THE DORMANT COMMERCE CLAUSE RISES AGAIN:

CUNO V. DAIMLER CHRYSLER

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I. INTRODUCTION

"Outsourcing to Bombay and Beijing gets the media attention, but job relocation among the 50 U.S. states is twice as common."[1]

In today's competitive global business environment, companies need to locate where they can maximize profits by keeping costs of production low. With the growing global economy, states are particularly interested in retaining jobs. Consequently, every state, "and virtually every city, country and metropolitan area with any ambition," has an economic development arm.[2] Incentives used to maintain and expand the employment base include direct expenditures and subsidies, as well as tax incentives for the company.[3] Tax incentives can include investment tax credits, job tax credits, research and development tax credits, small business growth companies tax credits, and alternative credits for large investments.[4]

The Constitution grants Congress the power to regulate interstate commerce,[5] and Supreme Court precedent has given the Commerce Clause not only a positive or pro-active interpretation in allowing Congress the right to regulate interstate commerce, but also a negative or dormant aspect. The Court has used this "dormant" aspect of the Commerce Clause to limit the states' ability to act in a manner which creates an undue burden on the free flow of commerce across state lines.[6] The Sixth Circuit Court of Appeals on October 19, 2004 used this negative aspect of the Commerce Clause to strike down Ohio's investment tax credit[7] in *Cuno v. Daimler Chrysler, Inc.*[8] In so doing, the ap-

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1. Editorial, *The Former Empire State,* WALL. ST. J., Jan. 5, 2005, at A11.

2. Daniel Gross, *The State-Tax Tug of War*, N.Y. TIMES, May 30, 2004, § 3, at 6. Economic development officials assume that companies will leave if taxes become too high, but businesses will be attracted by a low tax rate. *Id.* Dr. Arthur Laffer, for example, placed his Laffer Investments firm in Nashville because Tennessee doesn't have an income tax. *Id.*

3. David W. Rasmussen & Larry C. Ledebur, *The Role of State Economic Development Programs In National Industrial Policy,* 2 POLICY STUDIES REV. 750 (1983). The authors point out that state programs may just rob workers and their taxes from other states. *Id.* at 752. The authors point also out that "the programs at the state level must be oriented to serve the national interest as well as those of the state and local jurisdictions." *Id.*

4. Keith R. Ihlanfeldt & David L. Sjoquist, *Conducting an Analysis of Georgia's Economic Development Tax Inventive Program,* 15 ECON. DEVELP. QUART.217, 218 (2001). Georgia's economic development tax inventive program, for example, includes the above credits, and more. *Id.*

5. U.S. CONST. art. I, § 8, cl. 3.

6. *See infra* notes 10-97 and accompanying text.

7. *See infra* note 163 and accompanying text.

8. 386 F.3d 738 (6th Cir. 2004). *See infra* notes 141-180 and accompanying text.

peals court potentially puts Ohio and the other states in the Sixth Circuit – Michigan, Kentucky, and Tennessee – who may also have offending investment tax credits, at a competitive disadvantage.[9] This article will examine The Supreme Court's jurisprudence on the dormant aspect of the Commerce Clause, and will also examine *Cuno* and its ramifications. It will conclude with suggestions as to how states can attract and retain jobs without violating the boundaries imposed by the constitution.

II. A BRIEF BACKGROUND ON THE DORMANT COMMERCE CLAUSE

"The Congress shall have the power . . . [t]o regulate Commerce with foreign nations, and among the several states, and the Indian tribes."[10]

While on the surface, the Commerce Clause conveys only an affirmative authority on behalf of Congress to legislate with respect to interstate commerce, the clause has been held to contain a negative or dormant aspect as well.[11] Specifically, numerous Supreme Court decisions provide that the clause serves as a limitation on the ability of the several states to act in a manner which creates an undue impediment to the free flow of commerce across state lines.[12] In its most dramatic form the Commerce Clause prohibits a state from engaging in "economic protectionism" of business activity occurring within a state.[13] Thus, state actions which provide a benefit or remove a detriment from an in-state business or activity not equally available to an out-of-state business are prohibited. Several examples from recent Supreme Court cases are illustrative of this point and provide the necessary background for understanding the *Cuno* decision. The cases which follow are discussed in chronological sequence. The intent of the discussion of these cases is to be illustrative, not exhaustive.

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9. The United States Court of Appeals, 6th Circuit, reviews appeals from the federal district courts in Kentucky, Michigan, Ohio, and Tennessee, *available at* http://pacer.ca6.uscourts.gov/courtinfo/main.php.

10. U.S. CONST. art. I, § 8, cl. 3.

11. *See generally* Martin H. Redish & Shane V. Nugent, The Dormant Commerce Clause and the Constituional Balance of Federalism, 1987 Duke L.J. 567, 569-70.

12. Hughes v. Oklahoma, 441 U.S. 322, 326 (1979); H.P. Hood and Sons, Inc. v. DuMond, 336 U.S. 525, 531-33 (1949).

13. Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 270-273 (1984); *DuMond*, 336 U..S. at 532-33; Guy v. Baltimore, 100 U.S. 434, 443 (1879).

A. *Boston Stock Exchange v. State Tax Commission*[14]

The *Boston Stock Exchange* case in 1977 began a series of modern Supreme Court dormant commerce clause cases.[15] The case concerned the state of New York's 1968 amendment to its transfer tax statute to create a higher transfer tax on out-of-state security sales than those occurring in-state.[16] The methodology employed to do so was a 50% reduction in the tax for in-state sales up to a maximum liability of $350.[17] A unanimous Supreme Court held the amended statute to be unconstitutional as a violation of the Commerce Clause.[18]

The case had been brought by six regional exchanges outside New York who alleged that New York's scheme attempted to channel security sales into New York and away from out-of-state sales.[19] The states in which those exchanges were located did not tax transfers on sales.[20] Justice White, writing for the Court, determined that the revised tax structure impermissibly discriminated against out-of-state sales and could not be justified as compensatory to a burden on in-state sales nor to negate a previous economic advantage.[21] The Court rejected the state's argument that the amended structure removed a perceived disadvantage suffered by New York stock exchanges.[22] White and his brethren declared that, "[r]ather than 'compensating' New York for a supposed competitive disadvantage resulting from [the statute prior to amendment] the amendment forecloses tax-neutral decisions and creates both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister States."[23] A permissible avenue for assisting New York exchanges without running afoul of the Commerce Clause would have been to not tax sales, according to the Court.[24]

B. *Complete Auto Transit, Inc. v. Brady*[25]

Less than two months after *Boston Stock Exchange*, the Su-

14. Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977).
15. *Id.*
16. *Id.* at 319.
17. *Id.* at 324. The $350 limit applied to both resident and nonresident taxpayers. *Id.*
18. *Id.* at 336-37
19. *Id.* at 319-20.
20. *Boston Stock Exchange*, 429 U.S. at 323.
21. *Id.* at 332.
22. *Id.*
23. *Id.* at 331.
24. *Id.* at 330, n.11.
25. Complete Auto Transit, Inc. v. Brady, 430 U.S. 274 (1977).

preme Court upheld a Mississippi tax on the privilege of doing business within the state by a motor carrier delivering automobiles to Mississippi dealers.[26] Once again the Court was unanimous.[27] In upholding the tax, the Court delineated a four part test that was satisfied by Mississippi's statute.[28] The test required that the tax have a "substantial nexus" with the state, be fairly apportioned, not discriminate against interstate commerce, and be fairly related to the services the state renders in return.[29] The Court described the test as one of "practical effect", not focused on the formal language of the statute.[30] Complete Auto did not challenge the compliance of the Mississippi tax with the four prongs of the test.[31] Rather, they argued that any tax on an activity part of interstate commerce violated the Commerce Clause and its "free trade" immunity.[32] The Court rejected that view and overruled a line of cases holding that "privilege of doing business" taxes were per se unconstitutional.[33] Hence, state taxation of interstate commercial activity is permissible so long as the activity a) is adequately connected to the state and the services it provides; b) is non-discriminatory between in-state and out-of-state activity; and c) is fair.[34] It is an oft-quoted phrase that, "interstate commerce may be made to pay its way."[35]

C. *Westinghouse Electric Corp. v. Tully*[36]

In 1984, the Supreme Court arrived at yet another unanimous decision in *Westinghouse Electric*, in which it struck down a New York franchise tax credit that was based on the gross receipts of all goods shipped from New York businesses.[37] Westinghouse, a Pennsylvania corporation, had a wholly owned sub-

26. *Id. See generally*, R. Douglas Harmon, *Judicial Review Under Complete Auto Transit: When Is a State Tax on Energy-Producing Reserves "Fairly Related"?*, 1982 DUKE L.J. 682 (1982).

27. *Complete Auto Transit*, 430 U.S. at 274.

28. *Id.* at 279.

29. *Id.* at 279, 287.

30. *Id.* at 279.

31. *Id.* at 277-78.

32. *Id.* at 278 & 278 n.7 (summarizing the "free trade" theory).

33. *Complete Auto Transit*, 430 U.S. at 288–89.

34. *Id.* at 279.

35. *Id.* at 289 n.15.

36. 466 U.S. 388 (1984).

37. *Id. See generally* Walter Hellerstein, *Commerce Clause Restraints on State Taxation: Purposeful Economic Protectionism and Beyond*, 85 MICH. L. REV. 758 (1987); Donald Regan, *The Supreme Court and State Protectionism: Making Sense of the Dormant Commerce Clause*, 84 MICH. L. REV. 1091 (1986).

sidiary that operated as a Domestic International Sales Corporation (DISC).[38] New York law required the consolidation of the subsidiary's finances with the parent but, in essence, allowed a credit against tax for exports of goods from New York places of business.[39] The greater the amount of goods shipped from New York, the greater the credit.[40]

The Court did not take issue with New York's apportionment formula which rightly apportioned Westinghouse's total income within and outside New York.[41] However, the Justices pointed out that "fairly apportioned" and "nondiscriminatory" were not the same thing.[42] While the New York tax was fairly apportioned, the credit for New York based export sales was discriminatory.[43] Taxpayers otherwise alike in all particulars save the amount of exports shipped from New York would pay a different amount of tax.[44] The Court concluded that outcome not only impermissibly provided incentives for New York activity but also discouraged activity in other states.[45] Citing *Maryland v. Louisiana*[46] and *Boston Stock Exchange*,[47] the Court said New York's tax credit formula violated the dormant Commerce Clause by seeking to promote local business by inflicting greater burdens on out-of-state activity than in-state activity.[48] Furthermore, and of particular relevance to the *Cuno* case, the Court stated, "it [is not] relevant that New York discriminates against business carried on outside the state by disallowing a tax credit rather than imposing a higher tax.[49] The discriminatory effect of these two measures would be identical."[50]

Finally, New York's Tax Commissioner argued that any discriminatory burden on interstate commerce was relatively minor and that the legislative intent was not to channel business to New York but to act as a preventative against the loss of business outside the state.[51] The Court was unpersuaded. Regardless of the intended purpose, the tax was discriminatory and

38. *Westinghouse Elec.*, 466 U.S. at 388.
39. *Id.* at 393.
40. *Id.* at 393-94.
41. *Id.* at 398.
42. *Id.* at 399.
43. *Id.* at 399–400.
44. *Westinghouse Elec.*, 466 U.S. at 400.
45. *Id.* at 400 & n.9.
46. 451 U.S. 725 (1981).
47. 429 U.S. 318. *See also, supra* notes 14–24 and accompanying text.
48. *Westinghouse Elec.*, 466 U.S. at 404.
49. *Id.*
50. *Id.*
51. *Id.* at 405–06.

"foreclose[d] tax-neutral decisions."[52] The degree of discrimination was of no consequence.[53]

D. *Armco, Inc. v. Hardesty*[54]

In *Armco*, also in 1984, the Supreme Court faced a relatively straight-forward case of tax discrimination, although it did generate a dissent from then Justice Rehnquist.[55] The majority, however, held that West Virginia's gross receipts tax violated the Commerce Clause because of its discriminatory nature.[56]

West Virginia imposed a tax on wholesale gross receipts of persons engaged in the business of selling tangible personal property.[57] Significantly, however, local manufacturers were exempt from the tax.[58] Armco argued that the tax was discriminatory with regard to persons engaged in interstate commerce and the Court agreed.[59]

The State of West Virginia argued and the West Virginia Supreme Court agreed that the tax was not discriminatory because local manufacturers paid a higher "manufacturing tax."[60] The argument was that the exemption afforded local manufacturers was compensatory for the manufacturing tax.[61] An otherwise discriminatory tax may be salvaged from constitutional scuttling if it is to compensate for a burden intrastate activity tolerates that an out-of-state actor does not.[62] But the U.S. Supreme Court held that West Virginia's was not a compensating tax because manufacturing and wholesaling were not "substantially equivalent events," a requirement to be considered a com-

52. *Id.* at 406, quoting *Boston Stock Exchange*. *See supra* notes 14–24 and accompanying text.

53. *Id.* at 406–07.

54. 467 U.S. 638 (1984).

55. *Id.* at 646. In his dissent, Rehnquist argued that the tax did not discriminate against interstate commerce because the manufacturing tax rate was three and a half times higher than the wholesale tax, thus making it likely that Armco paid less state tax than a local manufacturer/wholesaler. *Id.* at 646-48. Further, according to Rehnquist, Armco had not shown they incurred a higher tax in West Virginia as a result of their interstate operation. *Id.*

56. *Id.* at 645-46; *See generally*, Philip M. Tatarowicz and Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause,* 39 VAND. L. REV. 879 (1986).

57. *Armco*, 467 U.S. 638.

58. *Id.*

59. *Id.* at 640-41.

60. *Id.* at 642.

61. *Id.*

62. *See id.* at 643.

pensating tax.[63] The Court further held that even together the taxes impermissibly discriminated because other states could implement a manufacturing tax and businesses in those states would pay both a manufacturing and wholesale tax.[64] West Virginians conversely, would only pay the manufacturing tax.[65] That, said the Court, was discriminatory to non-West Virginia businesses.[66]

E. *Bacchus Imports, Ltd. v. Dias*[67]

This 1984, five-to-three decision[68] implicated several provisions of the Constitution including the import-export clause,[69] the 21st Amendment,[70] as well as the Commerce Clause.[71] In fact, Justice Rehnquist was able to obtain the dissenting votes of Justices Stevens and O'Connor on the grounds that the 21st Amendment precluded the Commerce Clause claim.[72] The appellants were a group of liquor wholesalers that contended that Hawaii had impermissibly exempted certain locally made alcoholic beverages from its 20 percent excise tax on wholesale liquor.[73] The Hawaii Supreme Court had upheld the tax against Commerce Clause challenge on the basis that the ultimate burden of the tax fell on consumers, not the wholesalers.[74] The U.S. Supreme Court majority disagreed and held the exemption scheme to be unconstitutional.[75]

After a determination that the wholesalers had standing to sue despite their ability to pass on the tax to retailers, the Court had little trouble in finding that the local beverage exemptions had both the purpose and the effect of discriminating in favor of

63. *Armco*, 467 U.S. 638 at 643.

64. *Id.* at 644.

65. *Id.*

66. *See id* at 644-46. Rehnquist, in dissent, said this type of analysis was inappropriate where a state tax was "linked exactly to the activities taxed." Id. at 648.

67. Bacchus Imps., Ltd. v. Dias, 468 U.S. 263 (1984).

68. *Id.*

69. "No state shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports..." U.S. CONST. art. I, § 10, cl. 2.

70. "The transportation or importation into any State, Territory or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited." U.S. CONST. amend. XXI, § 2.

71. *Armco,* 467 U.S. 638.

72. *Bacchus Imps.*, 468 U.S. at 278-79. The second clause of the 21st Amendment expressly permits states to prohibit or restrict the exportation into a state of intoxicating liquor. U.S. CONST. amend. XXI, § 2. The dissent argued that this power superceded the normal confines of the commerce clause. *Bacchus Imps.*, 468 U.S. at 281-82. In their view, this clause permitted Hawaii to do exactly what it did. *Id.* at 282.

73. *Bacchus Imps.*, 468 U.S. at 265-66.

74. *Id.* at 267, 272.

75. *Id.* at 273.

local products and thus formed a design of economic protectionism.[76] This protectional intent had been acknowledged by the Hawaii Supreme Court in quoting from the statute's legislative history.[77] Similarly, the *effect* was discriminatory because these local products were exempt from the 20% tax and out-of-state liquor products were not.[78] While conceding a state's police power to promote local business, the Court reminded the State that this power was limited by the Commerce Clause admonition that a state may not, "discriminatorily tax the products manufactured or the business operations performed in any other state."[79]

The Court also rejected arguments by Hawaii that Supreme Court decisions had created a distinction in Commerce Clause cases between state efforts to promote successful existing businesses and struggling or start-up businesses[80] and that Hawaii's legislation was not aimed at harming out-of-state products but rather the promotion of local ones.[81] These secondary arguments were disposed of in quick order as having no basis in case law or logic.[82]

F. *New Energy Co. of Indiana v. Limbach*[83]

In 1988, the Supreme Court once again revisited the Constitutionality of a state tax credit. The State of Ohio provided a tax credit toward the Ohio motor vehicle sales tax for purchases of ethanol produced in Ohio. It also provided the credit for purchases of ethanol produced outside Ohio if the state in which it was produced gave its citizens a credit for Ohio-produced ethanol.[84] New Energy produced ethanol in Indiana, a state which did not provide a credit for Ohio ethanol.[85] New Energy brought suit for an injunction and a declaration that Ohio's credit scheme violated the Commerce Clause.[86] Ohio courts denied the requested relief.[87] A unanimous U. S. Supreme Court invalidated Ohio's tax credit.[88]

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76. *Id.* at 267, 270-71.
77. *Id.* at 270-72.
78. *Id.* at 271.
79. *Bacchus Imps.*, 468 U.S. at 272
80. *Id.*
81. *Id.*
82. *Id.* at 272-73.
83. 486 U.S. 269 (1988).
84. OHIO REV. CODE ANN. § 5735.145(B) (Anderson 1986).
85. *Limbach*, 468 U.S. at 272. .
86. *Id.* at 273.
87. *Id.*
88. *Id.* at 280. *See generally*, Barton B. Clark, *Give 'Em Enough Rope: States, Subdivisions and Market Participant Exception to the Dormant Commerce Clause*, 60 U. CHI.

The Court first rejected Ohio's contention that the arrangement actually promoted interstate commerce because Ohio gave the credit if another state provided a credit for Ohio ethanol.[89] Ohio argued that this type of reciprocity encouraged states to enact such credits and thereby promote interstate sales of ethanol.[90] The Court in 1988 rightly pointed out that for Commerce Clause purposes the disadvantage to out-of-state produced ethanol was not negated by the ability of a state or states to accept the reciprocity arrangement.[91] It still amounted to an unacceptable discrimination against interstate commerce.[92]

The other argument of the State germane to this article is that the credit was permissible under the market-participant exception.[93] Again, the Supreme Court correctly determined that Ohio was neither buying nor selling ethanol but was taxing it or providing tax credits.[94] That was a governmental activity, not a market activity.[95] Significantly, in the course of its opinion the Court stated, "[d]irect subsidization of domestic industry does not ordinarily run afoul of [the prohibition against favoring local business]; discriminatory taxation of out-of-state manufacturers does."[96]

G. *West Lynn Creamery v. Healy*[97]

By the mid-1990's the composition of the Supreme Court had changed considerably since the mid-1980's and the decisions in *Westinghouse Electric*,[98] *Armco*,[99] and *Bacchus Imports*.[100] Now Chief Justice Rehnquist had been joined by Justices Kennedy, Scalia, and Thomas in a worldview generally more favorable to

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L. REV. 615, 620-21 (1993).

89. *Limbach,* 486 U.S. at 274-75.

90. *Id.* at 274.

91. *Id.* at 275-76.

92. *Id.*

93. The market-participant doctrine deems it permissible for a state to favor local business when it is acting as a member of the marketplace as distinguished from a primeval governmental capacity. *See* South-Cent. Timber Dev. v. Wunnicke, 467 U.S. 82, 94 (1984); White v. Mass. Council of Constr. Employers, 460 U.S. 204, 206-07, 214-15 (1983); Reeves, Inc. v. Stake, 447 U.S. 429, 435-37 (1980); Hughes v. Alexandria Scrap Corp., 426 U.S. 794, 809-11 (1976). *See generally*, Michael J. Polelle, *A Critique of the Market Participant Exception,* 15 WHITTIER L. REV. 647, 655-57 (1994).

94. *Limbach*, 486 U.S. at 277.

95. *Id.*

96. *Id.* at 278.

97. 512 U.S. 186 (1994).

98. *See supra* notes 36-53 and accompanying text.

99. *See supra* notes 54-66 and accompanying text.

100. *See supra* notes 67-82 and accompanying text.

state's powers and rights.[101] Nevertheless, in *West Lynn Creamery*, Rehnquist was only able to bring Justice Blackmun along in his attempt to uphold a Massachusetts subsidy for local dairy farmers who sold to local retailers.[102] Justices Scalia and Thomas concurred in the result.[103]

Massachusetts imposed an assessment on all milk sold to Massachusetts retailers whether from in-state or out-of-state dealers.[104] The state, in turn, returned the assessment to Massachusetts dairy farmers proportionate to each farmer's contribution to the monthly milk total.[105] Most of the milk sold by petitioners came from out-of-state.[106] When they refused to pay the assessment, the State revoked their licenses.[107]

The Court's majority in 1994 invalidated the arrangement.[108] First, the Court held that even though the assessment was made against both in-state and out-of-state dealers, the effect was discriminatory because the subsidy to Massachusetts dairy farmers allowed them to sell their milk to the dealers at a lower price than out-of-state farmers.[109] Second, the Court disagreed with Massachusetts' argument that because the tax component was non-discriminatory and the subsidy arrangement was a constitutional exercise of state spending power, the arrangement as a whole was valid.[110] Even assuming arguendo that the state's reasoning was correct, the Court rejected it because the subsidy was primarily funded by taxes on milk from outside Massachusetts.[111] The taxes impermissibly burdened interstate commerce.[112] Further, the Court refused to consider the tax and subsidy wholly independent of their integrated effect.[113] The Supreme Court also refused to succumb to what it regarded as a formalistic reading of the two components and not consider their discriminatory purpose and effect.[114]

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101. *Healy*, 512 U.S. at 186.
102. *Id.* at 212.
103. *Id.* at 207.
104. *Id.* at 188.
105. *Id.* at 190-91.
106. *Healy*, 512 U.S. at 199.
107. *Id.* at 191.
108. *Id.* at 194.
109. *Id.* at 194-95.
110. *Id.* at 198-99.
111. *Id.* at 199.
112. *Id.*
113. *Healy,* 512 U.S. at 201.
114. *Id.*

In the course of its discussion, the Court made two observations relevant to the *Cuno* case. At one point the Court noted, "A pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business."[115] Then, in a footnote, the Court also observed, "We have never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that 'direct subsidization of domestic industry does not ordinarily run afoul' of the negative Commerce Clause."[116] This language may provide a potential mechanism for assisting local economic activity without violating the strictures of the dormant Commerce Clause.

H. *Camps Newfound/Owatonna v. Town of Harrison*[117]

In 1997, the Court addressed the dormant Commerce Clause once again. The State of Maine provided an exemption from real estate and personal property taxes for charitable institutions incorporated in Maine but provided a very limited exemption if the principal beneficiaries of the institution were non-Maine residents.[118] Petitioner in this case was a Maine-incorporated church camp that primarily served non-Maine campers.[119] Maine's Supreme Judicial Court upheld the statute but the Supreme Court of the United States, in a five-to-four decision, struck it down as a violation of the Commerce Clause.[120]

There was no question in the majority's mind that the statute would be unconstitutional if visited upon for-profit activities.[121] It would be the quintessential discriminatory treatment of out-of-state entities.[122] Likewise, prior Court decisions held the dormant Commerce Clause applied to non-profits because there was no principled distinction, for Commerce Clause purposes, between profits and non-profits, i.e. they both buy and sell goods and services and appeal to a variety of customers both in-state and out-of-state.[123] Particularly interesting was the Court's unwillingness to accept the Town's arguments that the exemption was akin to a legitimate subsidy of an entity serving local inter-

115. *Id.* at 199.

116. *Id.* at 199 n.15. Other arguments advanced by Massachusetts were disposed of by the Court with a minimum of discussion. *See id.* at 202-05.

117. 520 U.S. 564 (1997).

118. *Id.* at 568. *See generally*, Michael Ryan, *A Requiem for Religiously Based Property Tax Exemptions,* 89 GEO. L.J. 2139 (2001).

119. *Camps Newfound/Owatonna*, 520 U.S. at 567.

120. *Id.* at 566, 570-72.

121. *Id.* at 575.

122. *Id.*

123. *Id.* at 584-86.

ests or that it amounted to the Town's "purchase" of charitable services and was thus covered by the so called "market participant" exception allowed in dormant Commerce Clause cases.[124] Noting that in *West Lynn Creamery* the Court expressly declined to decide the constitutionality of subsidies, the majority asserted that an exemption was not a subsidy based on prior case law.[125]

The market participant exception provides that when a state itself acts as a buyer or seller of goods or services it may do so in a way that favors in-state business.[126] Such involvement does not implicate Commerce Clause prohibitions.[127] In the *Maine* case, as was true of the tax credit in *Limbach*,[128] the state's attempt to re-characterize a tax exemption was unsuccessful.[129] Imposing taxes and offering exemptions are exclusively governmental functions.[130] They are not activities of a direct market participant required for the market participation exception. In the words of the Court, "A tax exemption is not the sort of direct state involvement in the market that falls within the market-participation doctrine."[131] The Court also feared that allowing the exception to apply in this circumstance would eviscerate the Commerce Clause prohibition against discriminatory state tax schemes.[132] Any exemption or credit provided by a state could then arguably be permitted as a market purchase of goods or services.

I. *Hillside Dairy Inc. v. Lyons*[133]

Hillside Dairy, decided by the Court in 2003, held that California's milk-pricing and milk-pooling program was not exempt from Commerce Clause scrutiny.[134] The Federal Agricultural Improvement and Reform Act of 1996[135] did unambiguously intend to limit Commerce Clause challenges to California's com-

124. *Id.* at 588-89.

125. *Camps Newfound/Owatonna*, 520 U.S at 589.

126. *Id.* at 592-93.

127. *Id.* at 592.

128. New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 277 (1988); *see supra* notes 83-96 and accompanying text.

129. *Camps Newfound/Owatonna*, 520 U.S. at 588-89.

130. *See id.* at 593 (quoting *New Energy Co.*, 486 U.S. at 277).

131. *Id.*

132. *Id.* at 593-94.

133. 539 U.S. 59 (2003).

134. *Id.* at 66.

135. Federal Agricultural Improvement and Reform Act of 1996, Pub. L. No. 104-127, 110 Stat. 888 (codified as amended in scattered provisions of 7 U.S.C.).

positional and labeling laws on milk, but did not clearly intend to protect milk pricing and pooling laws from a Commerce Clause challenge.[136] An interesting aspect of this case is Justice Thomas's dissent, which stated that "[t]he negative Commerce Clause has no basis in the text of the Constitution, makes little sense, and has proved virtually unworkable in application."[137] But notwithstanding Justice Thomas' opinion, the Court has upheld the application of the negative aspect of the Commerce Clause to state enactments which create an undue impediment to the free flow of commerce across state lines.[138] Except for occasional dissents,[139] there is a long line of Supreme Court precedent setting the stage for *Cuno v. Daimler Chrysler*.[140]

III. CUNO V. DAIMLER CHYRSLER[141]

"[W]hile we may be sympathetic to efforts by the City of Toledo to attract industry into its economically depressed areas, we conclude that Ohio's investment tax credit cannot be upheld under the Commerce Clause of the United States Constitution."[142]

In 1998, Daimler Chrysler agreed to build a new vehicle-assembly plant in Toledo, Ohio, near its existing Jeep plant.[143] To attract this new facility to Toledo, the city of Toledo granted an estimated $280 million in tax incentives on a $1.2 billion project, which was supposed to have provided several thousand new jobs.[144] These incentives included a ten-year, 100% exemption from personal property taxes.[145] Further, under Ohio's invest-

136. *Hillside Dairy*, 539 U.S. at 66; *see* 7 U.S.C. § 7254 (2000).

137. *Hillside Dairy*, 539 U.S. at 68 (Thomas, J., dissenting) (quoting *Camps Newfound/Owatonna*, 520 U.S. at 610 (Thomas, J., dissenting)).

138. *See supra* notes 11-137 and accompanying text.

139. *See supra* notes 102 and 137 and accompanying text.

140. Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977); Complete Auto Transit v. Brady, 430 U.S. 274 (1977); Westinghouse Elec. Corp. v. Tully, 466 U.S. 388 (1984); Armco, Inc. v. Hardesty, 467 U.S. 638 (1984); Bacchus Imps., Ltd. v. Dias, 468 U.S. 263 (1984); New Energy Co. v. Limbach, 486 U.S. 269 (1988); West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994); Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564 (1997); Hillside Dairy, Inc. v. Lyons, 539 U.S. 59 (2003); *see supra* notes 11-137 and accompanying text.

141. 386 F.3d 738 (6th Cir. 2004).

142. *Id.* at 746.

143. *Id.* at 741.

144. *Id.*

145. *Id.* at 741. The property tax exemption is authorized by sections 5709.62 and 5709.631 of the Ohio Code. OHIO REV. CODE ANN. §§ 5709.62, 5709.631 (Anderson 2003). It allows municipalities to offer incentives for establishment, expansion, or renovation in economically depressed areas with the hiring of new employees or the retention of existing employees. *See id.* § 5709.62(C)(1). Municipalities may offer a personal property tax exemption for up to 75% of the assessed value, which can go up to 100% with the consent of the affected school districts. *See id.* § 5709.62(D)(1).

ment tax credit, Daimler Chrysler was granted a credit against its state corporate franchise tax for certain qualifying investments.[146] Ohio's investment tax credit may be granted to a taxpayer that purchases new manufacturing machinery and equipment if it is installed in Ohio.[147] The maximum rate is 13.5% if the investment is used in economically depressed areas.[148]

Eighteen plaintiffs challenged the incentives granted to Daimler Chrysler under Ohio law.[149] The plaintiffs contended that both incentives were unconstitutional under the Commerce Clause[150] and the Equal Protection Clause of the Ohio Constitution.[151] Further, even if the property tax exemption was constitutional, the plaintiffs contended that Daimler Chrysler was not entitled to it.[152] The defendants, which included the City of Toledo and its mayor at that time, two school districts, and certain state officials, requested, and were granted, a motion to dismiss.[153]

While the plaintiffs contended that both the credit and the exemption compelled a conclusion of corporate favoritism, the district court disagreed.[154] Under the State Constitution, the purpose of both the credit and the exemption was to encourage industrial investment and development in Ohio, especially in economically depressed areas, thus creating a legitimate state interest with a rational nexus to the credit and the exemption.[155] The district court applied the Supreme Court's four-prong test of *Complete Auto Transit* to determine whether Ohio law violated the Commerce Clause.[156] The court concluded that the laws had sufficient nexus with Ohio, did not discriminate against interstate commerce, were fairly apportioned, and were related to services provided by the State of Ohio.[157]

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146. *Cuno*, 386 F.3d at 741.

147. *Id.* (quoting OHIO REV. CODE ANN. § 5733.33(B)(1)).

148. *Id.* (citing OHIO REV. CODE ANN. § 5733.33(C)(2)). Unused credits may be carried forward for three years. *Id.* (citing OHIO REV. CODE ANN. § 5733.33(D)).

149. Cuno v. DaimlerChrysler, Inc., 154 F .Supp. 2d 1196, 1198 (N.D. Ohio 2001).

150. *Id.*

151. *Id*; OHIO CONST. art I, § 2 ("All political power is inherent in the people. Government is instituted for their equal protection and benefit, and they have the right to alter, reform, or abolish the same, whenever they may deem it necessary; and no special privileges or immunities shall ever be granted, that may not be altered, revoked, or repealed by the General Assembly.").

152. *Cuno*, 154 F. Supp. 2d at 1198.

153. *Id.* at 1198 & n.1.

154. *Id.* at 1201-02.

155. *Id.* at 1201.

156. *Id.* at 1202 (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)); *see supra* note 28-30 and accompanying text.

157. *Cuno*, 154 F. Supp. 2d at 1202.

The district court further held that the Ohio incentives were of neither of the two types of tax structures deemed unconstitutional under the Commerce Clause by the Supreme Court.[158] First, neither the investment tax credit nor the property tax exemption was a protective tariff or customs duty which taxed goods imported from other states but which did not tax similar products produced in the state.[159] Second, because neither the credit nor the exemption varied with increased activity outside the State of Ohio, the state laws did not violate the terms of *Westinghouse Electric*.[160] Thus, the district court concluded that the exemption and the credit did not discriminate against interstate commerce in either prohibited way and the motion to dismiss was granted.[161]

On appeal, the Court of Appeals for the Sixth Circuit reversed the district court on the Constitutionality of the investment tax credits, but upheld the district court's ruling on the property tax exemption.[162] The court first addressed the limitation on states' ability to tax interstate commerce under the Commerce Clause,[163] citing the four-part test given by the Supreme Court in *Complete Auto Transit*.[164] The appeals court recognized that "[t]he United States Supreme Court has never precisely delineated the scope of the doctrine that bars discriminatory taxes."[165] It does not matter, though, whether one "focuses on the benefited or burdened party" delineated in *Bacchus Imports*[166] or whether a statute "discriminates against business carried on outside the State by disallowing a tax credit rather than by imposing a higher tax" under *Westinghouse Electric*.[167] The "challenged credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face, or if, on the basis of . . . [its] 'purposes and effects,' . . . [it] 'discriminate[s] against interstate commerce.'"[168] If there is a state tax provision which dis-

158. *Id.* at 1203.

159. *Id.*

160. *Id.*; *see supra* notes 36-53 and accompanying text.

161. *Cuno*, 154 F. Supp. 2d at 1203-04.

162. *See Cuno*, 386 F.3d at 746, 748, 750. On appeal, plaintiffs argued that both the credit and the exemption violate the Commerce Clause of the U.S. Constitution and the Equal Protection Clause of the Ohio Constitution. *Id.* at 742.

163. U.S. CONST. art. I, § 8, cl. 3.

164. *Cuno*, 386 F.3d at 742 (citing Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 279 (1977)); *see supra* notes 25-35 and accompanying text.

165. *Cuno*, 386 F.3d at 743.

166. *Id.* (quoting Bacchus Imps., Ltd. v. Dias, 468 U.S. 263, 273 (1984)); *see supra* notes 67-82 and accompanying text.

167. *Cuno*, 386 F.3d at 743 (quoting Westinghouse Elec. Corp. v. Tully, 466 U.S. 388, 404 (1984)); *see supra* notes 36-53 and accompanying text.

168. *Cuno*, 386 F.3d at 743 (quoting West Lynn Creamery, Inc. v. Healy, 512 U.S.

criminates against interstate commerce, it must advance "a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives" according to *Limbach*.[169]

The Court of Appeals first examined the investment tax credit, which was equally available to in-state and out-of-state businesses.[170] While the defendants argued that the Supreme Court jurisprudence should be read narrowly, holding tax incentives "permissible as long as they do not penalize out-of-state economic activity,"[171] the court stated, "it is clear that the court itself has not adopted this approach in analyzing dormant Commerce Clause cases."[172] The defendants also argued that the investment tax credit was like a direct subsidy which would normally pass scrutiny under the Commerce Clause because direct subsidies are not "connect[ed] with the State's regulation of interstate commerce" through the state's power to tax.[173] The appellate court disagreed, holding that the challenged Ohio investment tax credit[174] failed Commerce Clause scrutiny.[175]

The personal property tax exemption at issue, on the other hand, was constitutionally permissible because the conditions imposed upon the recipient were directly linked to the use of the exempted personal property and provided only minor collateral requirements on the recipient.[176] A property tax exemption would violate the Commerce Clause "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."[177] However, if they "do not discriminate based on an independent form of commerce, they are permissible," as in this case.[178] Thus,

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186, 201 (1994)); *see supra* notes 97-116 and accompanying text.

169. *Cuno*, 386 F.3d at 743 (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988)); *see supra* notes 83-96 and accompanying text.

170. *Cuno*, 386 F.3d at 743.

171. *Id.* at 745. In support of their position, defendants cited *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*. *Id.* (citing Tatarowicz & Mims-Velarde, *supra* note 56, at 929).

172 *Id.*

173. *See id.* at 746 (quoting *New Energy Co.*, 486 U.S. at 278); *see generally* Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 806-11 (1996) (discussing state use of tax incentives to regulate interstate commerce and their categorization as coercive or noncoercive).

174. *See supra* notes 146-48 and accompanying text.

175. *Cuno*, 386 F.3d at 746. The challenged credit withstood scrutiny under the Ohio Constitution because it was rationally related to a legitimate state interest. *Id.* at 749.

176. *Id.* at 747.

177. *Id.* at 746.

178. *Id.* at 747. Similarly, under rational basis review, the exemptions do not violate the Ohio Constitution Equal Protection Clause. *Id.* at 749.

the appeals court struck down the Ohio investment tax credit but upheld the Ohio property tax exemption.[179]

IV. CONCLUSION

The Sixth Circuit Court of Appeals sent a strong message to Ohio that its investment tax credit, although it may have a laudable purpose, does not pass Commerce Clause scrutiny.[180] The *Cuno* decision, at the time of this writing, is the law in Ohio, Kentucky, Tennessee and Michigan.[181] Some forty other states have similar investment tax credits.[182] So while the playing field is leveled in the Sixth Circuit, these states currently are at a competitive disadvantage in recruiting and keeping businesses vis-à-vis other distressed areas. These authors believe that for fairness and equity the playing field needs to be leveled nationally.

In the meantime, states affected by this decision, if they choose, may continue to use property tax exemptions so long as those exemptions are directly linked to the use of the exempted property and provide only minor collateral requirements on the recipient.[183] Additionally, states may be able to use subsidies rather than tax credits to lure and keep businesses,[184] particularly in distressed areas, as the Supreme Court has expressly re-

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179. *Id.* at 746, 748, 750.

180. *Id.* at 746; *see supra* note 155 and accompanying text.

181. *See* United States Court of Appeals for the Sixth Circuit, Court Description, *at* http://pacer.ca6.uscourts.gov/courtinfo/main.php (last visited Mar. 21, 2005) (noting the Sixth Circuit reviews appeals from federal district courts in Kentucky, Michigan, Ohio, and Tennessee).

182. Gary Young, *Court Rejects Ohio's Use of Tax Credit: Dozens of States That Lure Businesses With Tax Credits Could Be Affected*, NAT'L L.J., Sept. 13, 2004, at 4.

183. *Cuno*, 386 F.3d at 747; *see supra* text accompanying note 176.

184. *See Cuno*, 386 F.3d at 746 (quoting New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988)); *see supra* text accompanying note 172.

served judgment on their constitutionality.[185] However, as noted in *West Lynn Creamery*, such a subsidy would have to be funded by general state revenues, not a special tax, in order to pass constitutional muster.[186] In conclusion, while *Cuno* seems to fall in line with prior Supreme Court jurisprudence, it has, at this time, given the affected states a competitive disadvantage in the very competitive global business environment.

185. *See Cuno*, 386 F.3d at 746 (citing West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199 n.15 (1994)); *see supra* text accompanying note 116.

186. West Lynn Creamery, Inc. v. Healy, 512 U.S. 186, 199 (1994).