Testimony of Walter Hellerstein

on

Economic Development and the Dormant Commerce Clause:
Lessons of *Cuno v. DaimlerChrysler* and its Effect on
State Taxation Affecting Interstate Commerce

Before the

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and the

Subcommittee on Commercial and Administrative Law

Of the
Committee on the Judiciary
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I am Walter Hellerstein, the Francis Shackelford Professor of Taxation at the University of Georgia School of Law and Of Counsel to the law firm of Sutherland Asbill & Brennan LLP.[1] I have devoted most of my professional life to the study and practice of state taxation and, in particular, to the federal constitutional restraints on the exercise of state tax power. My work in this area is reflected in my current vita, which I have attached as Appendix A to this testimony.

I am honored by the Chairmen's and the ranking minority Members' invitation to testify today. I welcome the opportunity to share with the Subcommittees my views on the restraints that the dormant Commerce Clause imposes on state tax incentives to encourage in-state economic development and on the options available to Congress to modify those restraints. 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.

The first part of my testimony describes the dormant Commerce Clause doctrine limiting state tax incentives prior to the decision of the U.S. Court of Appeals for the Sixth Circuit in *Cuno v. DaimlerChrysler*. The next part of my testimony addresses the question of whether the *Cuno* decision should be regarded as a judicial aberration inconsistent with the preexisting judicial understanding of the dormant Commerce Clause described in Part I. The final part of my testimony considers the options available to Congress to modify dormant Commerce Clause doctrine affecting state tax incentives to encourage in-state economic development.

I. DORMANT COMMERCE CLAUSE DOCTRINE LIMITING STATE TAX INCENTIVES PRIOR TO *CUNO*

Prior to the decision of the U.S. Court of Appeals for the Sixth Circuit in *Cuno v. DaimlerChrysler, Inc.,* there was a substantial body of judicial doctrine emanating from both the U.S Supreme Court and from lower federal and state courts delineating the dormant Commerce Clause restraints on the states' power to grant tax incentives to encourage economic development within their borders.[2] In briefly summarizing this doctrine below, my purpose is simply to describe these judicial precedents, without defending or criticizing them, in order to provide the Subcommittees with an overview of the constitutional landscape that courts (like the *Cuno* court) encountered when adjudicating Commerce Clause challenges to state tax incentives.

[1] In the interest of full disclosure, it should be noted that Sutherland Asbill & Brennan LLP 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 state below, the following testimony represents my independent professional judgment and does not necessarily represent the views of any institution or organization with which I am affiliated.

[2] This doctrine is described in detail in Walter Hellerstein & Dan T. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 *Cornell L. Rev.* 789 (1996). The ensuing discussion draws freely from the cited article, which is attached as Appendix B to this testimony.

A. U.S. Supreme Court Precedents

Over the past three decades, the U.S. Supreme Court considered four taxing schemes involving measures explicitly designed to encourage economic activity within the state. In each case, the Court invalidated the measure. Moreover, the Court did so with rhetoric so sweeping that a literal reading of the Court's opinions cast a constitutional cloud over a broad array of tax incentives.

1. *Boston Stock Exchange*

In *Boston Stock Exchange v. State Tax Commission*,[3] the Court considered the constitutionality of an amendment to a New York stock transfer tax that created an incentive designed to assist New York stock exchanges. The tax applied to all *transfers* of stock regardless of where the *sale* occurred; because the lion's share of stock transfers was effectuated through New York transfer agents, the tax applied to most stock transfers, even when the sale was effectuated through a non-New York exchange. To encourage stock purchasers to use New York exchanges, the statute was amended to provide reduced rates for certain transfers of stock when the *sale* was made within New York, *i.e.*, on a New York exchange. 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"[4] 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"[5] because a seller's decision as to where to sell would no longer be made "*solely* on the basis of *nontax* criteria."[6] 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 deal with New York rather than out-of-state exchanges, the state had, in the Court's eyes, "*foreclose[d] tax-neutral decisions*."[7] 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."[8]

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[3] 429 U.S. 318, 329 (1977).

[4] *Id*. at 330.

[5] *Id*.

[6] *Id*. at 331 (emphasis supplied).

[7] *Id*. at 331 (emphasis supplied).

[8] *Id*. at 336.

Because tax incentives, by their nature, are designed to "foreclose tax-neutral decisions" by bringing "tax criteria" to bear on business decision making, courts could easily read *Boston Stock Exchange* to mean that a constitutional infirmity afflicts every state tax incentive. Perhaps for this reason, the Court felt moved to observe that its "decision . . . does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[9] The Court did not explain, however, how states could effectively pursue this objective under the constraints of its reasoning in *Boston Stock Exchange*.

2. *Bacchus*

In *Bacchus Imports, Ltd. v. Dias,*[10] the Court encountered an exemption from Hawaii's excise tax on wholesale liquor sales for certain locally produced alcoholic beverages. It was "undisputed that the purpose of the exemption was to aid Hawaii industry."[11] This benign purpose, however, could not sanctify a tax incentive that unmistakably defied the prohibition against taxes that favor in-state over out-of-state products. However legitimate the goal of stimulating local economic development, the Court explained, "the Commerce Clause stands as a limitation on the means by which a State can constitutionally seek to achieve that goal."[12] It was "irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the makers of locally produced beverages rather than to harm out-of-state producers."[13]

The Court in *Bacchus* recognized that "a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry"[14] and even declared "that competition among the States for a share of interstate commerce is a central element of our free-trade policy."[15] It was also true, however, that "the Commerce Clause limits the manner in which the States may legitimately compete for interstate trade."[16] Beyond reiterating the ban on discriminatory taxation and applying it to strike down the Hawaii tax, however, the Court offered no new counsel on how far the Commerce Clause prohibition extends.

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[9] *Id*. at 336.

[10] 468 U.S. 263 (1984).

[11] *Id*. at 271.

[12] *Id*.

[13] *Id*. at 273.

[14] *Id*. at 271.

[15] *Id*. at 272.

[16] *Id*.

3. *Westinghouse*

Westinghouse Electric Corp. v. Tully[17] arose out of New York's response to Congress's provision of tax incentives for American corporations to increase their exports. In 1971, Congress accorded preferred status to any entity that qualified as a "Domestic International Sales Corporation" or "DISC."[18] Under the federal tax laws, DISCs were not taxable on their income, and their shareholders were taxable on only a portion of such income. If New York had incorporated the federal DISC legislation into its corporate income tax, it would have suffered a substantial loss of revenue.[19] On the other hand, if New York had sought to tax DISC income in full, it risked discouraging the manufacture of export goods within the state.[20]

With these conflicting considerations in mind, New York enacted legislation that did two things: first, it provided that a DISC's income be combined with the income of its parent for state tax purposes; second, in an effort to "'provide a positive incentive for increased business activity in New York State,'"[21] it adopted a partial credit for the parent against the tax on the federally-exempt DISC income included in the New York tax base.[22] The credit was limited, however, by reference to the percent of DISC receipts from export shipments from New York.[23] As result, New York taxed the income attributable to export shipments from New York at 30 percent of the rate applicable to income attributable to export shipments from other states.

After examining the operation of New York's DISC credit scheme,[24] the Court in *Westinghouse* found that New York's effort to encourage export activity in the state suffered from constitutional infirmities similar to those that had disabled New York's earlier effort to encourage stock sales in the state. Like the reduction in tax liability offered to sellers of

[17] 466 U.S. 388 (1984).

[18] I.R.C. §§ 991-97. In 1984, Congress largely repealed the DISC legislation.

[19] *Westinghouse*, 466 U.S. at 392.

[20] *Id*. at 392-93.

[21] *Id*. at 393 (quoting New York State Division of the Budget, Report on A.12108-A and S. 10544 (May 23, 1972), reprinted in Bill Jacket of 1972 N.Y. Laws, ch. 778, p. 18).

[22] During the tax years at issue, a corporation's New York business allocation percentage, which is employed to determine the amount of a multistate taxpayer's income that is fairly attributable to New York, was determined by taking the average of the ratio of the taxpayer's property, payroll, and receipts in New York to its total property, payroll, and receipts wherever located. N.Y. Tax Law § 210.3 (McKinney 1986).

[23] *Westinghouse*, 466 U.S. at 394.

[24] The Court explicated the effect of the DISC credit scheme in detail employing, among other things, a series of hypothetical examples demonstrating that similarly situated corporations operating a wholly owned DISC in New York would face different tax assessments in New York depending on the location from which the DISC shipped its exports. *Westinghouse*, 466 U.S. at 400-02 n.9.

securities who effectuated their sales in New York, the reduction in tax liability offered to exporters who effectuated their shipments from New York "'creates . . . an advantage' for firms operating in New York by placing 'a discriminatory burden on commerce to its sister States.'"[25] It was "irrelevant"[26] to the constitutional analysis that the earlier tax incentives the Court had considered "involved transactional taxes rather than taxes on general income,"[27] because a State cannot "circumvent the prohibition of the Commerce Clause against placing burdensome taxes on out-of-state transactions by burdening those transactions with a tax that is levied in the aggregate rather than on individual transactions."[28] Nor did it matter "[w]hether the discriminatory tax diverts new business into the State or merely prevents current business from being diverted elsewhere";[29] it was "still a discriminatory tax that 'forecloses tax-neutral decisions.'"[30]

4. *New Energy*

The Court's most recent encounter with a state tax incentive involved an Ohio tax credit designed to encourage the production of ethanol (ethyl alcohol) in the state. Ethanol, which is typically made from corn, can be mixed with gasoline to produce the motor fuel called "gasohol." Ohio provided a credit against the state's motor fuel tax for each gallon of ethanol sold as a component of gasohol, but only if the ethanol was produced in Ohio or in a state that granted similar tax benefits to Ohio-produced ethanol.

In *New Energy Co. v. Limbach,*[31] the Court had little difficulty concluding that this tax incentive failed to satisfy the strictures of the Commerce Clause. It observed that the Ohio provision at issue "explicitly deprives certain products of generally available beneficial tax treatment because they are made in certain other States, and thus on its face appears to violate the cardinal requirement of nondiscrimination."[32] As for the claim that Ohio could have achieved the same objective by way of a cash subsidy, the Court responded that the Commerce Clause does not prohibit all state action favoring local over out-of-state interests, but only such action that arises out of the state's regulation of interstate commerce.[33] While

[25] *Id*. at 406 (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 331 (1977)).

[26] *Id*. at 404.

[27] *Id*.

[28] *Id*.

[29] *Id*. at 406.

[30] *Id*. (quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 331 (1977)).

[31] 486 U.S. 269 (1988).

[32] *Id*. at 274.

[33] *New Energy*, 486 U.S. at 278.

"direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does."[34]

B. Other Federal and State Court Precedents

Like the U.S. Supreme Court, lower federal courts and state courts have frequently invalidated state tax provisions that reasonably may be characterized as economic development incentives on the ground that such incentives discriminate against interstate commerce in violation of the dormant Commerce Clause.

- The United States Court of Appeals for the Fifth Circuit held that a property tax exemption for new manufacturing establishments, limited to taxpayers maintaining an 80 percent in-state work force and using 80 percent in-state materials, discriminates against interstate commerce.[35]

- The District of Columbia Court of Appeals held that a property tax exemption for personal property used by a telecommunications company to produce taxable gross receipts and a sales tax exemption for property purchased by a telecommunications company for use in producing services subject to gross receipts tax discriminate against interstate commerce.[36]

- The Florida Supreme Court held that a tax preference for alcoholic beverages made from citrus fruits and other agricultural products grown primarily, though not exclusively, within the state discriminates against interstate commerce.[37]

- The Florida Supreme Court held that a corporate income tax credit for fuel taxes limited to Florida-based air carriers discriminates against interstate commerce.[38]

- The Illinois Supreme Court held that a tax preference for gasohol made from products that were used by almost all in-state producers but not many out-of-state producers discriminates against interstate commerce.[39]

- The Maryland Court of Special Appeals held that an exemption from state corporate income tax for DISC dividends if at least 50 percent of the net taxable

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[34] *Id*.

[35] *Pelican Chapter, Associated Builders & Contractors, Inc. v. Edwards*, 128 F.3d 910 (5th Cir. 1997).

[36] *Sprint Communications Co. v. Kelly*, 642 A.2d 106 (DC 1994), *cert. denied*, 513 U.S. 916 (1994).

[37] *Division of Alcoholic Beverages & Tobacco v. McKesson Corp*., 524 So. 2d 1000 (Fla. 1988), *rev'd on other grounds*, 496 U.S. 18 (1990).

[38] *Delta Air Lines, Inc. v. Department of Revenue*, 455 So. 2d 317 (Fla. 1984).

[39] *Russell Stewart Oil Co. v. Department of Revenue*, 529 N.E.2d 484 (Ill. 1988).

income of the DISC is subject to taxation in the state discriminates against interstate commerce.[40]

- The Minnesota Supreme Court held that a tax reduction for gasohol produced in the state discriminates against interstate commerce.[41]

- The Minnesota Tax Court held that an exemption from sales tax with respect to receipts from leases of flight equipment if lessees made three or more flights into the state discriminates against interstate commerce.[42]

- The Missouri Supreme Court held that the requirement that an affiliated group of corporations derive at least 50 percent of its income from sources within the state in order to file a consolidated income tax return discriminates against interstate commerce.[43]

- The Nevada Supreme Court held that a sales and use tax exemption for aircraft leased to air carriers headquartered in Nevada, but not to air carriers headquartered outside the state, discriminates against interstate commerce.[44]

- The New Mexico Court of Appeals held that a gasoline excise tax deduction for ethanol-blended gasoline manufactured exclusively within the state discriminates against interstate commerce.[45]

- The New York Court of Appeals held that a deduction for access charges paid by long-distance telephone companies to local telephone companies, which is reduced only for interstate long-distance companies by their state apportionment percentage, discriminates against interstate commerce.[46]

- The New York Appellate Division held that an accelerated depreciation deduction limited to in-state property discriminates against interstate commerce.[47]

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[40] *Comptroller of the Treasury v. Armco*, Inc., 521 A.2d 785 (Md. Ct. Spec. App. 1987).

[41] *Archer Daniels Midland Co. v. State ex rel. Allen*, 315 N.W.2d 597 (Minn. 1982).

[42] *Northwest Aerospace Training Corp. v. Commissioner of Revenue*, 1995 WL 221639 (Minn. Tax Ct. 1995).

[43] *General Motors Corp. v. Director of Revenue*, 981 S.W.2d 561 (Mo. 1998).

[44] *Worldcorp v. Nevada Dep't of Tax'n*, 944 P.2d 824 (1997).

[45] *Giant Indus. of Ariz., Inc. v. Taxation & Revenue Dep't*, 796 P.2d 1138 (N.M. Ct. App. 1990).

[46] *American Tel. & Tel. Co. v. New York State Dep't of Tax'n & Fin.*, 637 N.E.2d 257 (N.Y. 1994).

[47] *R.J. Reynolds Tobacco Co. v. City of N.Y. Dep't of Fin.*, 667 N.Y.S.2d 4 (N.Y. App. Div. 1997), *appeal dismissed*, 694 N.E.2d 885 (N.Y. 1988).

- The Wisconsin Supreme Court held that an exemption from an occupation tax on iron ore dock operators for iron ore taxed under the occupation tax imposed on local mineral producers discriminates against interstate commerce.[48]

- The Wisconsin Tax Appeals Commission held that an accelerated depreciation deduction limited to in-state property discriminates against interstate commerce.[49]

II. WAS *CUNO* A JUDICIAL ABERRATION INCONSISTENT WITH PREEXISTING DORMANT COMMERCE CLAUSE DOCTRINE?

As these Subcommittees are well aware, in *Cuno v. DaimlerChrysler, Inc.*,[50] the U.S. Court of Appeals for the Sixth Circuit struck down Ohio's income tax credit for new in-state investment on the ground that it discriminated against interstate commerce but at the same time sustained the state's personal property tax exemption for new in-state investment. After reviewing the U.S. Supreme Court's decisions discussed above, the court agreed with the plaintiffs' argument that the income tax credit discriminated against interstate economic activity "by coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state."[51] Paraphrasing plaintiffs' argument, the court observed:

> [A]ny corporation currently doing business in Ohio, and therefore paying the state's corporate franchise tax in Ohio, can reduce its existing tax liability by locating significant new machinery and equipment within the state, but it will receive no such reduction in tax liability if it locates a comparable plant and equipment elsewhere. Moreover, as between two businesses, otherwise similarly situated and each subject to Ohio taxation, the business that chooses to expand its local presence will enjoy a reduced tax burden, based directly on its new in-state investment, while a competitor that invests out-of-state will face a comparatively higher tax burden because it will be ineligible for any credit against its Ohio tax.[52]

When it came to the personal property tax exemption for property first used in business in the state, the court took a different view of the incentive's constitutionality under the Commerce Clause. The plaintiffs contended that the property tax exemption discriminated against interstate commerce because of the conditions that Ohio placed on eligibility for the exemption – conditions that required beneficiaries of the exemption to

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[48] *Burlington N., Inc. v. City of Superior*, 388 N.W.2d 916 (Wis. 1986), *cert. denied*, 479 U.S. 1034 (1987).

[49] *Beatrice Cheese, Inc. v. Wisconsin Dep't of Revenue*, 1993 WL 57202 (Wis. Tax App. Com. 1993).

[50] 386 F.3d 738 (6^{th} Cir. 2004).

[51] *Id.* at 743.

[52] *Id.* at 746.

agree to maintain a specified level of employment and investment in the state. They argued that these conditions effectively subjected two similarly situated owners of Ohio personal property to differential tax rates: A taxpayer who agrees to focus his employment or investment in Ohio receives preferential treatment in the form of a tax break, while a taxpayer who prefers to preserve the freedom to hire or invest elsewhere does not.

The court, while recognizing that conditions imposed on property tax exemptions may independently violate the Commerce Clause, declared that "exemptions raise no constitutional issues when the conditions for obtaining the favorable tax treatment are related to the use or location of the property itself."[53] In other words, "an exemption may be discriminatory if it requires the beneficiary to engage in another form of business in order to receive the benefit or is limited to businesses with a specified economic presence."[54] However, if the conditions imposed on the exemption do not discriminate based on an independent form of commerce, they pass muster under the Commerce Clause. The court characterized the conditions imposed on the receipt of the Ohio property tax exemption as "minor collateral requirements . . . directly linked to the use of the exempted personal property."[55] The statute required only an investment in new or existing property within an enterprise zone and maintenance of employees. It did not impose specific monetary requirements, require the creation of new jobs, or encourage a beneficiary to engage in an additional form of commerce independent of the newly acquired property.

Finally, the court focused on the differences between tax credits and tax exemptions:

> Unlike an investment tax credit that reduces pre-existing income tax liability, the personal property exemption does not reduce any existing property tax liability. The exemption merely allows a taxpayer to avoid tax liability for new personal property put into first use in conjunction with a qualified new investment. Thus, a taxpayer's failure to locate new investments within Ohio simply means that the taxpayer is not subject to the state's property tax at all, and any discriminatory treatment between a company that invests in Ohio and one that invests out-of-state cannot be attributed the Ohio tax regime or its failure to reduce current property taxes.[56]

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[53] *Id.*

[54] *Id.* at 746.

[55] *Id.* at 747

[56] *Id.* at 747 (citing Walter Hellerstein & Dan T. Coenen, "Commerce Clause Restraints on State Business Development Incentives," 81 *Cornell Law Review* 789, 806-09 (1996)).

Returning to the question posed at the outset of this section of my testimony – was *Cuno* a judicial aberration inconsistent with preexisting dormant Commerce Clause doctrine – I believe that the short answer is "No." I could hardly say anything different, because the *Cuno* court explicitly relied on the analysis that Professor Coenen and I set forth in our *Cornell Law Review* article in reaching its conclusion. In that article, Professor Coenen and I attempted to describe the dormant Commerce Clause doctrine governing state business development incentives, and the best we could do was to suggest a line of reasoning, based on the Supreme Court precedents as we read them, that the *Cuno* court embraced.

Having said that, we would be the first to recognize – and, in fact, explicitly did recognize – that much of the Court's dormant Commerce Clause doctrine is difficult to discern and that ours was not the only reading that could be given to the Court's precedents. Thus, there is a case to be made – and Professor Peter Enrich has already made it – that a much broader universe of state tax incentives than the one we identified as constitutionally suspect is invalid under a proper reading of the Court's precedents.[57] Moreover, there is also a case to be made – and Justices Scalia and Thomas, as well as academics like Professor Zelinsky have already made it[58] – for abandoning any judicial inquiry into the validity of state legislation (or, at least allegedly discriminatory state tax legislation) under the Commerce Clause. Indeed, perhaps the one point on which virtually all observers of the Court's negative Commerce Clause doctrine would agree is that the law in this area is indeterminate. Less charitably put, it is a mess, albeit a mess that keeps many lawyers and law professors busy.

This leads naturally into the final section of my testimony, namely, whatever one's view of the defensibility of the *Cuno* decision under the "hand it was dealt" in the form of preexisting judicial precedent, what options are available to Congress in light of the obvious concerns created by the implications of that decision?

III. OPTIONS AVAILABLE TO CONGRESS IN LIGHT OF *CUNO* TO MODIFY DORMANT COMMERCE CLAUSE DOCTRINE AFFECTING STATE TAX INCENTIVES TO ENCOURAGE ECONOMIC DEVLOPMENT

As a preliminary matter, it is worth noting that in the final analysis it is up to Congress, not the courts, to determine what constitutes a burden on interstate commerce. Congress possesses unquestioned power under the Commerce Clause to regulate state taxation of interstate commerce. Congress may exercise its affirmative Commerce Clause power in one of two ways. First, Congress may restrict the taxing power the states otherwise

[57] Peter D. Enrich, "Saving the States From Themselves: Commerce Clause Restraints on State Tax Incentives for Business," 110 *Harv. L. Rev.* 377 (1996).

[58] *See, e.g., Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 200 (1995) (Scalia and Thomas, JJ., concurring); *Tyler Pipe Industries, Inc. v. Washington State Dep't of Revenue*, 483 U.S. 232, 259-65 (1987) (Scalia, J., concurring in part and dissenting in part); Edward A. Zelinsky, "Restoring Politics to the Commerce Clause: The Case for Abandoning the Dormant Commerce Clause Prohibition on Discriminatory Taxation," 29 *Ohio Northern Univ. L. Rev.* 29 (2002).

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' power in Prudential *Insurance Co. v. Benjamin*:[59]

> The power of Congress over commerce exercised entirely without reference to coordinated actions of the states 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.[60]

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. So, given this broad authority, what might Congress do?

A. Congress Could Do Nothing

Congress's first option is simply to do nothing. If Congress does nothing and leaves the validity or invalidity of state tax incentives designed to encourage economic development to the outcome of Commerce Clause litigation under existing judicial doctrine, it would probably have the following consequences.

First, it would almost certainly be years, and more likely decades, before courts resolved the question of the validity or invalidity of the wide variety of state tax incentives that are on the books in virtually every state and that are now subject to challenge under *Cuno* and the precedents it cites.

Second, if the U.S. Supreme Court were to deny review of *Cuno*, taxpayers would likely confront the particularly unhappy possibility of having one rule governing state tax incentives designed to encourage economic development in the Sixth Circuit, which would be controlling law in the States of Kentucky, Michigan, Ohio, and Tennessee, and another rule governing state tax incentives in other states, where courts may take a different view of the meaning of the Court's precedents.

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[59] 328 U. S. 408 (1946).

[60] *Id*. at 434.

Third, even if the U.S. Supreme Court were to grant certiorari in *Cuno*, it is unlikely that it would resolve all or even most of the potential challenges to state tax incentives. The Court decides cases on their particular facts, and it typically is careful to "leave for another day" even questions that are closely related to the particular case before it. 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.
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> 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.[61]

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 to 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.

B. Congress Could Legislate Narrowly to Reverse, Affirm, or Modify *Cuno*

A second option available to Congress is to legislate narrowly to overturn, reaffirm, or modify the result in *Cuno*. The *Cuno* decision is not the first state tax decision that has created concern in Congress, and Congress has from time to time legislated to reverse the result in a particular case in targeted terms. For example, eight months after the U.S. Supreme Court's decision in *Oklahoma Tax Commission v. Jefferson Lines, Inc.*,[62] which sustained over Commerce Clause objections an unapportioned tax on the sale of interstate bus services, Congress acted to bar state taxation of interstate passenger transportation.[63] Similarly, following the U.S. Supreme Court's decision in *Evansville-Vanderburgh Airport Authority District v. Delta Air Lines, Inc.*,[64] which sustained a municipal airport's $1 per

[61] *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).

[62] 514 U.S. 1995).

[63] Pub. L. No. 104-88, 109 Stat. 803, Dec. 29, 1995, codified at 49 U.S.C. § 14505.

[64] 405 U.S. 707 (1972).

passenger service fee for each passenger boarding a commercial aircraft, Congress enacted legislation preventing any "tax, fee, head charge, or other charge" on air travel.[65]

A narrow overruling, affirmation, or modification of *Cuno* would provide the immediate benefit of removing the uncertainty over the fate of the precise holding of *Cuno* itself. It would therefore provide some relief to taxpayers and taxing authorities, who now find themselves facing considerable uncertainty regarding *Cuno*-like provisions. However, such legislation would do nothing to address the broader concerns identified above. It would therefore leave the vast majority of state tax incentives designed to encourage economic development precisely where *Cuno* left them.

C. Congress Could Legislate Broadly to Provide Rules Regarding the Validity of State Tax Incentives Designed to Encourage Economic Development

A third option available to Congress is to provide a set of principles governing the validity of state tax incentives that goes beyond the narrow issue raised in *Cuno*. Such action has the potential to clarify the law in an area crying out for clarification and to remove the uncertainty that now confronts taxpayers, tax administrators, and state legislators in evaluating the legality of various state tax incentives. The legislation introduced into Congress by Senator Voinovich and Representative Tiberi[66] reflects the third option.

Without speaking to the merits of the particular proposal, I do believe that the proposal represents a template for the proper approach by 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.

Having said that, I do not wish to understate the extraordinary complexity of the task facing Congress. One should not lose sight of the fact that one person's "economic development incentive" is another person's "discriminatory tax." New York's "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. In the end, however, I believe that we are at the point where it is incumbent upon Congress to draw these lines in a careful, sensible, responsible, and understandable way. In doing so, Congress in my view should be extremely careful to retain the core features of the antidiscrimination principle, which has facilitated growth of a vibrant national common market over the past century and a half. At the same time, while moving cautiously, it seems to me that Congress should act. Otherwise it will be left to taxpayers, tax administrators, and the

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[65] 49 U.S.C. § 40116(b).

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

courts to speculate in every case as to whether a particular tax incentive amounts to a discriminatory effort to "foreclose[] tax-neutral decisions"[67] or reflects the states' appropriate "structuring their tax systems to encourage the growth and development of intrastate commerce and industry."[68]

[67] *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 331 (1977).

[68] *Id*. at 336.