of the legislation. But to imagine that technical improvements to the current bill would solve the underlying problems seems implausible. After all, the bill is the product of many months of effort, supported by many of the leading experts in the field.

Instead, the failures likely reflect some fundamental flaws in the overall strategy behind the bill, namely the strategy of granting a broad authorization for a wide range of economic

---

[15] Thus a state could achieve the very result that the Court disallowed in *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994), albeit by slightly different means.
[16] *See* Hellerstein, *supra* n. 11, at 19-21.
[17] *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318 (1977).
[18] *See* Hellerstein, *supra* n. 11, at 10.
[19] The provisions of the Ohio investment tax credit challenged in the *Cuno* case requires that the qualifying manufacturing machinery or equipment be "installed in this state." Ohio Rev. Code § 5733.33(B)(1).
[20] Professor Hellerstein's article, *supra* n. 11, identifies a number of other portions of the bill where the drafting is far from clear or precise in its drafting or interpretation.

development incentives and then excluding specific categories previously found to be unconstitutionally discriminatory. Two flaws in that strategy are noteworthy:

First, the strategy presumes that the set of incentives that the courts have previously addressed and invalidated constitutes a self-contained and coherent universe that can be frozen in time and deployed as an intelligible limit on the realm of forbidden incentives. But in reality, the history of the courts' applications of the Commerce Clause as a restraint on discriminatory state tax measures suggests a very different picture. Over the past century and a half, the courts have continually encountered novel and unanticipated forms of discrimination, often involving new forms of business taxation and new commercial patterns and practices, and have had to develop new applications of underlying Commerce Clause principles to address the new practices. Indeed, many of the exceptions that S. 1066 seeks to codify would not have been on a similarly constructed list a couple of decades ago, because they reflect more recent case law developments. There is no reason to expect that the evolution of business and of taxation, or the ingenuity of state lawmakers and business tax advisers, will not continue to produce an array of new kinds of tax measures which, while not captured on the statutory list, involve comparable problems of favoritism for in-state business interests. Any list assembled on the basis of the cases decided as of a specific point in time is sure to prove partial and incomplete.

Second, and perhaps more fundamentally, the strategy behind S. 1066 assumes that there is an intelligible line to be drawn between the types of measures that have historically been invalidated by the courts and the types of economic development incentives that the bill seeks to authorize. But it is by no means clear that such a line exists, other than the temporal line between measures the Supreme Court has already invalidated and others that it has not yet addressed. Indeed, the plaintiffs' arguments for invalidation of Ohio's investment tax credit in *Cuno* rest on a body of legal scholarship, including articles by both myself[21] and Professor Hellerstein,[22] that concludes that investment tax credits are indistinguishable for Commerce Clause purposes from many of the provisions previously invalidated by the Court. But, if that is so, then it should come as no surprise that it is exceedingly difficult to draft a statute which forbids the measures previously invalidated, while authorizing investment tax credits.[23] The distinction is so hard to draw precisely because it is artificial and arbitrary.

By contrast, the anti-discrimination principle developed and deployed by the Supreme Court to delineate the class of tax incentive measures that violate the Commerce Clause offers a coherent, reasonable and time-tested boundary line. As the Court has articulated this principle, " 'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter. If a restriction on commerce is discriminatory, it is virtually per se invalid."[24]

The proponents of legislation seek to suggest that the Court's Commerce Clause jurisprudence is far from clear and consistent, and they often quote the Court's own description

---

[21] *See* note 1, *supra*.

[22] *See* Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on Business Development Incentives*, 81 Cornell L. Rev. 789, 817-18 (1996).

[23] *Cf.* Hellerstein, *supra* n. 11, at 3 (observing that, to draw the intended distinction, "Congress must act with surgical precision if it is to perform the operation without killing the patient").

[24] *Oregon Waste Sys., Inc. v. Dept. of Envtl. Quality*, 511 U.S. 93, 99 (1994).

of its Commerce Clause case law as a "quagmire." This is, no doubt, a fair characterization of some aspects of the Court's analysis of state tax issues. But it does not apply to the aspect of Commerce Clause analysis – the anti-discrimination principle – that is at issue in the *Cuno* case and that the proposed legislation would supplant. As the Court has explained,

> From the quagmire, there emerge . . . some firm peaks of decision which remain unquestioned. Among these is the fundamental principle . . . : No State, consistent with the Commerce Clause, may impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business. The prohibition against discriminatory treatment of interstate commerce follows inexorably from the basic purpose of the Clause. Permitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses would invite a multiplication of preferential trade areas destructive of the free trade which the Clause protects.[25]

Indeed, the anti-discrimination principle is the one element of the Court's Commerce Clause jurisprudence which has remained a central tenet throughout its history and which has commanded wide acceptance even from those Justices who have expressed deep doubts about other aspects of its Commerce Clause reasoning.[26] And it is noteworthy that those who emphasize the problems with the Court's jurisprudence as a justification for Congressional intervention are unable to point to any tensions or conflicts relating to the courts' application of the anti-discrimination principle to state tax incentives.

In short, the Supreme Court, over the course of the past one hundred and fifty years has developed a clear, straightforward and consistent boundary between those state tax measures which unconstitutionally discriminate against out-of-state activity and those which do not, a boundary that effectively furthers the fundamental purposes behind the Commerce Clause. Congress should be cautious about superseding the Court's careful and cogent approach, unless it is prepared to offer a similarly coherent and administrable alternative boundary. S. 1066 clearly fails to provide such an alternative, and its failings suggest the very great difficulties that will confront any attempt to devise legislation relying on a similar approach.

---

[25] *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329 (1977) (internal quotations and citations omitted).
[26] *See* Enrich, *supra* n. 1, 110 Harv. L. Rev. at 426 & n.249.

# Testimony of Peter Fisher

**on**

**The National Economic Policy Implications of State Tax Incentive Competition**

**at the hearing**

**"Cuno and Competitiveness: Where to Draw the Line"**

**Before the**

**Subcommittee on International Trade**

**Of the**

**Committee on Finance**
**United States Senate**

**March 16, 2006**

**The National Economic Policy Implications of State Tax Incentive Competition**

I am honored to be afforded this opportunity to present my views on state economic development tax incentives to the Subcommittee. I am a Professor of Urban and Regional Planning at the University of Iowa, and received my Ph.D. in economics from the University of Wisconsin - Madison in 1978. My particular area of expertise is state and local government finance. I have written and co-authored two books and several journal articles on state tax incentive policy, a subject that I have been researching for the past ten years.

I would like to focus my remarks today on the issue of whether or not it makes good economic sense, from the perspective of national economic policy, to encourage states to engage in competition with one another for business activity through the offering of tax incentives. I will argue that such competition is counterproductive, both for the states engaging in such activity and for the national economy. I would therefore conclude that federal legislation sanctioning or encouraging the use of tax credits and similar incentives by state governments is not in the national interest.

The Subcommittee is also referred to the "Brief of *Amici Curiae* Economics and Public Policy Professors" submitted to the U.S. Supreme Court in the case Daimler-Chrysler v. Cuno by Scott Cummings, UCLA law professor, on January 26, 2006. I was one of the twelve professors who signed that brief, and I drafted the economic sections of the brief. The brief contains further elaboration of and documentation for the arguments I will make today.

**Tax Incentive Competition is at Best a Zero-Sum Game**

State tax incentives are designed to change the location of economic activity by inducing a firm to locate in, expand to, or move a facility to, the state offering the incentive rather than another state. To the extent that such incentives are effective, they merely move economic activity from one state to another. This has been described as a "zero-sum game" since the gains to one state are offset by the losses to another. There is no national interest in encouraging economic activity to move in response to such incentives since no net gain in economic activity arises. Research has shown, for example, that state tax incentives aimed at encouraging research and development (R&D) result in increased R&D in the state offering the incentive, but reduced R&D in other states, with no net gain to the nation.

**Tax Incentive Competition Harms Economic Efficiency**

It is likely that state tax incentive competition is, in fact, a negative sum game; that is, it produces a net loss to the national economy. In the absence of incentives, firms would choose locations based on economic rationality: the location that minimizes the costs of production and distribution would be selected. Labor supply and productivity, labor costs, access to markets and to suppliers, and costs of utility services such as energy and telecommunications, are major determinants of location. Locating so as to minimize such costs maximizes the efficiency of the national economy since these costs represent the value of resources consumed. This is the virtue

of market competition: firms seek to produce a given output of goods and services with the least use of society's scarce resources.

Tax incentives, however, are designed to alter the location choices of business and in so doing to override market considerations. This will result in a pattern of economic activity that requires greater use of real resources and hence reduces national economic efficiency. Furthermore, tax incentives will at times induce a business to move facilities from a location that has made a substantial investment in infrastructure and public services to support that facility to a new site, leaving redundant public investment in the old location and requiring new public investment at the new site. This is a waste of national resources.

**Tax Incentive Competition Undermines Economic Growth**

Our federal system places much of the responsibility on state and local governments for providing the public services that businesses directly use and depend on: education for entrants into the labor force, police and fire protection, the provision of streets and highways, and water and sewer systems. Investment in these services provides the foundation for economic activity. Tax incentive competition undermines the ability of state and local governments to finance those services and thereby degrades the quality of the basic services that the nation needs to support economic growth. At a time when even the most skilled workers face global competition, it is particularly counterproductive to divert resources from our education system to a wasteful interstate competition for jobs. Yet it will be difficult to finance increasingly expensive incentives year after year without cutting funding for the education and infrastructure services that make up the majority of state and local budgets.

**Tax Incentive Competition Does Not Benefit the States**

One must conclude from the extensive research on incentives within the U.S. that they are a marginally effective and very expensive tool for attracting business from one state to another. Since state and local taxes falling on businesses represent only about 1.2% of the total cost of doing business in the U.S., state tax incentives that reduce this fraction provide very little leverage over the location decision. For the vast majority of investment and location decisions, therefore, tax incentives will be swamped by differences in other economic factors. The typical tax incentive package offered routinely by a state to attract manufacturing investment can be expected to be a decisive factor in the location decisions of firms in only about one in ten instances. Ninety percent of the tax revenue lost from incentives thus goes to firms who would have made the same location decision without the incentives, and thus represents a waste of the state's money. Furthermore, if public services must be cut to finance the tax incentives, even this minimal level of effectiveness will an all likelihood be lost. Public services matter to business.

**Interstate Tax Incentive Competition is an Inappropriate Vehicle for Enhancing the Competitiveness of the U.S. in the Global Economy**

It might be argued that interstate tax incentive competition drives down the level of taxes on business activity and makes the U.S. as a whole more competitive internationally. This is a poor argument in defense of state tax incentives. First of all, state taxes are small relative to federal

taxes. Second, state taxes are small relative to the enormous variation in transportation costs, labor costs, and labor productivity across nations. Thus even very large state tax incentives will not cause much variation in the overall tax bill facing a firm locating in the U.S. and will not be enough to offset even small differences in the other factors that are more important in determining the profitability of U.S. versus overseas locations.

More importantly, it hardly makes sense for Congress to delegate to the fifty states the task of ensuring that economic activity remains in the U.S. If this is a compelling national interest, surely it calls for measures at the national level. State tax incentive competition is neither an adequate nor a cost effective tool for stemming the outflow of jobs from the U.S. As stated above, incentives are a weakly effective and costly tool even for altering the location decisions of firms from one state to another within the U.S. As a tool for offsetting the much more substantial differences in cost between U.S. and overseas locations, they must be even less effective and more costly.

I would note furthermore that Congress some twenty years ago apparently determined that the federal investment tax credit was an ineffective tool for stimulating the U.S. economy and enhancing national competitiveness. It is not clear why Congress would now consider a multiplicity of state investment tax credits to be more effective.

**Conclusions**

States have available to them a variety of strategies for enhancing economic growth that are more cost effective and that do not require a beggar-thy-neighbor strategy. Investments in infrastructure, education, and workforce development are important not only to a state's economic growth potential but to the ability of the U.S. to compete in the global economy. Encouraging states to compete with one another through tax incentives deprives them of the resources to fund the investments that we as a nation must depend upon as we confront the challenges of globalization in an increasing number of economic sectors. We cannot afford a national economic strategy that relies on each of the fifty states to figure out for themselves how to stem the outflow of production and jobs from the U.S. and that encourages them to engage in an apparently never-ending race to cut taxes more than their neighbor. This is surely a self-defeating strategy in the long term.

**Nos. 04-1704, 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
FOR THE STATE OF OHIO, *ET AL.*,

*Petitioners,*

v.

CHARLOTTE CUNO, *ET AL.*,

*Respondents.*

**On Writ Of Certiorari To The United States Court Of Appeals For The Sixth Circuit**

**BRIEF OF *AMICI CURIAE* ECONOMICS AND PUBLIC POLICY PROFESSORS RANDY ALBELDA, HOWARD CHERNICK, PETER FISHER, ROBERT LYNCH, THOMAS MALONEY, ANN MARKUSEN, DICK NETZER, ROBERT REICH, ANDREW RESCHOVSKY, JOHN SOLOW, KENNETH THOMAS, AND JOHN YINGER IN SUPPORT OF RESPONDENTS**

SCOTT L. CUMMINGS
*Counsel of Record for Amici Curiae*
UCLA School of Law
405 Hilgard Avenue
Los Angeles, California 90095
(310) 794-5495
January 23, 2006

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

TABLE OF CONTENTS

| | Page |
|---|---|
| TABLE OF CONTENTS | i |
| TABLE OF AUTHORITIES | iii |
| INTERESTS OF THE *AMICI CURIAE* | 1 |
| SUMMARY OF ARGUMENT | 1 |
| ARGUMENT | 3 |
| I. AN ANALYSIS OF THE ECONOMIC IMPACT OF STATE TAX INCENTIVES IS RELEVANT TO THE CONSTITUTIONAL ISSUE AT STAKE | 3 |
| II. THE ECONOMIC EVIDENCE SHOWS THAT STATE TAX INCENTIVES, AT BEST, PRODUCE A ZERO-SUM COMPETITION AND, AT WORST, RESULT IN A NATIONAL ECONOMIC LOSS | 8 |
| A. Tax incentive competition is at best a zero-sum game | 8 |
| B. Tax incentive competition produces economic inefficiency | 10 |
| C. Tax incentive competition harms long-term economic growth | 13 |
| D. Tax incentive competition does not enhance international competitiveness | 14 |
| III. STATE TAX INCENTIVES DO NOT PRODUCE MEANINGFUL INTRASTATE ECONOMIC BENEFITS THAT JUSTIFY THEIR HARMFUL INTERSTATE EFFECTS | 15 |
| A. Tax incentives are at best marginally effective in altering business locations | 16 |
| B. Tax incentives are costly | 22 |

TABLE OF CONTENTS – Continued

Page

C. Tax incentives are an inferior policy tool given the alternative strategies available to encourage economic development ........ 22

D. Incentive strategies are adopted for political, not economic, reasons .................. 24

CONCLUSION .............................................................. 26

## TABLE OF AUTHORITIES

Page

CASES

*Am. Trucking Assocs., Inc. v. Michigan Pub. Serv. Comm.*, 125 S.Ct. 2419 (2005) .................................... 2, 6

*Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) .......... 5

*Boston Stock Exchange v. State Tax Comm.*, 429 U.S. 318 (1977) ................................................................ 5

*Gibbons v. Ogden*, 22 U.S. 1 (1824) .................................... 7

*Hughes v. Oklahoma*, 441 U.S. 322 (1979) ...................... 1, 4

*Maryland v. Louisiana*, 451 U.S. 725 (1981) ................. 2, 5

*New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988) ........................................................ 5, 12, 15

*West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) ........................................................................ 4, 16

*Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388 (1984) ........................................................................... 5

OTHER AUTHORITIES

ALAN ALTSHULER & JOSE GOMEZ-IBANEZ, REGULATION FOR REVENUE: THE POLITICAL ECONOMY OF LAND USE EXACTIONS (1993) .......................................... 13

Timothy Bartik, *Jobs, Productivity, and Local Economic Development: What Implications Does Economic Research Have for the Role of Government?*, 47 NATIONAL TAX J. 847 (1994) .................... 20, 24

TIMOTHY BARTIK, WHO BENEFITS FROM STATE AND LOCAL ECONOMIC DEVELOPMENT POLICIES? (1991)........ 18

TABLE OF AUTHORITIES – Continued

Page

Melvin L. Burstein & Arthur J. Rolnick, *Congress Should End the Economic War Among the States*, 9 THE REGION (Federal Reserve Bank of Minneapolis) 3 (March 1995) .......... 10, 11, 14

Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location: An Overview of the Literature*, 15 ECON. DEV. Q. 90 (February 2001) .......... 25

COMMERCE CLEARING HOUSE, 2005 STATE TAX HANDBOOK (2005) .......... 5, 12

John Due, *Studies of State-Local Tax Influences on Location of Industry,* 14 NATIONAL TAX J. 163 (1961) .......... 19

PETER K. EISINGER, THE RISE OF THE ENTREPRENEURIAL STATE (1988) .......... 23

Ronald Fisher, *The Effects of State and Local Public Services on Economic Development*, NEW ENGLAND ECON. REV. 53 (March/April 1997) .......... 20

William F. Fox & Matthew N. Murray, *Do Economic Effects Justify the Use of Fiscal Incentives?*, 71 SOUTHERN ECON. J. 78 (2004) .......... 17

BRONWYN HALL & MARTA WOSINKA, THE CALIFORNIA R&D TAX CREDIT: DESCRIPTION, HISTORY, AND ECONOMIC ANALYSIS (1999) .......... 9

ROBERT G. LYNCH, RETHINKING GROWTH STRATEGIES: HOW STATE AND LOCAL TAXES AND SERVICES AFFECT ECONOMIC DEVELOPMENT (2004) .......... 17, 19, 20

Robert Newman & Dennis Sullivan, *Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know, and How Do We Know It?*, 23 J. OF URBAN ECONOMICS 215 (1988) .......... 19

TABLE OF AUTHORITIES – Continued

Page

ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, REVENUE STATISTICS 1965-2003 (2004) .......... 15

Alan Peters & Peter Fisher, *The Failures of Economic Development Incentives*, 70 J. OF THE AMERICAN PLANNING ASSOC. 27 (Winter 2004) .......... 17, 19

ALAN PETERS & PETER FISHER, STATE ENTERPRISE ZONE PROGRAMS: HAVE THEY WORKED? (2002) .......... 14, 21

Barry Rubin & Kurt Zorn, *Sensible State and Local Economic Development Policy*, 45 PUBLIC ADMINISTRATION REV. 333 (1985) .......... 8

Kirk J. Stark & Daniel J. Wilson, *What Do We Know About the Interstate Economic Effects of State Tax Incentives?*, 4 GEORGETOWN J. OF LAW & PUBLIC POLICY (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=868692 .......... 6

KENNETH THOMAS, COMPETING FOR CAPITAL (2000) .......... 14

Michael Wasylenko, *Taxation and Economic Development: The State of the Economic Literature*, NEW ENGLAND ECON. REV. 37 (March-April 1997) .......... 16, 17, 19, 20

Daniel J. Wilson, *Beggar Thy Neighbor? The In-State vs. Out-of-State Impact of State R&D Tax Credits*, FEDERAL RESERVE BANK OF SAN FRANCISCO WORKING PAPER 08 (2005) .......... 9

Daniel J. Wilson, *The Rise and Spread of State R&D Tax Credits*, FEDERAL RESERVE BANK OF SAN FRANCISCO ECONOMIC LETTER, Number 2005-26 (October 14, 2005) .......... 8, 9

TABLE OF AUTHORITIES – Continued

Page

UNITED STATES CENSUS BUREAU, 2002 CENSUS OF GOVERNMENTS, Table 1 (State and Local Government Finances by Level of Government and by State: 2001-2002), *available at* http://ftp2.census.gov/govs/estimate/02slsstab1a.xls ..................... 22

## INTERESTS OF THE *AMICI CURIAE*

*Amici* are distinguished economics and public policy scholars with long histories of academic research and public policy engagement in the field of tax policy and economic development.[1] A list of the *amici* and brief biographical information are attached in the addendum to this brief. *Amici* are interested in this matter based on their professional and public concern that state tax incentives like the Ohio investment tax credit at issue in this case produce wasteful interstate tax competitions that harm the national economy. They are filing this brief because they believe that the negative economic consequences that stem from tax incentives weigh in favor of declaring the Ohio investment tax credit unconstitutional.

## SUMMARY OF ARGUMENT

1. The purpose of the Court's dormant Commerce Clause jurisprudence is to prevent states from enacting tax policies designed to improve their own economic positions at the expense of the national marketplace. *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979). Toward this end, the Court has repeatedly held that state policies that preference in-state business activity in a manner that

[1] This *amici curiae* brief in support of the briefs of the Respondents is submitted pursuant to Rule 37 of the Supreme Court Rules. The parties have consented to the filing of briefs *amicus curiae* and have filed blanket consent letters with the Clerk of the Court. Pursuant to Supreme Court Rule 37.6, counsel for *amici* state that this brief was not authored in whole or in part by counsel for a party and no person or entity other than *amici* or their members has made a monetary contribution to the preparation or submission of this brief.

harms out-of-state competitors improperly infringe on the federal government's core authority to regulate commerce. *See, e.g., Maryland v. Louisiana*, 451 U.S. 725 (1981). Because of the Court's role as arbiter of disputes over interstate commerce, it has grown increasingly attuned to the practical economic effects of state policies. *See, e.g., American Trucking Assocs., Inc. v. Michigan Public Serv. Comm.*, 125 S.Ct. 2419 (2005). Following the Court's lead, *amici* believe that an empirical analysis of the economic and public policy impact of state tax incentives like the Ohio investment tax credit (ITC) on interstate commerce would illuminate the Court's constitutional analysis in this case.

2. What the empirical evidence shows is that state tax incentives like the Ohio ITC do, in fact, have substantial negative consequences for interstate commerce. Competition among the states for business activity through the offering of such state tax incentives is largely a zero-sum game in that economic gains to the state that enacts tax incentives are offset by losses to other states. Moreover, tax incentive competition has an overall negative effect on the national economy by producing business location decisions that are either economically inefficient (because firms do not locate in states with the lowest real costs of production) or wasteful (in that firms are given incentives to locate in states where they would go anyway). Finally, by fostering a "race to the bottom" in which states must continually increase tax incentives in order to lure businesses, tax incentive competition undermines the ability of state and local government to finance the investments in public education and infrastructure that provide the foundation for future economic growth. Because these consequences are precisely the type of harms

that the Commerce Clause was designed to prevent, *amici* believe that they provide support for the Sixth Circuit's conclusion that the Ohio ITC impedes interstate commerce in violation of the Constitution.

3. This harm to the national economy, moreover, is not offset by gains to the states engaging in incentive competition. Indeed, the local economic benefits claimed by advocates of such policies are negligible and, to the extent that they do exist, could be accomplished by alternative state polices that do not harm the national economy. In particular, the general conclusion based on extensive research on state tax incentives is that incentives are, at best, only marginally effective in changing the location of business activity. And even when they do, it is at the expense of spending on local infrastructure (education, utilities, transportation) that undercuts long-term growth. Because state investments in workforce development, technology, education, and public infrastructure are viable alternative means of enhancing state economic growth, tax incentives like Ohio's ITC can only be viewed as costly, inefficient policies.

---

## ARGUMENT

### I. AN ANALYSIS OF THE ECONOMIC IMPACT OF STATE TAX INCENTIVES IS RELEVANT TO THE CONSTITUTIONAL ISSUE AT STAKE

The Court's Commerce Clause jurisprudence is rooted in a fundamental concern about the destructive impact of certain types of state economic regulation on the national economic welfare. Though the Commerce Clause itself – which confers upon Congress the "Power . . . To regulate

Commerce . . . among the several States," U.S. Const. art. I, § 8, cl. 3 – imposes no explicit limitation on the power of the states over their own economic activity, it has long been interpreted as providing an essential bulwark against self-interested state policies that injure the national market. Indeed, the inclusion of the Commerce Clause in the Constitution reflected

> the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation.

*Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979). In order to protect against such "Balkanization," the Court has, through the "dormant" or "negative" aspect of the Commerce Clause, sought for nearly two hundred years to protect interstate economic activity by rooting out discriminatory state regulation. *See West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994). Thus, even though the Commerce Clause itself is simply a grant of regulatory power to the federal government, what the "dormant" Commerce Clause jurisprudence stands for is the principle that the individual states may not usurp the federal role by enacting their own regulations that impede interstate commerce.

The paradigmatic violation of the dormant Commerce Clause is when a state imposes a tariff on goods imported from other states that is not imposed on in-state goods. *See West Lynn Creamery*, 512 U.S. at 193. However, the Court has made it clear that this paradigm does not exhaust the situations in which state regulation of economic activity will constitute a violation of the Commerce Clause. To the contrary, the Court has affirmed that state regulation that

preferences in-state economic actors to the detriment of their out-of-state counterparts is equally suspect from a constitutional perspective. *See New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988) (holding that an ethanol tax credit limited to ethanol produced in Ohio or in a state with a similar tax credit provision violated the Commerce Clause principle of nondiscrimination); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388 (1984) (striking down New York tax credit for export-oriented corporations based on the proportion of New York business activity); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (invalidating a Hawaii state law exemption on liquor tax for locally produced alcoholic beverages); *Maryland v. Louisiana*, 451 U.S. 725 (1981) (striking down a Louisiana tax scheme that provided tax credits solely to in-state producers of natural resources); *Boston Stock Exchange v. State Tax Comm.*, 429 U.S. 318 (1977) (holding that a New York statute that reduced the tax on in-state stock transfers in order to prevent the loss of stock trades from the New York Stock Exchange violated the Commerce Clause).

It is the concern with the detrimental impact of preferential state regulation on interstate commerce that lies at the heart of the Court's examination of the Ohio investment tax credit (ITC) at issue in this case. *See* Ohio Rev. Code Ann. §§ 5733.33(C)(1), (C)(2).[2] The key question before the Court is whether the ITC – which was given to DaimlerChrysler to construct a new vehicle-assembly plant in Toledo – constitutes economic discrimination in violation of the Commerce Clause.

---

[2] We note that the Ohio tax credit in its general outlines is similar to the type of investment tax credits currently in place in 38 states. *See* COMMERCE CLEARING HOUSE, 2005 STATE TAX HANDBOOK 275-80 (2005).

At the core of this constitutional inquiry is a set of very practical questions: What are the real interstate economic impacts of state tax incentives like Ohio's ITC? Does the adoption of tax incentives by one state influence the level of economic activity in other states or otherwise impair the free flow of trade across state borders? Do state tax incentives actually yield economic benefits for states that adopt them? In order to assess whether the Ohio ITC and others like it impermissibly burden interstate commerce or actually promote productive economic competition between the states, it is therefore helpful to consider what we know as an empirical matter about the actual economic effects of such policies.

In its recent Commerce Clause jurisprudence, the Court has underscored the importance of examining the practical economic impact of challenged state policies.[3] For instance, in *American Trucking Assocs., Inc. v. Michigan Public Serv. Comm.*, 125 S.Ct. 2419 (2005), the Court held that Michigan's $100 flat fee imposed on trucks that "undertake point-to-point hauls between Michigan cities," *id.* at 2422, did not violate the Commerce Clause, *id.* at 2423. In reaching this conclusion, the Court emphasized that "the record contains little, if any, evidence that the $100 fee imposes *any significant practical burden* upon interstate trade." *Id.* at 2423-24 (emphasis added). Particularly given

[3] In a forthcoming article, Professor Kirk Stark and Federal Reserve Bank economist Daniel Wilson discuss the constitutional importance of considering the economic effects of tax incentives in the context of the *Cuno* controversy. *See* Kirk J. Stark & Daniel J. Wilson, *What Do We Know About the Interstate Economic Effects of State Tax Incentives?*, 4 GEORGETOWN JOURNAL OF LAW & PUBLIC POLICY (forthcoming), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=868692.

the Court's central institutional role in resolving interstate commercial disputes, *Gibbons v. Ogden*, 22 U.S. 1 (1824), we believe it appropriate for the Court to give attention to the practical economic effects of state tax incentives in considering this case.[4]

[4] The significance of undertaking such an analysis is highlighted by the frequency with which *amici* for the Petitioners invoke the practical economic impact of state tax incentives to support arguments in favor of their constitutionality. Indeed, a prominent theme in the *amici* briefs for Petitioners is that state tax incentives foster healthy economic competition between the states. *See* AlphaGenetics, Inc. *et al. Amici Curiae* Brief, at 19 (arguing that "the decision of the Court of Appeals will result in the unintended consequence of impeding innovation among early-stage companies and impacting on entrepreneurship"); City of New York *Amicus Curiae* Brief, at 2 (stating that an investment tax credit "helps to encourage increased local business activity"); National Governors Association, *et al. Amicus Curiae* Brief, at 13 (stating that "while there is no record here, the ITC likely functions in a manner that promotes interstate commerce" by reducing the purchase price of goods and serving as an export subsidy); Nissan *Amicus Curiae* Brief, at 25 (suggesting that Nissan's tax break package in Tennessee "transformed Tennessee's economy"); Pacific Legal Foundation *Amicus Curiae* Brief, at 3 (suggesting that state tax incentives like Ohio's promote "competitive federalism," "in which states compete with one another to provide the best regulatory regime for mobile citizens"); Tax Executives Institute, Inc. *Amicus Curiae* Brief, at 7 ("Investment tax credits, along with an array of other tax incentives, are widely used by States to encourage growth in economically distressed areas, spur investment, increase jobs, and hence, enlarge the tax base."); Tax Foundation *Amicus Curiae* Brief, at 14 (stating that the sensitivity of companies like DaimlerChrysler to state tax systems "provides the opportunity for meaningful and beneficial tax competition among the States for jobs and investment"); The Right Place, Inc. and the City of Grand Rapids, Michigan *Amici Curiae* Brief, at 12 (arguing that if all states adopted a tax credit similar to the Ohio investment tax credit, "it would result in lower corporate taxes and more national commerce"). However, while these *amici* suggest that negative economic consequences would result from the elimination of state tax incentives like the Ohio ITC, there is a complete lack of empirical evidence provided to support this claim.

## II. THE ECONOMIC EVIDENCE SHOWS THAT STATE TAX INCENTIVES, AT BEST, PRODUCE A ZERO-SUM COMPETITION AND, AT WORST, RESULT IN A NATIONAL ECONOMIC LOSS

This part addresses the most fundamental concern of the dormant Commerce Clause: What are the inter-state economic consequences of state tax incentives?

### A. Tax incentive competition is at best a zero-sum game

To the extent that a state is successful in attracting more business investment through the offering of tax incentives, it does so at the expense of other states. That, in fact, is the stated rationale for incentive policies: to change the location choices of business firms. Moving business activity from one place to another has been described as a zero-sum game: the gain to one state is offset by a loss to another, with no net benefit to the nation. *See* Barry Rubin & Kurt Zorn, *Sensible State and Local Economic Development Policy*, 45 PUBLIC ADMINISTRATION REV. 333 (1985).

Recent studies on research and development (R&D) spending support this conclusion. While previous studies have looked at state tax levels and certain measures of economic growth in order to discern the influence of general tax reductions on economic activity, these more recent studies attempt to isolate the discrete effect of state tax incentives on firm investment behavior. In one recent study, for example, economist Dan Wilson of the Federal Reserve Bank examines firm-level data on research and development (R&D) spending in order to estimate how sensitive firm R&D spending is to its after-tax price or

"user cost," and specifically to state R&D credits. Daniel J. Wilson, *Beggar Thy Neighbor? The In-State vs. Out-of-State Impact of State R&D Tax Credits*, FEDERAL RESERVE BANK OF SAN FRANCISCO WORKING PAPER 08 (2005). Relying on comprehensive data of after-tax R&D prices, Wilson finds that state R&D tax credits do appear to spur R&D spending within the state adopting the credit. Wilson also finds, however, that the out-of-state effect is roughly opposite and equal in absolute value to the in-state effect. The key finding of Wilson's research that is most relevant for the dormant Commerce Clause analysis is the influence of R&D tax credits on R&D spending *in other states*. Thus, as the cost of research and development undertaken inside of State A decreases, as it would when State A enacts or increases R&D tax credits, the level of R&D activity undertaken outside of State A falls.

These results provide support for the view that a state's adoption of R&D tax credits has adverse practical effects on the level of R&D undertaken within other states. Over the past quarter-century, numerous states have adopted R&D tax credits, ostensibly to provide a friendly business climate for high-tech investment. *See* Daniel J. Wilson, *The Rise and Spread of State R&D Tax Credits*, FEDERAL RESERVE BANK OF SAN FRANCISCO ECONOMIC LETTER, Number 2005-26 (October 14, 2005). For example, California adopted its R&D tax credit in 1988, allowing businesses a credit equal to 20 percent of the excess of the taxpayer's "qualified research expenses" over a specified base amount.[5] Based on Wilson's findings, the

[5] For a description of California's R&D tax credit, see BRONWYN HALL & MARTA WOSINKA, THE CALIFORNIA R&D TAX CREDIT: DESCRIPTION, HISTORY, AND ECONOMIC ANALYSIS (1999).

expected effect of a state's adoption of such a credit would be an increase in R&D spending in that state and a corresponding decrease in other states. It is as though a single state has appropriated for itself the power to direct the geographical sourcing of R&D spending – precisely the sort of "regulation of interstate commerce" that the Court's dormant commerce clause jurisprudence is meant to foreclose.

### B. Tax incentive competition produces economic inefficiency

When viewed from the perspective of the national economy, the evidence suggests that state tax incentive competition is likely more damaging than a zero-sum game: It is, in fact, a negative-sum game in that the distortions it creates produce inefficient locational decisions that result in a national economic loss. *See* Melvin L. Burstein & Arthur J. Rolnick, *Congress Should End the Economic War Among the States*, 9 THE REGION (Federal Reserve Bank of Minneapolis) 3 (March 1995). In order to understand the harmful national consequences of state tax incentives, we must first consider the range of factors that a business considers when choosing a location in which to build, relocate, or expand a facility:

i. Access (transport cost and reliability) to raw materials or components;

ii. Access to the major markets for the finished products;

iii. Availability of labor with needed skills and the productivity of that labor;

iv. Wage rates;

v. Employee health insurance costs;

vi. Energy and telecommunications services costs; and

vii. Quality of local public services, particularly those related to education and training of the labor force, infrastructure investment, and public safety.

Businesses naturally seek locations with the lowest resource cost. That is, they seek to minimize the costs of transporting raw materials or finished products, the total cost of labor embodied in the finished product, and the costs for energy, water, sewer, and communications services. These costs to the firm also reflect the real social costs associated with consumption of scarce resources. When firms minimize transport costs, for example, society gains: For a given volume of finished product, the economy consumes the minimum tons of concrete and gallons of gasoline required for the transportation services needed to produce and deliver those finished products. The efficient operation of the national economy requires that firms choose the least-cost locations, a result generally produced by the competitive pressures on firms to reduce costs.

The purpose of tax incentives is to change location decisions. Two Federal Reserve economists have argued that incentives, if they are effective in changing the location of economic activity, change the distribution of facilities from the set of least-cost locations as described above to one that consumes more resources and is therefore less efficient. *See* Burstein & Rolnick, *supra*. These economists describe this as a "negative-sum" result because the benefits and costs to local economies offset each other (the zero-sum game), but the losses to the national economy produce a negative sum.

One counter argument is that incentives simply reinforce the existing geographic pattern of costs. However, this argument does not save them from the charge of inefficiency. To the contrary, to the extent that incentives do reinforce existing cost patterns, they are entirely inefficient since the same location decisions would have been made in the absence of incentives. Incentives only make a difference when they trump economic considerations and induce inefficient location choices.[6]

There is an additional way in which incentive competition can produce net losses. When a business firm actually

---

[6] We do not suggest that the Commerce Clause prohibits, or that sound economic development policy should avoid, all state policies that pursue other values at the cost of economic efficiency. First, the Commerce Clause, in this context, applies only to tax policy and leaves states free to pursue economic development or social policy goals by other means. *See New Energy*, 486 U.S. at 278 ("The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description in connection with the State's regulation of interstate commerce. Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does."). Second, the Commerce Clause prohibits only those tax policies that seek to enrich one state by moving economic activity to that state from another state. The Commerce Clause does not prohibit states from using tax policy to encourage desired corporate behavior within a state, or even to encourage location decisions within a state that may be economically inefficient but meet other policy objectives. *Id.* Similarly, the Commerce Clause obviously does not limit the ability of the *federal* government to encourage location decisions based on factors other than economic efficiency. Rather, the basic constitutional limitation is a narrow one: States cannot use their sovereign taxing power to pursue the goal of strengthening their own economies by undermining the economic base of other states. In setting this policy, the framers of the Constitution were not only establishing an important rule to protect political and social harmony among the several states, they were also practicing fundamentally sound economic theory.

relocates an existing facility, it moves from a locality with the necessary public infrastructure and services already in place, to a locality that must expand services to accommodate the facility and the population growth that ensues. The result is redundant public investment in the old locale that must then be maintained with revenues from a smaller tax base, while resources must be committed to provision of new public investment in the new locale.[7] While these effects are felt locally, they represent real national economic costs.

### C. Tax incentive competition harms long-term economic growth

As part of the interstate competition, one state's decision to provide tax incentives to businesses induces reciprocal behavior on the part of other states. In order to "win" the interstate competition for new business activity, states are therefore placed in the position of having to continually increase tax breaks to lure businesses. As a result of this "race to the bottom," over time the zero-sum game becomes more costly to states as they devote larger shares of their budgets to the provision of tax incentives.[8]

---

[7] Several studies have estimated the cost of public investments, particularly streets and highways, necessitated by new business development. For a review of research on this topic see ALAN ALTSHULER & JOSE GOMEZ-IBANEZ, REGULATION FOR REVENUE: THE POLITICAL ECONOMY OF LAND USE EXACTIONS 77-96 (1993).

[8] In a study of 20 states that together accounted for 75% of the manufacturing investment in the U.S., Alan Peters and Peter Fisher documented the growth of incentive programs from 1990 to 1998 and found that the average set of state and local tax incentives for manufacturing activity had approximately doubled in value (measured as the percentage reduction in total state-local taxes) over that eight-year

(Continued on following page)

This country has a well-developed intergovernmental system that places responsibility on states and localities for providing the public services that businesses directly use and depend on: education for entrants into the labor force, police and fire service, and the provision of local infrastructure (such as streets, and water and sewer systems). Investment in these services provides the foundation for economic activity. Tax incentive competition undermines the ability of state and local governments to provide those services by diverting revenues to a costly and wasteful competition with one another. *See* Burstein & Rolnick, *supra*. As such it operates to degrade the quality of basic services that the nation needs to foster future growth.

### D. Tax incentive competition does not enhance international competitiveness

Some have argued that incentive competition drives down the average level of state and local taxes on business activity in the U.S., which in turn makes the nation more competitive in the world economy. However, there is reason to be skeptical of this claim. For one, U.S. state and local taxes are a small part of the overall cost of doing business and are already quite low compared to other industrialized countries. Among the 30 nations in the Organisation for Economic Cooperation and Development, the U.S. ranks 29th in terms of total federal, state and

---

period. ALAN PETERS & PETER FISHER, STATE ENTERPRISE ZONE PROGRAMS: HAVE THEY WORKED? 56-69 (2002); *see also* KENNETH THOMAS, COMPETING FOR CAPITAL 158-59 (2000) (finding that state and local business tax incentives and subsidies had grown in the 1990s and approached $49 billion in 1996).

local taxes as a percent of gross domestic product. *See* ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, REVENUE STATISTICS 1965-2003 (2004). Furthermore, when one considers the range of economic factors that play a significant role in firm location decisions – transportation, wages, and productivity – there is obviously enormous variation across the globe. U.S. state-local taxes are inconsequential when compared to differences in wages between, for example, Ohio and China. Because of this, a reduction in Ohio taxes would not have a decisive influence on a firm's decision to locate in China.

Moreover, to the extent that international competitiveness is an important policy concern, it is not of constitutional importance here. To the contrary, under the explicit terms of the Commerce Clause, the regulation of international commerce is squarely within the domain of the federal government. U.S. Const. art. I, § 8, cl. 3 (leaving to Congress the power to "regulate Commerce with foreign Nations").

## III. STATE TAX INCENTIVES DO NOT PRODUCE MEANINGFUL INTRASTATE ECONOMIC BENEFITS THAT JUSTIFY THEIR HARMFUL INTERSTATE EFFECTS

Once we understand the negative consequences of state tax incentives on the national economy, the question arises: Are they nevertheless worth it for the states that enact them? Under the Supreme Court's dormant Commerce Clause jurisprudence, even a discriminatory tax incentive may be upheld if "it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives." *New Energy*, 486 U.S. at 278. Do state tax incentives of the sort at issue here

produce the types of intrastate economic benefits that might still warrant their use? As we discuss in this section, the weight of the economic evidence suggests that the answer to this question is no. Specifically, we present evidence that the effects of state tax incentives on business location are small; incentives are costly to the states that offer them; and states have available to them a wide array of alternative economic development policies that are in fact cost-effective and beneficial to the national economy.

### A. Tax incentives are at best marginally effective in altering business locations

Some state and local government officials believe that business tax incentives are an effective policy tool to promote economic development in their states and localities. This belief is not supported by the evidence. Economists have researched this issue extensively over the past three decades. In fact, over 75 studies have been conducted exploring the question: Do taxes, or tax incentives, produce growth in investment or jobs? *See* Michael Wasylenko, *Taxation and Economic Development: The State of the Economic Literature*, NEW ENGLAND ECON. REV. 37 (March-April 1997).[9] The general conclusion that

[9] Much of this research has investigated the effects of reductions in the level of taxation rather than the effects of tax incentives per se. However, a tax incentive is by definition a reduction in a tax, so that the effects of "tax reductions" or "incentives" on economic activity will be similar. In discussing the research literature, we will use the term "incentives" to refer to tax reductions of whatever form. In doing so, however, we are not suggesting that tax reductions be subject to same constitutional scrutiny as tax incentives. Indeed, the Court has made it clear that general reductions in state tax levels do not raise dormant Commerce Clause concerns. *See West Lynn Creamery*, 512 U.S. at 199

(Continued on following page)

can be drawn from this large body of research is that incentives are, at best, only marginally effective in changing the location of business activity. *See* ROBERT G. LYNCH, RETHINKING GROWTH STRATEGIES: HOW STATE AND LOCAL TAXES AND SERVICES AFFECT ECONOMIC DEVELOPMENT (2004); Alan Peters & Peter Fisher, *The Failures of Economic Development Incentives*, 70 J. OF THE AMERICAN PLANNING ASSOC. 27 (Winter 2004); Wasylenko, *supra*. In addition, recent research has called into question whether the location of new firms produces significant net benefits for the host community. *See* William F. Fox & Matthew N. Murray, *Do Economic Effects Justify the Use of Fiscal Incentives?*, 71 SOUTHERN ECON. J. 78 (2004). As a result, there is reason to believe that tax incentives are both costly and potentially counterproductive even to the states that use them "successfully."

Firms consider the whole range of factors discussed earlier (access, labor productivity and cost, energy cost, public services) when choosing a location for a new facility or for relocating an existing facility. States vary widely on all these dimensions. Differences in state and local taxes are actually of little significance when stacked up against differences in these other costs. On average, state-local taxes falling on businesses represent only about 1.2% of the total cost of doing business in the U.S. *See* LYNCH, *supra*, at 4. A tax incentive that reduces this tax burden, therefore, would obviously represent an even smaller percentage of the total cost of doing business.

---

n. 15 (stating that "it is undisputed that 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").

For the vast majority of investment and location decisions, therefore, tax incentives will be swamped by differences in other economic factors. Labor costs, for example, are about 14 times the average state and local tax cost. *See* TIMOTHY BARTIK, WHO BENEFITS FROM STATE AND LOCAL ECONOMIC DEVELOPMENT POLICIES? 61 (1991). Thus even a tax incentive equal in value to 50% of the total state-local tax burden in a state would be more than offset by a mere 4% difference in wages between that state and another, because 4% of the wage bill is worth more than 50% of the annual tax bill. Furthermore, the incentive is temporary, while the wage difference may well persist for years. Thus we should expect, from the beginning, to find that tax incentives rarely tip the balance one way or the other; they would do so only in those few cases where the other cost factors are equal between two locations.

The effectiveness of tax incentives in stimulating economic activity can be researched by exploring the following hypotheses: If incentives are effective, then states or places that offer incentives should experience more growth than those that do not; states or places with larger incentives should experience more growth than those with smaller incentives; and states or places that adopt incentives should experience a higher growth rate after adoption than prior to adoption. These hypotheses can be tested statistically, by comparing growth across states to the incentives in those states, controlling for the other factors that influence growth rates. The hypotheses can be tested over time as well, comparing growth rates before and after the adoption or expansion of incentives, again controlling for other factors that changed over the time period in question.

Earlier studies (in the 1950s through the mid-1970s) generally concluded that incentives make little or no difference in the location or investment behavior of firms. *See, e.g.*, John Due, *Studies of State-Local Tax Influences on Location of Industry*, 14 NATIONAL TAX J. 163 (1961). Later studies that were more sophisticated methodologically found small effects.[10] One of the important differences is that these more recent studies found better ways to control for the influence of public services on growth. That is, they were better at finding the independent influence of incentives, holding all other factors (including public service levels) constant. It is important to understand what this means. What the recent studies found, in effect, is that states that offer larger incentives can expect some modest increase in economic activity provided that they can somehow do so without cutting public services.[11] The research findings are thus much more limited in scope than is often claimed, for they mean only that if a state can somehow be more efficient, providing the same level of services with lower taxes, then it will experience more economic growth (though not a lot more). It certainly does not mean that business tax incentives financed by service cuts will produce growth. *See* LYNCH, *supra*.

In the real world, state and local governments must, for the most part, balance their budgets. Business tax

---

[10] For one of the earliest reviews of several studies showing positive effects, see Robert Newman & Dennis Sullivan, *Econometric Analysis of Business Tax Impacts on Industrial Location: What Do We Know, and How Do We Know It?*, 23 J. OF URBAN ECONOMICS 215 (1988).

[11] Reviews of these studies can be found in BARTIK, *supra*; LYNCH, *supra*; Peters & Fisher, *The Failures of Economic Development Incentives*, *supra*; and Wasylenko, *supra*.

incentives must be offset by cuts in spending or increases in other taxes. Studies have found that public services, particularly education and infrastructure, are important factors contributing to growth. *See* LYNCH, *supra,* at 43-46; *see also* Ronald Fisher, *The Effects of State and Local Public Services on Economic Development*, NEW ENGLAND ECONOMIC REVIEW 53 (March/April 1997). If a state provides business tax incentives and cuts services at the same time, the research suggests that the magnitude of the negative effects of the spending cuts could be enough to offset the positive effects of the tax cut. *See* LYNCH, *supra*; Fisher, *supra*. In fact, research indicates that tax increases that finance spending increases can actually provide some economic stimulus. *See* LYNCH, *supra* (discussing the results of five separate studies). The positive effects of spending may (depending on the nature of the spending) be greater than the negative effects of business tax increases. *Id.*

In the mid-1990s, some economists argued that a consensus of sorts had been reached on the long-term effectiveness of state business tax incentives. *See* Timothy Bartik, *Jobs, Productivity, and Local Economic Development: What Implications Does Economic Research Have for the Role of Government?*, 47 NATIONAL TAX J. 847, 852 (1994); Wasylenko, *supra*, at 49. The measure of their effectiveness is summarized in an elasticity: the percentage change in business activity produced by a given percentage change in tax incentives. The consensus was that this elasticity was around .2 or .3, which means that an incentive equivalent to a 10% cut in taxes would eventually produce a 2% to 3% increase in economic

activity, provided, again, that incentives were not accompanied by cuts in public services.[12]

Is this a large effect or a small effect? One way of addressing this question is to ask: Given that level of influence, how much of the economic growth experienced by a state will be attributable to the incentives? Public officials routinely assert or assume that the answer to this question is: All of it. Once incentives are adopted, all subsequent growth is attributed to the incentives, as if no growth would occur on its own. This assumes that tax incentives are always the decisive factor, which flies in the face of the evidence that other factors are much more important, and tax incentives are rarely the decisive factor.

A typical array of business incentives offered for the average manufacturing business is equivalent to about a 30% cut in the state and local tax burden over a period of 20 years. *See* PETERS & FISHER, STATE ENTERPRISE ZONE PROGRAMS: HAVE THEY WORKED?, *supra* at 113. What the research shows is that, given incentives of this magnitude, and given the more generous estimate of incentive effectiveness (an elasticity of .3), only about 1 in 11 business investments can be attributed to the incentives. *See id.* The rest of the investment would have occurred anyway. Moreover, the effects of service cuts necessitated by the incentives may well offset even these modest gains, reducing the 9% effectiveness to near zero.

---

[12] An elasticity of .2 means that the percentage change in economic activity will equal .2 times the percentage change in taxes. This elasticity measures change over the long run; that is, the ensuing growth occurs not immediately but over a period of many years.

### B. Tax incentives are costly

The crux of the problem for state governments is this: Since the vast majority of business decisions will hinge on factors other than taxes, when you offer tax incentives, you have to spend an enormous amount of money (in the form of tax breaks that were unnecessary) to get a small benefit. This makes the tax cut strategy expensive and wasteful. Furthermore, even that low level of effectiveness, gained at high cost, is attainable only if the state can finance the tax cuts in a way that does not drive business from the state. Cuts in spending on education and infrastructure will offset any gains from the tax cuts and in fact will damage the state's long-run economic prospects. Yet it will be difficult to finance significant tax cuts year after year without reducing spending for education, transportation, utilities, and public safety. Those categories account for the majority (55%) of state and local budgets.[13]

### C. Tax incentives are an inferior policy tool given the alternative strategies available to encourage economic development

States have available to them a variety of strategies to foster economic growth. States invest in workforce development, for example, which benefits both the workers whose skills and earning potential are upgraded and the

[13] This figure is calculated by dividing the sum of expenditure of all state and local governments in the U.S. for education, transportation, public safety, and utilities by the sum of direct general expenditure and utility expenditure. *See* UNITED STATES CENSUS BUREAU, 2002 CENSUS OF GOVERNMENTS, Table 1 (State and Local Government Finances by Level of Government and by State: 2001-2002), *available at* http://ftp2.census.gov/govs/estimate/02slsstab1a.xls.

businesses that then can draw from a pool of higher skilled labor. States invest in business development through university technology transfer programs, business incubation centers, small business development assistance, and support for the provision of venture capital. *See, e.g.*, PETER K. EISINGER, THE RISE OF THE ENTREPRENEURIAL STATE (1988) (analyzing state high technology initiatives and venture capital programs). Most importantly, states invest in public education, which is essential to the development of the kind of workforce demanded in a modern economy. And they provide, often through local government, the public infrastructure essential to economic activity: streets and highways, public transit, water and sewer systems, and police and fire protection.[14]

The common feature of all of these alternative strategies for enhancing state economic growth is that they are productive and important activities from a national perspective as well. They are not beggar-thy-neighbor approaches, but instead are efforts to reinforce and enhance the nation's economic base. Furthermore, they are not hampered by the fundamental problem with incentives: the asymmetry of information that leads governments to spend money without knowing whether or not it is needed (since the business investment likely would have occurred anyway). As such, these alternatives are bound to be more cost effective.[15]

---

[14] Evidence of the importance of education, streets and highways, and public safety services on state economic growth can be found in Fisher, *supra*.

[15] Timothy Bartik is among those who have argued for a greater focus of state economic development policies on programs that enhance business productivity, and cites some evidence of the effectiveness of

(Continued on following page)

Far from creating irreparable harm to state economic development efforts, a court decision invalidating tax incentives would end a very inefficient, costly, and wasteful practice and free up state resources to devote to economic development strategies that are at once more cost effective to the states and beneficial, rather than harmful, to the national economy. From a constitutional perspective, the existence of these more effective economic development alternatives further undercuts the validity of discriminatory tax incentives like Ohio's ITC.

### D. Incentive strategies are adopted for political, not economic, reasons

The economic war between the states continues unabated, not for sound economic reasons, but for a variety of political reasons. The opening of a new plant that benefited from tax incentives provides politicians with a valuable opportunity to take credit for something of tangible benefit to the state, even if the incentives in actuality played no part in the firm's decision. The investments in education and infrastructure that would be of greater long-term economic benefit, on the other hand, will produce results that are less tangible, harder to take credit for, and that occur long after most current elected officials have left office.

The political risk associated with "losing" a major employer, or failing to land a new manufacturing facility after an intense competition with other states, is enormous. The risk associated with spending money unnecessarily

---

certain workforce training and technology programs. Bartik, *Jobs, Productivity, and Local Economic Development*, *supra*.

is small, particularly since, sooner or later, there will be business expansions or relocations somewhere in the state that can be attributed to the spending, and it will rarely be clear to the public that the spending was unnecessary. *See* Terry F. Buss, *The Effect of State Tax Incentives on Economic Growth and Firm Location: An Overview of the Literature*, 15 ECON. DEV. Q. 92 (February 2001). Furthermore, incentives can be couched as tax cuts, not spending programs, even though, as "tax expenditures," they are equivalent. It is difficult to run for office on a platform opposing tax cuts that appear to have little cost to the average taxpayer and that one's opponent will argue create jobs.

Thus the political incentives are all on the side of granting incentives. Benefits to the state can always be plausibly asserted, however weak the causal connection, and the costs in lost revenue are hidden. Disavowing tax incentives, on the other hand, presents great risks and few benefits to political leaders, as their opponents in the next election will attack them for failing to do all they could to capture development and increase jobs. It is no wonder that states, left to themselves, continue the race to the bottom.

## CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted,

SCOTT L. CUMMINGS
*Counsel of Record for*
*Amici Curiae*
UCLA School of Law
405 Hilgard Avenue
Los Angeles, California 90095
(310) 794-5495

January 23, 2006

## ADDENDUM

The *amici curiae* include the following economics and public policy scholars:

Randy Albelda is a professor of economics in the Public Policy graduate program at the University of Massachusetts, Boston. She has worked as research director of the Massachusetts State Senate's Taxation Committee and the legislature's Special Commission on Tax Reform. Her research and teaching covers a broad range of economic policies affecting low-income families. Her most recent work includes the edited volumes THE DILEMMAS OF LONE MOTHERHOOD: ESSAYS FROM FEMINIST ECONOMICS and LOST GROUND: POVERTY, WELFARE REFORM, AND BEYOND, and co-authored reports, *A Tale of Two Decades: Changes in Work and Family in Massachusetts 1979-1999* and *Beyond Welfare: Emergency Services in Massachusetts*. Other publications include the book, ECONOMICS AND FEMINISM: DISTURBANCES IN THE FIELD, co-authored books, GLASS CEILINGS AND BOTTOMLESS PITS: WOMEN'S WORK, WOMEN'S POVERTY; THE WAR ON THE POOR: A DEFENSE MANUAL; and UNLEVEL PLAYING FIELDS: UNDERSTANDING WAGE INEQUALITY AND DISCRIMINATION. She is the author or co-author of over 20 articles, ten book chapters and dozens of policy reports.

Howard Chernick is a professor at Hunter College of the CUNY Graduate School. He holds a Ph.D. in economics from the University of Pennsylvania and is a Research Affiliate of the Institute for Research on Poverty at the University of Wisconsin-Madison. Before coming to Hunter College in 1982, he was a senior researcher in the U.S. Department of Health and Human Services. From 1989-90 he was a Visiting Fellow at the Russell Sage Foundation.

Professor Chernick's research specializes in the economics of the public sector, with special attention to the distributional impacts of government spending and taxation. He is a recipient of the Presidential Award for Excellence for applied Scholarship, Hunter College, 2005. He is actively involved in public policy in New York, serving as a consultant to the City of New York Independent Budget Office and the Campaign for Fiscal Equity.

Peter Fisher is a professor in the Graduate Program in Urban and Regional Planning at the University of Iowa, where he has taught since 1977. His research and interests are centered on state and local government finance, economic development policy, and poverty and income inequality. He has consulted with state government agencies in Ohio and Iowa regarding tax incentives and economic development policy. He has written or co-authored three books: Peter Fisher and Alan Peters, INDUSTRIAL INCENTIVES: COMPETITION AMONG AMERICAN STATES AND CITIES (Upjohn Institute for Employment Research, 1998) Alan Peters and Peter Fisher, STATE ENTERPRISE ZONES: HAVE THEY WORKED? (Upjohn Institute, 2002); and Peter Fisher, GRADING PLACES: WHAT DO THE BUSINESS CLIMATE RANKINGS REALLY TELL US? (Economic Policy Institute, 2005). His article, co-authored with Alan Peters, *The Failures of Economic Development Incentives*, (JOURNAL OF THE AMERICAN PLANNING ASSOCIATION, Winter 2004), won the prize for the best article in that journal in 2004.

Robert G. Lynch is the Everett E. Nuttle Professor of Economics and Chair of the Department of Economics at Washington College, where he has taught since 1998. He is also a Research Associate with the Economic Policy Institute. From 1983 to 1998, he taught at the State

University of New York at Cortland where he served as Chair of the Department of Economics between 1991 and 1993. He also taught at Huanghe University (1985-86) in the People's Republic of China. Dr Lynch has served as a consultant to numerous organizations including private businesses, governments, labor unions, and research organizations. His areas of specialization include Public Policy, Public Finance, International Economics, Economic Development and Comparative Economics. Over the past 20 years Dr. Lynch has evaluated the adequacy and effectiveness of various state and local government economic policies, reviewed government economic growth strategies, and studied the efficiency, fairness, and stability of state and local tax systems. He is the author of numerous works that have analyzed the effectiveness of state and local government economic policies in promoting economic development and creating jobs including his 2004 publication RETHINKING GROWTH STRATEGIES: HOW STATE AND LOCAL TAXES AND PUBLIC SERVICES AFFECT ECONOMIC DEVELOPMENT. In addition, he has written several papers that examined issues related to the definition and measurement of income inequality.

Thomas Maloney received his Ph.D. in economics from the University of Michigan in 1992 and was a Post-Doctoral Fellow at the Center for the Study of Urban Inequality, University of Chicago, from 1992 to 1994. He is currently an Associate Professor in the Department of Economics at the University of Utah. His research on U.S. economic history, racial discrimination, migration, and labor markets has appeared in the JOURNAL OF ECONOMIC HISTORY, EXPLORATIONS IN ECONOMIC HISTORY, SOCIAL SCIENCE HISTORY, THE JOURNAL OF INTERDISCIPLINARY HISTORY, ECONOMIC INQUIRY, and elsewhere. He served on the

editorial board of the JOURNAL OF ECONOMIC HISTORY from 2001 to 2005.

Ann Markusen is Professor of Public Affairs at the University of Minnesota and is the director of the Institute's Project on Regional and Industrial Economics. Currently, her research focuses on occupational approaches to regional development and on the arts, high tech and defense activities as regional economic stimulants. Before joining the Humphrey Institute, Markusen was State of New Jersey Professor of Urban Planning and Policy Development at Rutgers University. She has held faculty positions at Northwestern, the University of California at Berkeley, and the University of Colorado. Markusen has been an economic policy fellow with the Brookings Institution and a research economist with the Michigan speaker of the house's office. She was a Fulbright Lecturer in regional development economics in Brazil and has written on European, Korean and Japanese regional economies as well as on North American cities and regions. From 1995 to 2002, she served as a Senior Fellow at the Council on Foreign Relations in New York and in 2002, as a Visiting Fellow at the Public Policy Institute of California. Markusen has served as president of the North American Regional Science Association, regional planning track chair for the American executive committee and board member of the Economics Policy Institute in Washington, D.C.

Dick Netzer is Professor Emeritus of Economics, Planning and Public Administration at New York University's Wagner Graduate School. He has worked in urban public finance and urban economics as a researcher, teacher, consultant, and public official for more than 40 years. He is the author of ECONOMICS OF THE PROPERTY TAX

(Brookings, 1966), ECONOMICS AND URBAN PROBLEMS (Basic Books, 1974), and THE SUBSIDIZED MUSE (Twentieth Century Fund Press, 1978) and principal author of *Financing Government in New York City*. He is also the author of *An Evaluation of Interjurisdictional Competition Through Economic Development Incentives*, in Daphne Kenyon and John Kincaid, editors, COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM. Urban Institute Press, 1991. In addition, he is the author or co-author of more than 200 other articles, papers, and book chapters, and is a nationally recognized expert in the economics of property taxation. From 1969 through 1982, Professor Netzer served as the dean of the Wagner School and was the founding director of the Taub Urban Research Center. He is a member of the Board of Directors of the Citizen's Union Foundation.

Robert B. Reich is Professor of Public Policy at the Goldman School of Public Policy at the University of California at Berkeley. He has served in three national administrations, most recently as secretary of labor under President Bill Clinton. He has written ten books, including THE WORK OF NATIONS, which has been translated into 22 languages; the best-sellers THE FUTURE OF SUCCESS and LOCKED IN THE CABINET, and his most recent book, REASON. His articles have appeared in the NEW YORKER, ATLANTIC MONTHLY, NEW YORK TIMES, WASHINGTON POST, and WALL STREET JOURNAL. Mr. Reich is co-founding editor of THE AMERICAN PROSPECT magazine.

Andrew Reschovsky is Professor of Applied Economics and Public Affairs at the University of Wisconsin, Madison Robert M. La Follette School of Public Affairs. His research focuses on tax policy and intergovernmental fiscal

relations. Professor Reschovsky has worked in the Office of Tax Analysis at the U.S. Treasury and at the Organisation of Economic Co-operation and Development in Paris. He has conducted research for several state and local governments in the United States. His most recent articles have appeared in the PUBLIC FINANCE REVIEW, STATE AND LOCAL GOVERNMENT REVIEW, PUBLIC BUDGETING AND FINANCE, and the NATIONAL TAX JOURNAL. He has recently contributed chapters to RESTRUCTURING LOCAL GOVERNMENT FINANCE IN DEVELOPING COUNTRIES: LESSONS FROM SOUTH AFRICA; HELPING CHILDREN LEFT BEHIND: STATE AID AND THE PURSUIT OF EDUCATIONAL EQUITY; and CITY TAXES, CITY SPENDING.

John L. Solow is Associate Professor of Economics at the University of Iowa's Tippie College of Business. Professor Solow received his B.A. from Yale University and M.A. and Ph.D. from Stanford University and joined the Iowa faculty in 1981. He has published articles in the areas of energy and natural resource economics, tax incidence and durable goods markets, and his research interests include law and economics, antitrust, and public policy. He has worked at the Federal Energy Administration and the Electric Power Research Institute, served as a consultant to the U.S. Departments of Energy and Justice, MidAmerican Energy, Qwest Telecommunications and numerous law firms, and has been a visiting scholar at Stanford University, the University of Auckland in New Zealand, and Monash University in Australia.

Kenneth P. Thomas received his Ph.D. in Political Science from the University of Chicago in 1992. An internationally known expert on subsidies, he is the author of COMPETING FOR CAPITAL: EUROPE AND NORTH AMERICA IN A GLOBAL ERA (Washington: Georgetown University Press, 2000),

which compares subsidies and subsidy control in the EU, Canada, and the U.S. He has taught at the University of Missouri-St. Louis for 14 years, where he is also a Fellow in the Center for International Studies.

John Yinger is Trustee Professor of Public Administration and Economics at the Maxwell School, Syracuse University, and Director of the Education Finance and Accountability Program in the Maxwell School's Center for Policy Research. Professor Yinger has taught at Syracuse since 1986; he has also held academic positions at Harvard University, the University of Michigan, and the University of Wisconsin. His recent scholarly publications include articles on education finance, the incidence of the property tax, and the causes of housing discrimination. Professor Yinger has authored or co-authored four books, two on topics in local public finance, one on discrimination in housing markets, and one on discrimination in mortgage lending. His edited volume, HELPING CHILDREN LEFT BEHIND: STATE AID AND THE PURSUIT OF EDUCATIONAL EQUITY, was published in June, 2004. Professor Yinger has also been a Senior Staff Economist at the President's Council of Economic Advisors, and he was co-director of a tax study in Nebraska and an aid commission in Minnesota.

---

**Responses to Questions for the Record From Dr. Peter Fisher**
**Senate Committee on Finance Hearing of March 16, 2006**

***From Senator Snowe***

*Question:* How can the Federal tax code be used to encourage investment and economic development in our Nation's most distressed communities?

*Answer:* With my colleague Alan Peters I have conducted extensive research on State enterprise zones over the past several years, culminating in publication of the book *State Enterprise Zone Programs: Have they Worked?* The focus of these programs was, at least originally, on distressed neighborhoods and communities, and the principal tool is almost always State and local tax incentives. I think there are some important lessons from this research that are useful when considering the general issue of tax incentives to promote development in distressed areas. First of all, the targeting of incentives weakened over time, as more kinds of localities demanded the tools being made available within enterprise zones. This undercut the zone strategy as a means to help distressed areas, as more affluent areas were given the tools to effectively attract business away from those distressed areas. Second, State and local tax incentives by themselves have not made much of a difference; most research has found that distressed areas with enterprise zone incentives have done about the same as similar areas without such incentives.

Third, labor markets are much larger than neighborhoods or even cities; they are metropolitan in scope. The majority of those working within enterprise zones live outside the zones, commuting from across the metro area, and the majority of those living within zones commute to jobs outside the zones. In other words, targeting economic development at distressed areas does not do as much as one might think to help the residents of those areas. Fourth, because of the limited effectiveness of incentives in actually increasing the employment rates of enterprise zone residents, zone incentives are a very costly strategy. Most of the incentives go to firms that would have located in that zone even without incentives, and even where the incentives were decisive, many if not most of the jobs go to non-zone residents.

It is likely that Federal policy can be more effective in stimulating the development of distressed areas. The New Markets Tax Credit program, for example, is probably less likely to see the targeting eroded over time. As long as bona fide community development financial institutions (CDFIs) must be the recipients of the capital encouraged by the credits, it seems to me that the program will remain appropriately focused and you will not see the kind of political pressures to relax geographic eligibility standards that have characterized enterprise zone programs. It takes considerable effort to establish a functioning CDFI, and this acts as an important sort of "matching" requirement. Community leaders (in the public, private and non-profit sectors) in effect have to demonstrate a substantial level of commitment to developing the community before they get any benefit from the program. It is not an entitlement, whereby a

community qualifies just on the basis of meeting some criteria of distress, which can always be manipulated and weakened.

Secondly, Federal taxes in general are a larger cost factor for businesses and individuals than State and local taxes. Thus it is likely that Federal credits will be more influential than State credits. Given the inherent locational disadvantages of many distressed areas (some real, some more a matter of perception), it will take more to jump-start development there. Furthermore, effective aid to distressed areas is beyond the capabilities of local governments, who are faced often with a declining tax base and deteriorating services, and who risk further deterioration of their budgets through the granting of tax breaks that are only marginally effective to begin with. Development of distressed areas is appropriately a Federal responsibility, and one that is important not just to the localities involved but to the country as a whole. There is a national economic interest in putting underutilized human and physical resources to more productive use, and in reducing the economic drag caused by the social overhead expenses necessitated in poverty-stricken areas.

*Question:* Is the New Markets Tax Credit (NMTC) program an effective way of making low-income communities a more competitive location in which businesses can invest?

*Answer:* As far as I can determine, it is too early to find research results on the effectiveness of the New Markets Tax Credit Program. It does appear that the program has considerable promise. It also appears that there are some potential pitfalls that need to be monitored. As with any program that aims to increase the flow of capital to projects that otherwise would go unfunded, the danger is that the credits will be used instead to lower the costs of investments that would have passed the market test on their own. It appears that those administering the program are well aware of this issue and do take measures to prevent unnecessary subsidy of projects that could stand on their own. This will, I suspect, be an ongoing issue, however. The opposite problem can also occur: the credits will increase the flow of capital to projects that would not meet the market test, but which should not be funded at all because they will not be successful. This is a problem that all CDFIs deal with on a daily basis, however, and they have every incentive to ensure that their clients succeed. This is why CDFIs typically have a technical assistance arm that works with potential entrepreneurs and borrowers. It is important then that NMTC funds can be used for these kinds of activities.

It must also be recognized that augmenting the flow of capital to distressed areas by itself will not necessarily improve the lives of residents of those areas. A program like the New Markets Tax Credits will be most effective when it is part of a broader effort to redevelop communities and employ the hard-to-employ. Programs to develop human capital need to be in place to ensure that residents are in a position to take the jobs provided by the investment capital program. Otherwise we will have created nice new centers of employment for suburban commuters, while making little difference in the lives of the high-school dropouts in the neighborhood surrounding the facility. It also appears that a large share of the credits are used for real estate projects, which may not be the best use of these funds for economic development purposes.

I hope these comments are of some use. I am sure there are others who are more familiar with the details of the NMTC and who could provide more advice on how it might be strengthened.

Statement of Majority Leader Bill Frist, M.D.
*Cuno* and Competitiveness: Where to Draw the Line
Subcommittee on International Trade of the Committee on Finance
United States Senate
March 16, 2006

Mr. Chairman, I would like to begin by applauding you for scheduling this subcommittee hearing today to discuss the Sixth Circuit Court of Appeals case of *Cuno v. DaimlerChrysler*. I also want to thank Chairman Grassley and all of the Members of the Committee for their willingness to address this important issue.

As our witnesses will testify today, the appellate court in *Cuno* struck down Ohio's investment tax credit, finding that this credit granted preferential treatment to in-state investment in violation of the dormant Commerce Clause. Because *Cuno* serves as precedent for the Sixth Circuit, which includes my home state of Tennessee, this case has raised particular concern for me. Tennessee's investment tax credits are an important tool to the state in fostering economic development and are relied upon by most of our largest employers. If the decision in *Cuno* stands, I am concerned that many of Tennessee's tax incentives could be jeopardized as lower courts relying on *Cuno* may conclude that the state's credits are unconstitutional.

Last year, in reaction to this case, I proudly joined Senator Voinovich and every other member of the Sixth Circuit delegation in co-sponsoring the Economic Development Act of 2005. We will hear Senator Voinovich's testimony regarding this issue in a few minutes, and I want to thank him for his leadership on this issue. The purpose of the Economic Development Act is to affirm that states have the authority to offer tax incentives to businesses in order to stimulate economic development and to provide certainty that these credits are consistent with the principles under the Commerce Clause.

While *Cuno* only serves as precedent for the Sixth Circuit, this case has raised national concern. In reaction to this decision, similar lawsuits may be filed across the nation, placing tax credit provisions on the books in every state in jeopardy of being struck down as unconstitutional. In this global age, states are not only competing against other states to recruit businesses, but they are also competing with foreign countries. Investment tax credits, including the one discussed in the *Cuno* case, give states the ability to provide incentives to companies doing business in their state, while also encouraging companies to stay in the United States rather than re-locating abroad.

I understand that the Supreme Court heard oral arguments in the *Cuno* case earlier this month, and I am hopeful that the Court will reverse the Sixth Circuit's decision. However, should the Court decide not to address the constitutional issue raised by *Cuno*, I feel that it is necessary for Congress to act. We need to pass the Economic Development Act to show our support for states' rights to offer investment tax incentives that will encourage economic development, foster growth in our communities, and create new jobs for our citizens.

# Testimony of Walter Hellerstein

## Before the

## Subcommittee on International Trade

## of the

## Committee on Finance
## United States Senate

## Hearing on

## "*Cuno* and Competitiveness: Where to Draw the Line"

## March 16, 2006

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

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

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

## I. WHY CONGRESS SHOULD DRAW A LINE BETWEEN APPROPRIATE ECONOMIC DEVELOPMENT INCENTIVES AND INAPPROPRIATE STATE TAX DISCRIMINATION

It is not an overstatement to characterize the U.S. Supreme Court's dormant Commerce Clause doctrine imposing restraints on state taxation of interstate commerce as a "quagmire." Indeed, almost half a century ago the U.S. Supreme Court itself described the doctrine that way,[2] and things have not gotten much better.[3] Moreover, in no context is the confusion and uncertainty created by the Court's Commerce Clause doctrine more profound than in the domain of state tax incentives for economic development. As I testified earlier this year before a House Subcommittee looking into the *Cuno* problem,[4] perhaps the one point on which virtually all observers would agree is

---

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

[2] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959).

[3] See generally 1 Jerome R. Hellerstein & Walter Hellerstein, *State Taxation* ch. 4 (3rd ed. 1998 & Cum. Supp. 2005) (taking more than 300 printed pages to describe U.S. Supreme Court's dormant Commerce Clause doctrine).

[4] 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).

that "the law in this area is indeterminate," and that, "[l]less charitably put, it is a mess, albeit a mess that keeps many lawyers and law professors busy."[5]

The *Cuno* case, of course, is a poster child for this "mess." How can anyone explain, as the *Cuno* case held, how (a) an income tax credit to attract business to a state violates the Commerce Clause while (b) a property tax abatement to attract that same business to the state does not?[6] But *Cuno* is just the tip of the iceberg. There are literally hundreds of state tax incentives enacted for economic development purposes that arguably fall on one side or the other of the line the Court has drawn between permissible and impermissible inducements. Whether they fall on the right side or the wrong side of the line depends on an inquiry into such questions as whether the measure is:

- a permissible direct subsidy of domestic industry that "'does not ordinarily run afoul' of the negative Commerce Clause"[7]; or
- an incentive falling within the Court's recognition that its decisions "do[ ] not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry"[8]; or
- an incentive designed to achieve that same objective – "to encourage the growth and development of intrastate commerce and industry" – but that "forecloses tax-neutral decisions"[9]; or
- an incentive that "'provid[es] a direct commercial advantage to local business.'"[10]

Because the answers to these questions are often unclear, in many cases it is anyone's guess whether a particular economic development measure falls on the right or wrong side of that line.

---

[5] *Id.* at 10.

[6] Although I must plead guilty to having tried to explain that very distinction, Walter Hellerstein & Dan T. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 *Cornell Law Review* 789 (1996)), and acknowledge that the Court of Appeals for the Sixth Circuit relied on that explanation in striking down Ohio's investment tax credit while sustaining the property tax abatement, *Cuno v. DaimlerChrysler, Inc.* 386 F.3d 738 (6th Cir. 2004) (citing *id.* at 806-09), I would be the first to admit (and have in fact admitted) the extraordinary difficulties in attempting to delineate "the ill-defined distinction between the constitutional carrot and the unconstitutional stick in state tax, subsidy, and related cases." Hellerstein & Coenen, *supra*, at 792.

[7] *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 n.15 (1994) (quoting *New Energy Co. v. Limbach*, 486 U.S. 269, 278 (1988)).

[8] *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 336(1977).

[9] *Id.* at 331. One may reasonably ask whether a tax incentive that does *not* "foreclose tax-neutral decisions" is even worthy of its name, since that is precisely what a tax incentive is designed to do.

[10] *Id.* at 329 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)).

Right now, for example, in Wisconsin, the state supreme court is struggling with the question of whether the state's property tax exemption for airlines that operate "hub facilities" in the state violates the dormant Commerce Clause,[11] a question that the Wisconsin Court of Appeals certified to the state supreme court because it "presents issues of statewide and national importance involving the ability of the state to provide tax incentives for businesses to locate, upgrade, or remain in the state."[12] While perhaps not of the same pressing importance, except to my state and local tax students to whom I gave the problem as an examination question last semester, is the question of the constitutionality of Georgia's headquarters credit for new investment in the state.[13] I could have chosen a similar example from virtually any other state.

The problem created by this uncertainty for taxpayers and taxing authorities alike is self-evident. Taxpayers who have reasonably relied on these economic development incentives in the past have no assurance that these provisions will survive Commerce Clause challenge and thereby deprive them of benefits on which they may have made locational and budgetary decisions. Moreover, this uncertainty has a highly unsettling impact on future decision-making regarding industrial location. State taxing authorities whose incentive provisions may be vulnerable to attack likewise face difficult administrative decisions in determining how to redress the discrimination, especially in

---

[11] *Northwest Airlines, Inc v. Wisconsin Dep't of Revenue*, 281 Wis. 2d 117, 697 N.W.2d 475 (2005).

[12] *Northwest Airlines, Inc v. Wisconsin Dep't of Revenue*, No. 04-0319, 2005 WL 487882 (Wis. App. 2005).

[13] Here was the question:

> Georgia Code § 48-7-40.17 provides, in pertinent part:
>
> (a) As used in this Code section, the term: ...
>
> > (3) "Headquarters" means the principal central administrative office of a taxpayer or a subsidiary of the taxpayer.
>
> (b) A taxpayer establishing its headquarters in this state or relocating its headquarters into this state which:
>
> > (1) Within one year of the first date on which it withholds wages for employees at such headquarters ...employs at least 100 persons in new full-time jobs at such headquarters...; or
> >
> > (2) Within one year of the first date on which it withholds wages for employees at such headquarters ... incurs within the state a minimum of $1 million in construction, renovation, leasing, or other costs related to such establishment or relocation ...shall be allowed a credit for taxes imposed under this article equal to $2,500.00 annually per eligible new full-time job.

Your client has recently relocated its headquarters to Georgia. It has added 75 persons in "new full-time jobs at such headquarters" within the meaning of the foregoing statute, and it has incurred $500,000 of "construction, renovation, leasing, or other costs related to such establishment" within the meaning of the statute. The Georgia Department of Revenue has denied your client the credit described above, and your client has asked your advice as to whether a Commerce Clause challenge to such denial will be successful. Write a memorandum providing the requested advice.

light of the constitutional requirement that those who have been the victim of unconstitutional state tax discrimination are entitled to "meaningful backward-looking relief."[14] The state budgetary implications of this requirement can also be daunting. Accordingly, wholly apart from any question of whether state tax incentives are wise as a matter of policy – an issue on which others are better positioned to testify and to which my testimony is not directed – the existing indeterminacy of the law governing the constitutionality of these incentives under the Commerce Clause calls for a solution.

That solution will not come from the U.S. Supreme Court or from other courts that are bound to follow its guidance. As Justice Frankfurter observed nearly 50 years ago:

> At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.
>
> The problem calls for solution by devising a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power.[15]

In short, the problem raised by *Cuno* is broader than *Cuno* itself. Failure by Congress to act on the underlying issue raised by *Cuno* will effectively leave us in the "mess" we are in. Wholly apart from the wisdom or effectiveness of state tax incentives or the defensibility of various competing readings of the dormant Commerce Clause that may be advanced, failure by Congress to act will assure continuing uncertainty and, most probably, inconsistency in judicial determinations of the validity of state tax incentives. To reiterate what I said to a House subcommittee earlier this year: "However Congress may resolve the ultimate question of what types of tax incentives represent appropriate measures to encourage economic development, we are all better off if Congress draws a clear line that is discernible to all than if we are left to the vagaries of the judicial process that has created the uncertainty and controversy that we face today."[16]

---

[14] *McKesson v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 31 (1990).

[15] *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting). The Court expressed similar sentiments in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) and in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978).

[16] Hellerstein, *supra* note 4, at 13.

## II. HOW CONGRESS SHOULD DRAW THE LINE BETWEEN ACCEPTABLE ECONOMIC DEVELOPMENT INCENTIVES AND UNACCEPTABLE STATE TAX DISCRIMINATION

If Congress decides to legislate in this area and to draw a line between acceptable economic development incentives and unacceptable state tax discrimination, my principal recommendation is simple: *be careful*. I say that for the following reason: one person's "economic development incentive" is often another person's "discriminatory tax." New York's "economic development incentive" to attract sales to the New York exchanges was a "discriminatory tax" to the Boston Stock Exchange that viewed the incentive as diverting economic activity from the Boston exchange, a view with which the U.S. Supreme Court concurred.[17] Hawaii's "economic development incentive" for its fledging wine industry was a "discriminatory tax" to sellers of alcoholic beverages produced in other states, a view with which the U.S. Supreme Court concurred.[18] New York's "economic development incentive" for business involved in export shipment from New York was a "discriminatory tax" for those making export shipments from other states, a view with which the U.S. Supreme Court concurred.[19] And Ohio's "economic development incentive" for gasohol produced in the state was a "discriminatory tax" to those who produced gasohol in other states, a view with which the U.S. Supreme Court concurred.[20] Consequently, in drawing the line between acceptable and unacceptable economic development incentives, Congress must act with great care to assure that it is neither approving as "economic development incentives" provisions that, on further reflection, constitute unwarranted "state tax discrimination," or, alternatively, that it is not condemning as "state tax discrimination," provisions that, on further reflection, constitute permissible "economic development incentives."

Let me provide you with one recent example of the delicate task that Congress faces. Two weeks ago today the Missouri House of Representatives passed by a resounding 152-1 margin an exemption from Missouri sales taxes for "all sales of new motor vehicles assembled and sold in the State of Missouri after January 1, 2007."[21] The bill was obviously enacted with the wholly laudable and understandable purpose of encouraging economic development in Missouri by eliminating the tax on motor vehicles assembled in the state. But it does not take a Nobel-prize winning economist to appreciate the implications of this legislation for the sale in Missouri of automobiles manufactured in Illinois, Ohio, or Michigan. The question Congress faces, then, is how to draw the appropriate line between *Cuno*-type incentives, which many believe are

---

[17] *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318 (1977).

[18] *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984).

[19] *Westinghouse Electric. Corp. v. Tully*, 466 U.S. 388 (1984).

[20] *New Energy Co. v. Limbach*, 486 U.S. 269 (1988).

[21] House Bill No. 1249, 93rd General Assembly, State of Missouri, March 2, 2006,

appropriate, and the Missouri incentive, which, I will venture to presume, many would find inappropriate.

Without speaking to the merits of the particular line that Congress may wish to draw, I nevertheless believe that the legislation introduced into Congress by Senator Voinovich and Representative Tiberi[22] makes an excellent start at the process of drawing such a line. It represents a considered effort to strike a balance between the ability of the states, in their sovereign capacities, to adopt programs designed to attract economic activity to the state and the needs of the nation to maintain the national common market that has been essential to our country's economic prosperity.

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

* * *

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

---

[22] See S. 1066, 109th Cong., 1st Sess. (2005); H.R. 2471, 109th Cong., 1st Sess. (2005).

# *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 out-of-State manufacturers,

A final general observation regarding the EDA is that it does not prohibit any tax incentive. It simply authorizes certain tax incentives that might otherwise be unconstitutional under existing dormant Commerce Clause doctrine.[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 to say that Congress is legislatively adopting such doctrine. To the contrary, the EDA is

---

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

*Id.*; *see also* Arizona Public Service Co. v. 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.

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

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

[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).

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 incentive available to corporations commercially domiciled in the state but not corporations

---

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

[38] *See* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 8, at 4.13[2][j].

[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.

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 EDA to "except as otherwise provided by law" may be read to evince an intent not to

---

[43] A corporation's "commercial domicile" is "the principal place from which the trade or business of the taxpayer is directed or managed." UNIFORM DIVISION OF INCOME FOR TAX PURPOSES ACT § 1(b), 7A U.L.A. 148 (2002). The concept of commercial domicile in substance defines a taxpayer's residence in terms of its seat of management rather than its legal domicile (*e.g.*, place of incorporation). *See generally* 1 HELLERSTEIN & HELLERSTEIN, *supra* note 38, at 9.03[2].

[44] 520 U.S. 564 (1997).

[45] In *Camps Newfound*, the Court held that a Maine property tax exemption for charitable institutions discriminated against interstate commerce in violation of the Commerce Clause because it excluded charitable institutions that are "in fact conducted or operated principally for persons who are not residents of Maine." *Id.* at 568 (quoting 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.

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 beverages produced outside the state. *Bacchus* involved an exemption for locally produced alcoholic beverages from an excise tax on the wholesale sale of liquors. The state sought to avoid the force of the Court's precedents prohibiting such local favoritism by arguing that the locally produced beverages did not

that provides a tax credit to automobile manufacturers that invest in new facilities or equipment in the state (a provision that, standing alone, would fall within the EDA's authorization), if the credit were available only to automobile companies that furnished their automobiles with tires or mufflers produced in the state.

There is some risk that this provision extends to the tax incentive at issue in *Cuno* itself because, as practical matter, a tax credit for new investment in the state will almost invariably lead taxpayers to "acquire, lease, license, use, or provide services to property produced, manufactured, generated, assembled, developed, fabricated, or created in the State."[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?

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

---

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).

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

[59] EDA § 3(a)(3).

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

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

---

[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).

[62] EDA § 3(a)(3) (emphasis added).

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

---

[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.

[66] In this connection, it may be worth observing that there is nothing in the EDA to disturb the Court's holding in Moorman Manufacturing Co. v. Bair, 437 U.S. 267 (1978), that the single-factor sales formula is

D. Tax Incentives Reduced as a Result of a Third-Party's Increase In Out-of-State Activity or Lack of Presence in the State

The EDA's authorization of tax incentives does not apply to any state tax incentive that "is reduced or eliminated as a result of an increase in out-of-State activity by a person other than the recipient of the tax incentive or as a result of such other person not having a taxable presence in the State."[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 thrust of the limitation—like the limitation described immediately above[70]—is to deny

---

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 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).

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 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

---

[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).

[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).

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 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

[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).

[78] *Id.* at 102.

means."[79] Under the doctrine, the Court observed, "a facially discriminatory tax that imposes on interstate commerce the rough equivalent of an identifiable and 'substantially similar' tax on intrastate commerce does not offend the negative Commerce Clause."[80] Extracting from its earlier cases, the Court articulated a three-prong inquiry for determining whether the complementary tax doctrine applies:

> (1) The state must identify the intrastate tax burden for which the state is attempting to compensate.
>
> (2) The tax on interstate commerce must be shown to roughly approximate—but not exceed—the amount of the tax on intrastate commerce.
>
> (3) The events on which the interstate and intrastate taxes are imposed must be "substantially equivalent," i.e., they must be sufficiently similar in substance to serve as mutually exclusive proxies for each other.[81]

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

---

[79] *Id.*

[80] *Id.* at 102–03

[81] *Id.* at 103.

[82] *Id.* at 104.

are not imposed on substantially equivalent events."[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 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

---

[83] *Id.*

[84] *See supra* note 76.

[85] EDA § 4(a)(1).

[86] EDA § 3(a)(5).

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

qualify as complementary taxes if the states simply relabeled them as "tax incentives" for "economic development purposes"?[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 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

---

[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).

[89] EDA § 2.

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

locations" in the state, thus favoring merchants with fixed locations in the state, but without regard to the 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.

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

The EDA's authorization of tax incentives does not apply to any state tax incentive that "requires that other taxing jurisdictions offer reciprocal tax benefits."[93] The exclusion

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

[92] *See* HELLERSTEIN & HELLERSTEIN, *supra* note 8, at 262-63.

[93] EDA § 3(a)(6).

reflects the Supreme Court's decision in *New Energy Co. v. Limbach.*[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 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

---

[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)).

[97] EDA § 3(a)(7).

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]

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

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

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

[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).

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

This problem becomes clear when one examines the definition of "imposed on apportioned interstate activities."[102]

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

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

---

[101] EDA § 3(a)(7).

[102] EDA § 4(a)(3).

[103] EDA § 4(a)(3).

appropriately modified (in brackets) to account for the fact that a sales tax credit, rather than a severance tax credit, is at issue:

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

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

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

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

---

[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).

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

### H. Precedents Overruled by the EDA

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

---

[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.

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]

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

---

[109] *Id.* at 330.

[110] *Id.*

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

[112] *Id.*

[113] *Id.* at 336.

[114] *See supra* Part II.

EDA's authorization. The EDA's limitations generally do not preclude tax incentives directed to particular classes of sellers when the identity of the class is not further restricted, for example, by reference to the seller's residence or use of in-state property.

Insofar as the tax incentive at issue in *Boston Stock Exchange* is limited to nonresident sellers, however, it would appear to fall within the limitation that an authorized tax incentive not be "dependent upon State or country of incorporation, commercial domicile, or residence of an individual."[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

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:

---

[115] EDA § 3(a)(1).

[116] *Id.*

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

(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 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.

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

**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.

James H. Renzas
President and CEO
Location Management Services, LLC

Invited Testimony

United States Senate
Committee on Finance
Subcommittee on International Trade
The Honorable Craig Thomas
Chairman

*"Cuno and Competitiveness: Where to Draw the Line"*
215 Dirksen Senate Office Building
Thursday, March 16, 2006

Mr. Chairman and Members of the Committee:

I am honored to have been invited to testify before this distinguished body on an important issue affecting the future of this great country.

As President and CEO of Location Management Services, I am on the front lines of America's quest for competitiveness in the world. You see, LMS is one of a small group of international site selection consultants who work with expanding companies in the United States and throughout the world to counsel them on where to locate new jobs and investment.

Location Management Services is an outgrowth of my experience in the site selection industry for over 25 years. During this time, I have worked with hundreds of companies considering expansion or relocation and counseled them on the creation of thousands of American jobs and hundreds of millions of dollars in investment.

Today you have heard from a number of brilliant and distinguished experts in the field of state taxation and economic development. These experts have a variety of backgrounds and are highly educated and immersed in the body of research surrounding the effects of taxation and state economic policy on the creation of new jobs and investment.

As CEO of Location Management Services, I am unique in the respect that, rather than conduct research and theorize on what makes companies choose certain locations for new corporate facilities – I have actually done it – hundreds of times over in my career.

History is rife with examples of distinguished scientists and theoreticians holding a view of the world which is ultimately proven wrong by those to venture out to actually test these theories in a real-world environment. I have only to cite as an example Columbus, who bravely ventured out to disprove the conventional scientific wisdom that the world was flat and protected by dragons to show how highly respected theorists are often wrong in the absence of real world experience.

That said I would like to discuss my life helping companies select the most appropriate locations for new investment and job creation from the standpoint of one who has been "on the inside" with senior management and the Board Directors when comparing the pros and cons of potential corporate investment locations.

Location Management Services recently partnered with the National Association of Manufacturers to offer its members corporate site selection services in the United States through the Site Selection Network. This network provides confidential site selection consulting services to N A M members who are looking to establish new corporate manufacturing facilities, distribution centers, corporate headquarters operations, and back-office support centers throughout this country. Our services include assisting companies evaluate the best locational strategy to achieve corporate objectives, analyzing hundreds of potential state and local locations, and negotiating the final site selection deal on behalf of our clients. In addition, we provide compliance services to ensure that companies live up to the agreements that they make to state and local governments when accepting incentive dollars.

In the last two weeks I have conducted field work in the States of North Carolina and Georgia to help a U.S. manufacturer select the final location for a ½ million square foot manufacturing plant which will ultimately employ over 1,000 American workers. As a part of that field work I have interviewed numerous manufacturers in five semi-finalist counties throughout these states to assess the availability of labor and skills, employment costs, benefits policies and government cooperation. I have learned a great deal about what these small and medium sized U.S. manufacturers are facing in an increasingly competitive world market. Some of these companies have dropped product lines as their markets have been adversely impacted by dramatically lower prices resulting from the movement of their competition from the United States to offshore locations like China, India and the Philippines.

One textile company I interviewed in North Carolina last week downsized its workforce from over 300 manufacturing employees last year to just 65 employees today as global competition and pricing has eroded its profit margins. Another consumer products company simply discontinued manufacturing in the United States and moved operations to Mexico, where wage rates are a fraction of the wage rates in North Carolina. This relocation resulted in the displacement of over 800 American manufacturing workers who have almost no hope of finding a replacement job paying anywhere near what they formerly made in the manufacturing sector.

As we analyze these locations for labor force availability and skills, most employers have commented favorably on the commitment, skills and work ethic of the American worker.

Yet, given the competitive pricing advantage that offshore locations have in labor, materials, health care, real estate, and environmental compliance, many of our manufacturing companies cannot afford to continue employing these workers. In the last four years, the United States has lost close to 1 million manufacturing jobs resulting in the displacement of honest, hard-working American workers throughout this country, including many in the states that you represent.

I am sure that you are all well aware of the recent announcements of General Motors, Ford, Delphi, and many others in the domestic automotive industry who have chosen to close plants and lay off thousands of manufacturing workers in order to remain competitive. These workers went to work every day, paid their taxes did good work and did nothing to deserve this fate. Yet thousands will pay the price in the form of lost jobs, broken families and lost savings in the name of global competitiveness.

The Cuno case is concerned with the ability of state governments to compete with one another in order to attract and retain jobs and investment in the face of this increasing globalization of production. Relying on the commerce clause of the constitution, the plaintiff asserts that the provision of tax credits to a company willing to expand its Ohio operations and create thousands of new jobs, millions of dollars in additional taxes, and numerous small businesses supporting the expansion of this enterprise is illegal because it diverts tax revenues from other in-state taxpayers. Yet a thorough economic impact analysis will show that the provision of financial and tax incentives often results in the creation of far more direct and indirect tax benefits to a state and local government than the cost of the incentives. Most states and sophisticated local governments run cost-benefit analyses prior to making an offer of incentives to ensure that the benefits accruing to the indigenous taxpayers far outweigh the cost of incentives. In the cases where our firm has evaluated these benefits, the return-on-investment to local and state governments often exceeds 400 percent. In addition, state and local incentives are often limited in duration for 3, 5 or even ten years and are closely monitored to ensure corporate compliance with all terms and conditions. Benefits afforded a state or local government from business expansion continues to accrue long after these incentives have expired.

Some have postulated that incentives make no impact on the final decision of companies as to where they will place their corporate facilities. To be sure, incentives are most certainly not the end-all and be-all of the site selection decision. In fact, some very prominent CEO's have commented that state and local taxes, in general, do not have an impact of the final location decision.

Having been a consultant to hundreds of companies seeking new locations for corporate facilities, however, I can tell you unequivocally, that once the basic site selection criteria have been satisfied, incentives often do make a difference in the selection of the finalist location. And second place doesn't count in site selection.

In this country, state governments do not have a uniform application of tax policy and rates. In some states, there is no corporate income tax - in other states corporate income taxes are high. Some states have no sales taxes. Other states impose no ad valorem taxes on raw materials or finished goods inventory. I have been in states that provide free

training to all new hires. Other states provide no training services whatsoever. To insist that we have a level playing field among the states is an unrealistic expectation.

Some witnesses have calculated that state and local taxes comprise roughly 1 percent of business costs and therefore could not be sufficient enough incentive to influence the location decision one way or the other. Yet when one looks at the impact incentives have on Geographically Variable Operating Costs, i.e. the business costs that can vary from one location to another such as property taxes, real estate costs, labor costs, workers compensation costs, etc. – the impact of state and local incentives can often be equal to 10 to 20 percent of capital investment. A cost reduction of this nature is often enough to get the attention of the Chief Financial Officer and the Board of Directors who are often instrumental in the selection of the finalist site.

Incentives are but one tool that states currently use to help level that playing field and attract jobs and investment. If you look at what other countries, like China, India, and Ireland offer new companies by way of incentives, you will find that the incentive packages are often much more generous than any U.S. state. Yet these countries have much lower operating costs to begin with. Looking at the economic growth that these countries have achieved over the last decade it is difficult not to surmise that their policies to encourage new jobs and investment in their countries have been effective.

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

Competition makes us all better and more focused on achieving positive results. Federal legislation which would impede the ability of states to control their own economic destiny in the face of increasingly intense global competition would be short sighted and detrimental to the American worker, American investors, and American institutions. In the best tradition of state's rights, this is an area where the state political process should be used to weigh the pros and cons of any individual tax credit or incentives policy.

CRAIG THOMAS
WYOMING

United States Senate
WASHINGTON, DC 20510-5003

**Statement of Senator Craig Thomas, Chairman**
**Subcommittee on International Trade**

**Hearing on *Cuno* and Competitiveness: Where to Draw the Line**
**March 16, 2006**

Thank you for being here today. I appreciate you appearing before the Senate Finance International Trade Subcommittee to share your thoughts regarding the *Cuno* case and its impact on domestic and international competitiveness. I look forward to your comments.

The actions that gave rise to the issues to be discussed today began in 1998, when DaimlerChrysler entered into an agreement with Toledo, Ohio, and two school districts to construct a new vehicle assembly plant in exchange for approximately $280 million in tax incentives.

Under two separate provisions of Ohio law, DaimlerChrysler was to receive a 10-year 100 percent property tax exemption and an investment tax credit of 13.5 percent against the state corporate franchise tax for building the new facility in an economically-depressed area of Ohio.

A group of Ohio and Michigan taxpayers sued, alleging that these tax benefits discriminated against deciding to do business outside Ohio, in violation of the commerce clause of the U.S. Constitution and the equal protection clause of the Ohio Constitution. A federal court agreed on the issue of the investment tax credit, and the Supreme Court heard arguments on the constitutionality of the investment tax credit on March 1.

While I am hesitant to intervene in an issue that is still in the process of being litigated, I understand there is widespread interest in the issues presented. Additionally, there is a strong possibility that the issue of standing may prevent the court from reaching a substantive decision at this time, and the Supreme Court itself acknowledged that the issue of investment tax credits is one that may be best dealt with in the political arena.

The issues raised by the *Cuno* case are far-reaching – from encouraging healthy competition for investment between various domestic and international jurisdictions, to ensuring that states do not engage in activity that discriminates against interstate business. As a country that values its federalist system, we must take care to guard a state's ability to establish its own laws and exercise appropriate taxing jurisdiction, while at the same time ensuring that there is a clear line delineating where competition ends and discrimination begins.

**Statement of Senator George V. Voinovich**
**Subcommittee on International Trade**
**of the Senate Committee on Finance**
**"Cuno and Competitiveness: Where to Draw the Line"**
**March 16, 2006**

Chairman Thomas and Subcommittee members, good morning and thank you for this opportunity to testify before you at this important hearing to discuss the U.S. Court of Appeals for the Sixth Circuit's decision in *Cuno v. DaimlerChrysler* and its effect on competitiveness. I welcome this hearing, and believe it is an important step in enacting the Economic Development Act of 2005, which I introduced.

First, I want to make this clear: while I was governor, the investment tax credit at issue in *Cuno* was essential to Ohio's economic success. During my administration, the Ohio Legislature enacted the investment tax credit, as well as other incentives, to help attract new business and expand existing business in Ohio.

It worked. After the investment tax credit program was enacted, Ohio surged ahead of other states in new business development and existing business expansion. Since the investment tax credit was enacted, over 20,000 businesses have been able to claim a total of $2 billion in credits, leveraging $34 billion in new equipment investments across Ohio.

The Ohio investment tax credit had concrete effects on business decisions. For example, during a House Judiciary Subcommittee hearing on *Cuno*, Michele Kuhrt, currently Vice President Corporate Tax for Lincoln Electric, a 111-year old Cleveland-based manufacturing company, testified "without this tax credit, our investments in Ohio would certainly have been less. Since 1995 when the Ohio manufacturing credit began, Lincoln Electric's capital expenditures in Ohio have exceeded one-quarter of a billion dollars. In many of the investment analyses we prepare, taxes are a significant and, in some cases, a deciding factor on where to locate our capital."

Given that tax incentives are an important tool of economic development, and in the wake of the *Cuno* decision, I introduced the EDA. The bill has bi-partisan support, is co-

sponsored by all of the Senators in the Sixth Circuit, and is also supported by the National Governors Association, the National Association of Counties, the U.S. Conference of Mayors, the National League of Cities, the International Brotherhood of Teamsters, and the National Association of Manufacturers.

In *Cuno*, the Sixth Circuit held that Ohio's investment tax credit was discriminatory because it granted preferential tax treatment to in-state investments, and thus violated the so-called dormant Commerce Clause of the U.S. Constitution.

As you know, the Commerce Clause grants Congress the power to regulate interstate commerce. On the flip side, the dormant Commerce Clause restricts states from unduly burdening interstate commerce in the absence of Congressional action.

Applying the dormant Commerce Clause can be challenging. In *Cuno*, the federal trial court and the federal appellate court disagreed as to the appropriate application of the dormant Commerce Clause. The disagreement between these courts reflects the differences between two general, but conflicting legal principles the Supreme Court has developed regarding state taxes. The first principle is that a state may not impose a tax that discriminates against interstate commerce by providing a direct commercial advantage to local business. The second principle is that a state may use its tax system to encourage intrastate commerce and may compete with other states for interstate commerce so long as the state does not discriminatorily tax the products manufactured or the business operations performed in any other state. My understanding is that the Court has never completely reconciled these two principles.

On March 1, 2006, the Supreme Court heard oral arguments in *Cuno*, and a decision is expected later this year. If the Court chooses to uphold or reverse *Cuno*, its decision likely will be narrowly tailored, and there is no guarantee that the Court will reconcile these conflicting legal principles. If the Court dismisses the case for lack of standing by the plaintiffs, as many legal observers believe is the likely outcome, then states and

businesses will be left without clear guidance as to the validity of state tax incentive programs.

Whatever decision the Court reaches, Congress is in the position to clarify the legality of tax incentives used for economic development by exercising its Commerce Clause powers and enacting the EDA. If Congress enacts the EDA, it would end the legal ambiguity surrounding such incentives once and for all.

Without the EDA, other challenges to long-standing incentive programs in other states will occur. These are not speculative possibilities. There are lawsuits similar to the one brought in *Cuno* pending in a number of other states.

The uncertainty resulting from *Cuno* causes state and local governments and businesses to not be able to rely upon negotiated agreements with mutual benefits. This uncertainty will trigger large expenditures of public and private monies to determine what incentives or subsidies will pass legal muster. By enacting the EDA, Congress will prevent this confusion and waste of resources required by endless litigation, which is why the bill has gained such wide-spread support.

The EDA was drafted with input from the best tax and constitutional lawyers to ensure that the bill would be carefully crafted to protect the most common and benign forms of tax incentives, but not to authorize those tax incentives that truly discriminate against interstate commerce. Moreover, the EDA does not require that states offer tax incentives. The policy considerations and fiscal impact of tax incentives are complex questions that are driven by the facts and circumstances of each state. The EDA simply recognizes that the fifty states, not the Courts, are in the best position to evaluate these issues.

States are the laboratories of democracy and innovation. The economic development programs the states enact help create jobs and prosperity by allowing each state to tailor

packages to encourage new growth through tax incentives for job training, job creation, and investment in new plants and equipment.

As we all know, companies considering investment opportunities are comparing not just different states in the U.S., but also countries around the globe. As Ms. Kuhrt of Lincoln Electric stated, "Many other [international] locations offer exceptional tax incentives, low wages, and no litigation costs. For a company like Lincoln Electric, our preference is to create jobs inside the United States. However, the economic factors presented by many other jurisdictions can make an investment decision to locate outside the United States overwhelming."

As a former governor who had to compete against Japan, Canada, China, India and Europe for business expansion as well as new business projects, I know just how important a role tax incentives play in attracting new businesses, as well as in retaining existing businesses. As Ms. Kuhrt's statement demonstrates, and I can verify from my experience as governor, our international competitors are certainly not going to stop using tax and other incentives to attract business. We should not impede the states' ability to do the same.

To compete in the global economy, states need to be able to use tax incentive policies as one tool for economic development. By enacting the EDA, the winners will be working men and women, and their families, who will benefit from new business investment and existing business expansion.

Thank you for allowing me to testify today, and I look forward to working with you as we move forward.

**Senator George V. Voinovich**
**Appendix to Testimony Given to Senate Committee on Finance**
**Subcommittee on International Trade Regarding**
**"Cuno and Competitiveness: Where to Draw the Line"**

The following is an illustrative list of Supreme Court decisions that fall within the limiting provisions of Section 3 of the Economic Development Act of 2005:

1. *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388 (1984);
2. *New Energy Co. v. Limbach*, 486 U.S. 269 (1988);
3. *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994);
4. *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996);
5. *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564 (1997);
6. *South Central Bell Telephone Co. v. Alabama*, 526 U.S. 160 (1999).

# COMMUNICATIONS

---

## STATEMENT OF THE TAX FOUNDATION

March 28, 2006

Senator Craig Thomas, Chairman
Senator Jeff Bingaman, Ranking Member
Subcommittee on International Trade
Committee on Finance
219 Dirksen Senate Office Building
Washington, D.C. 20510-6200

**Re: Comments on DaimlerChrysler v. Cuno and the Appropriate Congressional Response**

Gentlemen:

We would like to submit comments in response to the March 16, 2006, hearing of the Subcommittee on International Trade concerning ***Cuno and Competitiveness: Where to Draw the Line***. While we have no official position on the propriety of S.1066, the Economic Development Act of 2005, we have filed two amicus briefs with the Supreme Court expressing our opposition to the Sixth Circuit's decision in *Cuno v. DaimlerChrysler*.

Our comments will focus on what we believe are the three most important issues in this debate:

- The *Cuno* ruling is flawed, and Congress will almost certainly need to enact corrective legislation even if the Supreme Court overrules the Sixth Circuit Court of Appeals.
- Businesses invest in a particular state for a variety of reasons; neither low taxes nor high spending on education or public infrastructure is the *sine qua non* of business decision-making.
- The high federal corporate income tax rate is damaging the ability of states and localities to compete for business investment in the international marketplace.

First, since we are the nation's oldest nonpartisan tax policy research organization, our chief concern is how the *Cuno* ruling will impact state tax reform. Many states (including Michigan, New York, South Carolina, and Utah) are currently in the process of redesigning their tax systems to encourage economic growth and investment. Lawmakers in these states understand the important role that taxes play in business decision-making, and the resulting tax competition enhances national economic growth and efficiency.

As we said in our amicus brief filed with the Supreme Court, the chief flaw in the Sixth Circuit's ruling is that it threatens tax competition. By ruling that Ohio's investment tax credit discriminated against interstate commerce because it "encouraged" DaimlerChrysler to invest in Ohio, the Sixth Circuit put a shot right across the bow of any state that is currently undertaking pro-growth tax reform.

Of course, not all forms of competition are equal from a policy perspective. The ideal tax system would compete by having a broad base (which minimizes distortion caused by granting preferential tax treatment to some businesses) and a low rate (which minimizes distortion caused by high tax rates, which lower the after-tax rate-of-return on investment).

As a policy matter, we would have advised Ohio to compete for DaimlerChrysler's investment by reducing its corporate franchise tax rate. A rate cut would have encouraged investment in Ohio just as much—if not more—than the investment tax credit. And yet, by the Sixth Circuit's reasoning, a tax rate cut would also be unconstitutional since it would have "encouraged" DaimlerChrysler to locate in Ohio.

Congressional legislation will be necessary no matter how the Supreme Court rules on *Cuno*. Even if the Court overrules the Sixth Circuit's ruling, it is likely to do so in a narrow fashion that will still leave Commerce Clause law in a state of confusion. Such a ruling will not give state and local lawmakers the certainty they need to enact tax legislation that seeks to make their state or locality more attractive for business investment. Thus, it is likely that Congress will need to act in a way that guarantees state and local lawmakers that the Constitution is no bar to non-discriminatory tax competition—no matter what form it takes.

Congress has taken such actions in the past. In 1959, the Supreme Court ruled in *Northwestern Cement Co. v. Minnesota*[1] that the Commerce Clause did not forbid the state of Minnesota from imposing its corporate income tax on a company whose only presence in Minnesota was a small sales force. Congress responded by passing the Interstate Commerce Act (Public Law 86-272).[2] The Interstate Commerce Act overruled the *Northwestern Cement* opinion and protected corporations from paying state corporate income taxes if their only in-state activities were the solicitation of sales.

Second, the Sixth Circuit—and a number of witnesses at the hearing—failed to see that a host of factors encourage companies to invest in a particular state, including general tax rates, apportionment laws, proximity to transportation networks, labor availability, etc. A recent report by KPMG found that the following factors were the most determinative in international business investment decision-making:

- Labor investment costs, including wages, salaries, and benefits
- Facility costs, including construction, purchase, and leasing costs
- Transportation costs
- Utility costs
- Taxes

The report found that taxes comprise between 3 and 10 percent of location-sensitive costs.[3]

---

[1] 358 U.S. 450 (1959).
[2] 15 U.S.C. § 381.
[3] *See Competitive Alternatives: KMPG's Guide to International Business Costs*, located at http://www.competitivealternatives.com/default.html.

Several of the witnesses at the hearing testified that state and local taxes are trivial to business decision-making. They also testified that education and transportation spending are far more important factors in the development of a state's business climate.

Clearly, there are many non-tax factors that affect a state's business climate: its proximity to raw materials or transportation centers, its regulatory or legal structures, the quality of its education system and the skill of its workforce, not to mention the intangible perception of a state's "quality of life." Some of these factors are, of course, outside of the control of elected officials. Montana lawmakers cannot change the fact that Montana's businesses have no immediate access to deepwater ports. Lawmakers do, however, have direct control over how friendly their tax system is to business.

Furthermore, while transportation and education are important for the state and local business climate, Congress should not refrain from legislating merely because tax competition would "drain" resources from education or transportation spending. The *Cuno* debate concerns the issue of whether, and to what extent, states may use their tax systems to compete for investment. This debate is not about education or transportation policy. The allocation of state and local resources between investments in the business tax climate, education, and transportation are best made by state and local lawmakers, not members of Congress or the Supreme Court.

Finally, but perhaps most importantly, Congress should realize that the federal corporate income tax system is putting state and local lawmakers at a significant disadvantage in the international competition for business investment. In a recent study, we reported that the U.S. now has the highest combined (federal and state) statutory corporate income tax rate in the Organization for Economic Cooperation and Development (OECD).[4] The five nations with the highest rates are:

- United States (39.3 percent)
- Japan (39.0 percent)
- Germany (38.9 percent)
- Canada (36.1 percent)
- Spain (35 percent)

This represents the average statutory corporate income tax rate that would be faced by new and/or inbound investment in the United States. It combines the federal top rate (35 percent) with the average state rate (4.3 percent). The average OECD rate is 29.2 percent. Most state and local officials are shocked to learn that a business making an investment in Kansas faces a higher statutory tax rate than a business making a similar investment in France or Sweden.

The higher the federal corporate income tax rate, the less leverage state and local officials have in designing their systems to attract business investment. Indeed, one would expect that with such a high federal rate (35 percent), state and local officials might be more tempted to use tax credits to exempt new investors from state taxes entirely, rather than rely on a fairer system that has a broad base and a low rate.

---

[4] *See* Scott Hodge and Chris Atkins, "The U.S. Corporate Income Tax System: Once a World Leader, Now a Millstone Around the Neck of American Business," *Tax Foundation Special Report* #136 (November 2005), located at http://www.taxfoundation.org/publications/show/1175.html.

Therefore, the congressional debate about *Cuno* and state tax competition should include a debate over the necessity of lowering the federal corporate income tax rate. Such a move would help state and local lawmakers as much—if not more—than protecting their ability to offer tax incentives.

Sincerely,

Chris Atkins
Staff Attorney
Tax Foundation
2001 L Street, NW
Tenth Floor
Washington, D.C. 20036