Nos. 04-1704 and 04-1724

IN THE

Supreme Court of the United States

DAIMLERCHRYSLER CORPORATION, ET AL.,
Petitioners,
v.
CHARLOTTE CUNO, ET AL.,
Respondents.

WILLIAM W. WILKINS, TAX COMM'R, OH, ET AL.,
Petitioners,
v.
CHARLOTTE CUNO, ET AL.,
Respondents.

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

BRIEF OF *AMICUS CURIAE* TAX FOUNDATION IN SUPPORT OF PETITIONERS

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November 2005

WILSON-EPES PRINTING CO., INC. – (202) 789-0096 – WASHINGTON, D.C. 20001

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INTEREST OF THE *AMICUS CURIAE*

The Tax Foundation submits this brief as *amicus curiae* in support of petitioners in the above-captioned matter.[1]

The Tax Foundation is a non-profit research organization formed in 1937 to educate taxpayers about sound tax policy. In this regard, the Tax Foundation disseminates information on taxes and promotes tax systems that are simple, fair, and favor economic growth. The Tax Foundation works to further this mission by educating the legal community on economic issues relating to tax law, educating lawmakers and the public on tax law issues in an understandable and relevant manner, and advocating that judicial decisions on tax law promote economic growth and tax competition.

SUMMARY OF ARGUMENT

As a threshold matter, it is critical to examine whether any respondent has standing to bring this suit. Each respondent lacks Article III standing, as any alleged injury is general, speculative, and attenuated. Further, a favorable decision would be unlikely to provide relief. Respondents in this case seek to change what they consider bad tax policy, not to address individual injuries. Such a grievance should be addressed to the legislature.

On the merits, respondents seek to transform this Court's past discussion of "tax neutrality" into a mandate for tax conformity. Disregarding this Court's clear recognition of the importance of permitting States to design tax systems that

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[1] No counsel for a party authored this brief in whole or in part, and no person or entity, other than *amicus curiae*, has made a monetary contribution to the preparation or submission of this brief. Written consents of petitioners and respondents have been obtained and filed with the Clerk of the Court.

foster a competitive business climate, respondents would have the Commerce Clause interpreted to preclude any tax measure that might affect capital investment decision-making.

Clarification is needed as to which types of competitive tax advantages States may enact consistent with the Commerce Clause. Further, this Court should take this opportunity to explain its statements about tax neutrality in previous decisions, which respondents have misinterpreted in pressing this lawsuit, and which have left lower courts, commentators, and economists struggling to articulate its import for the scope of the dormant Commerce Clause. A clarification that the Commerce Clause requires competitive neutrality, not tax or economic neutrality, would lift uncertainty surrounding programs that encourage investment. The Commerce Clause prohibits tariff-like coercion and punishment of out-of-state activity, not every law that affects economic decision-making.

ARGUMENT

I. RESPONDENTS LACK STANDING TO CHALLENGE OHIO'S TAX CREDIT PROVISION.

The respondents, plaintiffs below, are merely concerned citizens. They believe that tax credits like Ohio's are bad tax policy. As a matter of tax policy, Amicus agrees with the respondents. None of the respondents, however, were directly injured by this credit and none would directly benefit from any judicial ruling in this matter. Their grievances are with the State's policy decisions and should be directed to the legislatures, not to the courts.

Minimum standing requirements are imposed by the Constitution and additional standing requirements have been adopted for prudential reasons to prevent the politically disappointed from bringing legislative questions into a judicial forum. The law of "standing is built on a single basic idea—the idea of separation of powers." *Allen v. Wright*, 468 U.S. 737, 752 (1984). Respondents lack standing under both standards.

A. Respondents lack Article III standing.

According to their own complaint, the respondents are individual residents of Ohio, one not-for-profit Ohio corporation, two for-profit Ohio corporations, and individual residents of Michigan. Compl. ¶¶2–6. At least seventeen of the nineteen respondents were therefore not subject to Ohio's franchise tax at all. None of the respondents actually allege that they are subject to Ohio's franchise tax, or have been required to pay a tax or incur any other particular liability as a result of the challenged tax credit. *Cf.*, *e.g.*, *General Motors Corporation v. Tracy,* 519 U.S. 278, 286–87 (1997) (stating that taxpayer had standing to challenge a tax that it, itself, had paid).

The respondents do not claim that the challenged credit directly discriminated against them. None claim, for example, to be Ohio businesses that chose to invest outside the State instead of inside the State. *See Allen v. Wright,* 468 U.S. 737, 755 (1984) (ruling that only those who are personally discriminated against have standing to challenge the discrimination). None claim that Ohio required them to pay a tax imposed only on, or more heavily on, non-residents. *Cf.*, *e.g.*, *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 267 (1984) (holding that taxpayer had standing to challenge a tax that discriminated against imported products that directly affected its business). None even claim to be competitors with anyone who benefits from the credit. *See*, *e.g.*, *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 321, n.3

(1977) (holding that out-of-state stock exchanges had standing to challenge discriminatory tax scheme that diverted transactions to in-state exchange).

Accordingly, none of the respondents are the "object of the action (or forgone action) at issue." *See Lujan v. Defenders of Wildlife*, 504 U.S. 555, 561–62 (1992).

1. Ohio respondents' interests as citizens and taxpayers do not give them standing.

None of the Ohio respondents meet the "irreducible constitutional minimum" of Article III standing: concrete and particularized "injury in fact," caused by the conduct complained of, and likely to be redressed by a favorable decision. *Lujan,* 504 U.S. at 560.

The Ohio respondents' allegations that, as a result of the credit, the tax revenues of their State have been diminished, and that the credit "shifts to the Ohio [respondents] a disproportionate burden of supporting these government functions," are insufficient. Compl. ¶¶22, 40, 42. While tax credits do generally narrow the tax base, the injuries alleged by respondents are neither concrete nor particularized. A citizen's and taxpayer's "interest in the moneys of the Treasury . . . is shared with millions of others, is comparatively minute and indeterminable; and the effect upon future taxation, of any payments out of the funds, so remote, fluctuating and uncertain, that no basis is afforded for [judicial intervention]." *ASARCO Inc. v. Kadish,* 490 U.S. 605, 613 (1989) (quotations omitted). Standing is not established by a state taxpayer's showing that "he suffers in some indefinite way in common with people generally." *Doremus v. Board of Education,* 342 U.S. 429, 434 (1952) (quotations omitted).

Moreover, the causal connection between the tax credit offered to businesses that make large investments in Ohio and either lower tax revenues for Ohio or higher tax impositions on the Ohio respondents is, at best, tenuous. Respondents are only speculating that Ohio's tax revenues will decline as a result of this credit. The credit may, in fact, have the opposite effect. For example, DaimlerChrysler's investment in Ohio may well increase the State's revenues. DaimlerChrysler is likely buying supplies and contracting with service providers in Ohio. It is employing individual taxpayers in Ohio. The state tax revenues attributable to these vendors and employees, and to DaimlerChrysler itself, might actually increase as a result of the credit.

The Ohio respondents offer nothing to demonstrate that the credit will diminish overall state tax revenues. Even if respondents had a cognizable interest in reduced state revenues, which they do not, their claim that this has or will occur is entirely speculative. In addition, the alleged causal link is too attenuated. Whether Ohio's revenues increase as a result of the credit hinges on "unfettered choices made by independent actors" — investment, purchasing, and employment decisions made by various persons. *ASARCO*, 490 U.S. at 615. None are responsible for enacting the tax credit or capable of rescinding it.

Finally, the requirement that a favorable decision is likely to redress respondents' alleged injuries is not met. A favorable decision might just as likely exacerbate the alleged injuries as redress them. For example, if this Court were to uphold the Sixth Circuit and determine that the tax credit is unconstitutionally discriminatory in violation of the Commerce Clause, Ohio could fully redress such a constitutional violation by extending the credits to additional businesses. *See McKesson Corp. v. Division of Alcoholic*

Beverages, 496 U.S. 18, 50 (1990). By respondents' reasoning, that would further reduce the State's tax revenues.

Thus, the Ohio respondents have no cognizable interest in the injury they allege and there is no basis to conclude that the injury does or will even exist. Even if it did exist, the connection to the challenged provision is highly attenuated. And there is no basis to conclude that a favorable decision is likely to redress such injuries if they do exist. Each conclusion independently precludes respondents from maintaining this suit.

2. Michigan respondents do not have standing.

The Michigan respondents' allegations that, as a result of the credit, the tax revenues of their State have been diminished, that this shifts a disproportionate tax burden to them, and that they have been deprived of employment opportunities, is similarly insufficient. Compl. ¶ 42. The tax revenue allegations, like the parallel allegations of the Ohio respondents, is not cognizable because it is remote, indeterminable, and lacks certainty. *ASARCO*, 490 U.S. at 613. In addition, the causal connection between any of their alleged injuries and the tax credit, and the likelihood of a favorable decision redressing such injuries, is even more speculative with respect to the Michigan respondents than the Ohio respondents.

Michigan respondents' allegations that they have standing are based on two conclusions. First, DaimlerChrysler would not have chosen to locate its plant in Ohio, absent the tax credit. Second, if DaimlerChrysler had ruled out Ohio, it would necessarily have built the plant in Michigan instead. Both are entirely speculative. With respect to the first, there is no basis to conclude that DaimlerChrysler did not base its location decision on a variety of considerations in addition to the tax credit. Taxes are important to a state's business climate, but so is the quality of the work force and transportation systems. Even respondents' counsel concluded in his academic writings that tax credits alone rarely cause companies to make location decisions. *See* Peter D. Enrich, *Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 390–93 (1996).

With respect to the second, there is no basis to conclude that Michigan was the only, or even the most plausible, alternative if DaimlerChrysler had not chosen to build the plant in Ohio. Respondents provide nothing to substantiate their guesswork. And because the alleged injury hinges entirely on the "unfettered choices made by independent actors" − DaimlerChrysler − it is too attenuated to satisfy Article III's causality requirement.

The same "unadorned speculation" defeats any claim that a decision finding the tax credit invalid would redress Michigan respondents' alleged injuries. *See Simon v. Eastern Kentucky Welfare Rights Organization,* 426 U.S. 26, 45 (1976). There is no basis to conclude that, if the tax credit were found invalid, Ohio would rectify the identified Commerce Clause violation by rescinding the credit, or that if it did, DaimlerChrysler would tear down its Ohio plant and build a new plant in Michigan. No other businesses are identified or alleged to be in the process of or likely to make an investment decision between Ohio and Michigan in the foreseeable future.

The connection between the Ohio tax credit and their alleged lost "economic opportunities in the form of jobs" is even weaker. Compl. ¶ 42. Even if it were possible to accept all the conjecturing necessary to conclude that, but for the tax credit, DaimlerChrysler would have built its plant in Michigan, there would still be no basis to conclude that such an action would have provided jobs to the Michigan respondents. They do not identify what jobs would be created, whether they have the requisite skills to perform those jobs, whether the competition for employment in Michigan is such that they would have a reasonable assurance of obtaining employment, whether the new jobs would be preferable to any jobs they may currently hold, why they believe any such jobs would be located near their homes, or whether they would be prepared to move if they were not. Michigan is a large State. Moreover, the fact that they did not move to Ohio to obtain the same employment opportunity they claim to have been denied would undermine any allegations that they would move from one side of Michigan to the other for such a job and would be hired if they did move.

The likelihood that these alleged lost "economic opportunities" would be redressed by a favorable decision is even more speculative, as discussed above. If the tax credit were invalidated, the State could remedy any discrimination by extending the credit to those identified as discriminated against. *That* would certainly not provide the Michigan respondents with the "economic opportunities" they claim to seek. Even if the tax credit were rescinded, there is no basis to conclude that DaimlerChrysler would tear down its Ohio plant and build a new plant in Michigan, or that if it did, the Michigan respondents would apply, qualify, and be hired at that plant.

3. Respondents' eminent domain displacement does not give them standing.

The harm alleged by some respondents—that they were displaced by City of Toledo's exercise of eminent domain—is also insufficient. *See* Compl. ¶¶ 2, 23, 41. Displacement by the exercise of eminent domain can certainly impose distinct and particularized injuries. However, the displacement alleged here is not causally linked to the challenged *tax credit*. Moreover, the injuries alleged by respondents do not appear to still be in need of redress.

The claims of the one displaced corporate respondent have already been addressed through extensive litigation directed at the exercise of eminent domain itself, which resulted in payment of compensation, determined to be adequate by a court. *See*, *e.g.*, *City of Toledo v. Kim's Auto & Truck Service, Inc.*, 2003 WL 22390102 at *2 (Ohio App. 6th Dist. 2003) *appeal not allowed*, 804 N.E.2d 42 (Ohio 2004), *stay denied*, 811 N.E.2d 1148 (Ohio 2004), *cert. denied*, 72 U.S.L.W. 3750, 73 U.S.L.W. 3754, 73 U.S.L.W. 3755 (U.S. Jun. 28, 2005) (No. 03-1629). The individual respondents who claim to have been displaced do not allege that they were insufficiently compensated for the injury of relinquishing their property.

Even if there were still some uncompensated injury, its connection to the tax credit is entirely speculative. There is no basis to assume that, absent the credit, the city would not have exercised eminent domain. First, there is no basis to assume that DaimlerChrysler would not have chosen to build its plant on that land absent the credit. *See* Enrich, 110 HARV. L. REV. at 390-93; Op. Cert., *DaimlerChrysler Corp. v. Cuno*, No. 04-1704 and 04-1724, at 7 (stating that the actual influence of state tax incentives on business location decisions is, "at most, marginal"). Second, the characteristics of the property and the neighborhood that persuaded the city to make the property available to DaimlerChrysler might very well have persuaded the city to make the property available for a different use if DaimlerChrysler had decided not to build its plant there.

Finally, any injury attributable to the city's decision to exercise eminent domain would not be redressed by invalidating the credit. If the tax credit were found invalid under the Commerce Clause, the State can remedy the invalidity without rescinding the credit. Even if the State chose to cure by rescinding the credit, that would affect the taxes owned by DaimlerChrysler, not the ownership of the land or whether the former owners' homes and business would be rebuilt after demolishing the plant. No decision by this Court or the courts below, with respect to the tax credit, could remedy the harms these respondents have suffered through displacement. Those harms can only be remedied by challenging the exercise of eminent domain itself or negotiating for adequate compensation, which these respondents have apparently already done.

In sum, none of respondents satisfy Article III's standing requirements.

B. Respondents also do not satisfy this Court's "prudential" standing requirements.

Jurisdiction is also, independently, unavailable for prudential reasons. Their suit presents "'abstract questions of wide public significance' which … [are] most appropriately addressed in the representative branches." *Valley Forge Christian College v. Americans United for Separation of Church and State, Inc.*, 454 U.S. 464, 474–75 (1982) (internal citation omitted).

The respondents present generalized grievances appropriately addressed in the legislature. They think tax credits make bad public policy. Op. Cert. at 6. They further argue that credits, such as Ohio's, are ineffective at actually bringing jobs to a State. *Id.* at 7. Their goal is not to redress individual injury, but to fix what they perceive to be bad public policy. They are aware that tax policy and economic development are subjects with which legislatures grapple. Their counsel has written in academic journals that these credits are highly politicized and a subject of robust debate in the state legislatures. *See* Enrich, 110 HARV. L. REV. at 393–97.

It is because the proponents of credits keep winning this political debate, *id.*, that respondents and their counsel have decided that courts would be a more effective forum for them to advance their policy agenda. *See* Enrich, 110 HARV. L. REV. at 405–22. Respondents are trying to use the courts to remedy what they believe to be the self-destructive behavior of the Ohio legislature. This lawsuit is, as their counsel describes, an effort to "save Ohio from Ohio." *See* Enrich, 110 HARV. L. REV. at 377 ("Saving the states from themselves.").

In addition, whether respondents are viewed jurisprudentially as attempting to assert the rights of third parties or being outside the zone of interests protected by the dormant Commerce Clause doctrine, respondents are not appropriate parties to raise these claims. Because respondents do not allege that the tax credit discriminates against them by imposing a discriminatory tax on them or placing them at a competitive disadvantage, they are not even "arguably within the zone of interests to be protected … by the … constitutional guarantee in question." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 321 n.3 (1977) (quotation omitted). The right to complain that a state law is discriminatory in violation of the Commerce Clause belongs to those against whom the law discriminates. *Id*.

It is well-settled that respondents may not assert the rights of others who arguably were discriminated against, if the tax credit in fact violates the Commerce Clause. *See Kowalski v. Tesmer*, 543 U.S. __, 125 S.Ct. 564, 567 (2004). Third party standing is available only to those who have a particularly close relationship to the parties whose rights were allegedly violated and only if those parties are hindered in their ability to protect their own interests. *Id.* Respondents do not identify anyone who was or is discriminated against by the tax credit, much less allege the required close personal relationship with that person. Likewise, respondents do not allege that such parties are hindered in their ability to protect their own interests. *Id.* Such an allegation would be particularly dubious here because any party that could be discriminated against by the challenged franchise tax, in violation of the Commerce Clause, would necessarily be a business. Hundreds, perhaps thousands, of cases attest that businesses are not hindered in their ability to protect their economic interests from an unlawful tax. *See*, *e.g.*, *Fulton Corp. v. Faulkner*, 516 U.S. 325 (1996) (Commerce Clause challenge to state tax by business); *Oregon Waste Systems, Inc. v. Dep't of Environmental Quality of Oregon*, 511 U.S. 93 (1994) (same).

Thus, even if respondents could meet Article III's requirements, which they cannot, they nonetheless lack standing under this Court's established prudential standing doctrines. The respondents mean well, from a policy perspective, but allowing them to bring their claims would threaten to make the federal courts a forum for generalized tax policy grievances.

II. THE COMMERCE CLAUSE REQUIRES, AT MOST, COMPETITIVE NEUTRALITY, NOT ECONOMIC TAX NEUTRALITY.

The decision below suggests that state tax systems must be neutral with respect to business investment decisions. Thus, the Sixth Circuit explained its ruling that the Ohio tax credit is unconstitutional on the ground that "the economic effect of the Ohio investment tax credit is to encourage further investment in-state at the expense of development in other states and … the result is to hinder free trade among the states." *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738, 745

(6th Cir. 2004).[2] Requiring state tax economic neutrality, however, imposes state tax conformity. This Court has never ruled that the Commerce Clause requires this type of neutrality.

With the increase in labor and capital mobility in recent years, companies like DaimlerChrysler can now be more selective about where they will locate investment. This makes companies like DaimlerChrysler more sensitive than ever to state tax systems. This sensitivity to tax policy provides the opportunity for meaningful and beneficial tax competition among the States for jobs and investment. *See* J. William Harden and William H. Hoyt, *Do States Choose Their Mix of Taxes to Minimize Employment Losses?*, 56 NAT. TAX J. 7, 8 (2003) (reporting scholarly consensus that state taxes impact employment levels). The Sixth Circuit's decision is leading to considerable confusion in the States as to what is permissible. This case presents an opportunity for the Court to articulate precisely what limits the Commerce Clause places on the States' ability to structure their tax systems "to encourage the growth and development of intrastate commerce and industry." *Boston Stock Exch.*, 429 U.S. at 336.

A. This Court's "tax neutrality" formulation is misunderstood.

In their complaint, respondents challenged Ohio's franchise tax credit on the ground that it discriminated against interstate commerce by inducing DaimlerChrysler to locate a new automobile manufacturing plant in Ohio rather than another State. *See* Compl. ¶¶21, 39. In complaining of

[2] The Sixth Circuit panel did not explicitly adopt respondent's "economic effect" reasoning, but it did rule for respondents after recounting the arguments of both sides in the case.

the effect of Ohio's tax incentive, respondents seized on statements by this Court that suggest that "tax neutrality" is required under the Commerce Clause.

It is true that this Court has, on occasion, used expansive "tax neutrality" language in articulating Commerce Clause limitations. For example, *Boston Stock Exchange* struck down a New York stock transfer tax that levied higher tax rates on stock transfers that utilized out-of-state, as opposed to in-state, brokers on the ground that the challenged tax exemption "foreclose[d] tax-neutral decisions." 429 U.S. at 331. Elsewhere, this Court has also indicated that a state tax scheme is unconstitutional if it "forecloses tax-neutral decisions." *Westinghouse Electric Corporation v. Tully*, 466 U.S. 388, 406 (1984).

Even recently, this Court has spoken in terms of tax neutrality. In *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194 (1994), the Court stated that a tax is unconstitutional if it "neutraliz[es] the advantage possessed by lower cost out-of-state producers . . . ." In *American Trucking Associations, Inc. v. Michigan Public Service Comm'n*, 545 U.S. ___, 125 S.Ct. 2419, 2423 (2005), the Court commented that "[n]othing in our case law suggests that such a neutral, locally focused fee or tax is inconsistent with the dormant Commerce Clause."

These references to "tax neutrality" have caused lower courts to struggle with articulating applicable Commerce Clause standards. Some courts have suggested a standard under which any tax difference that affects behavior, in any way, is *per se* unconstitutional. *See*, *e.g.*, *PPG Industries, Inc. v. Commonwealth Board of Finance and Revenue*, 790 A.2d 252, 259–60 (Pa. 1999) (holding an exemption unconstitutional that "affords preferential treatment to corporations that engage in manufacturing activities in the Commonwealth"). Yet despite the sweeping ramifications suggested by the *PPG Industries* court's use of "tax neutrality" rhetoric, the case seems to have been decided on a narrow basis—PPG Industries' tax liability would have actually increased if it had made an investment outside Pennsylvania, just as the liability of the taxpayer in *Westinghouse* would have increased if it had exported goods from a state other than New York.

Other courts have more explicitly limited the sweeping "tax neutrality" rhetoric. *See*, *e.g.*, *Smith v. New Hampshire Department of Revenue Administration* , 692 A.2d 486, 497 (N.H. 1997) ("[S]tate statutes may not constitutionally encourage the development of local industry by means of taxing measures that impose greater burdens on economic activities taking place outside the State than would be placed on similar activities within the State."); *R.J. Reynolds Tobacco Co. v. City of New York Department of Finance*, 169 Misc.2d 674, 686 (N.Y.S. 1995) ("Whenever a municipality attempts to foster in-state economic growth by burdening out-of-state interests, these measures constitute economic protectionism. Economic protectionism, which is flatly prohibited by the Commerce Clause, cannot be used to justify these otherwise invalid ordinances.") (internal citations omitted); *Aurora Corp. of Illinois v. Tully*, 457 N.E.2d 735, 739 (N.Y. 1983) ("[W]here, as here, a statute creates an advantage for New York businesses while imposing a burden on foreign corporations, tax-neutral decisions as to where to incorporate or do business are foreclosed and the resulting discriminatory burden on interstate commerce requires that the statute be declared invalid."). *See also Polychrome International Corp. v. Krigger*, 5 F.3d 1522, 1542 (3rd Cir. 1993) ("Under this reasoning [from *Boston Stock Exchange*], states can impose taxes on interstate commerce to create equality between in-state and out-of-state transactions—to make the choice between in-state and out-of-state commerce tax neutral. When a tax equalizes burdens on interstate and intrastate commerce, the tax is … constitutionally valid ….")

In the decision below, the Sixth Circuit did not explicitly limit or define the "tax neutrality" rhetoric. *Cuno*, 386 F.3d at 744. Thus, if left undisturbed, other courts may take the "tax neutrality" standard literally. Yet if "tax neutrality" were the rule—particularly as understood by economists—then any state tax system whose economic impact is to encourage investment in-state will run afoul of the Commerce Clause. Indeed, if taken literally, this would strike at the very heart of state tax sovereignty and require state tax conformity. Accordingly, "tax neutrality" cannot be the rule.

B. What economists mean by tax neutrality.

Economists define a neutral tax system as one that will extract needed tax revenues in a manner that does the least possible damage to economic growth and in a way that does not distort investment decisions. "A major goal of tax reform is to make our tax system more 'neutral' so that it exerts less influence on our economic choices. The economy almost always benefits when people make decisions based on the economic merits of the alternatives rather than on their tax consequences." *See* Joel Slemrod & Jon Bakija, TAXING OURSELVES: A CITIZEN'S GUIDE TO THE DEBATE OVER TAXES 131 (3d ed. 2004).

Tax neutrality is a lofty and worthy tax policy goal. Unfortunately, it is a goal that is virtually unattainable, though other goals of neutrality can still be maintained:

> The only tax system that is perfectly 'neutral' … is a lump-sum tax because in this case *no* decision you make has any impact on your tax bill, so taxes cause no disincentive effects at all. The kind of neutrality

> that tax reformers strive for is less ambitious but still important—making sure that tax rates do not differ across various types of consumption and investment.

Id. Evaluating state tax systems for neutrality is tricky. For instance, there are at least two ways to consider tax neutrality in the income tax system of hypothetical state 'A.' The first, and most agreed upon approach, is to evaluate the neutrality of state A's income tax system in isolation (or, intrastate neutrality). If A's income tax system were neutral in isolation, it would tax all income at one rate and would provide no special credits or deductions beyond, perhaps, ordinary and necessary business expenses. This system is neutral because tax rates would not "differ across various types of consumption and investment." *Id.* Investor 'Z' would not be encouraged by state A's tax code to invest in manufacturing instead of retailing, for instance, because return on investment from retailing and manufacturing would be taxed at the same rate.

Intrastate neutrality is disturbed when a state creates tax incentives for certain behaviors. For instance, if state A adopted an investment tax credit like Ohio's, Investor Z would now be tempted to invest in capital intensive industries since those activities would generate a tax credit. Investors will artificially engage in more capital investment solely because of the tax benefits and not the underlying economic conditions. Tax credits for day care, deductions for charitable giving, and punitive taxes on tobacco are other examples of tax laws that upset intrastate neutrality because they distort behavior.

The second (and more controversial) way to consider the neutrality of state A's income tax system is to compare it to the system in other States (or, interstate neutrality). State A can have a perfectly neutral intrastate tax system that is nonetheless decidedly distortionary in an interstate context.

Even though state A is neutral to investor Z's decision to invest in retailing or manufacturing in state A, Z might be able to get a higher after-tax rate of return by investing in state B, which has lower taxes (either as a result of tax credits, lower tax rates, or favorable apportionment laws). If Z invests in state A or state B solely because of differences in either state's tax system, economists would call that distortion. *See* Daniel Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 MICH. L. REV. 895, 900 (1992) ("As an economic matter…it is optimal that the tax levied on a given amount of profit or a given taxpayer be invariant with regard to where property or persons are located.").

Even if states A and B conformed their income tax bases but maintained different rates, distortion would still remain. In this case, differential rates would lead to different after-tax rate of returns on investment, depending on where Z chooses to locate its investment. *Id*. at 910 ("For example, assume that North Dakota has a ten percent flat rate income tax on residents and South Dakota has a five percent flat rate income tax on residents. All else being equal, residing in South Dakota is tax-favored relative to residing in North Dakota. Or assume that North Dakota taxes real property while South Dakota taxes sales. Now the locational biases favor owning real property in South Dakota and making sales in North Dakota.").

The only way the interstate tax system can attain true economic tax neutrality is for the States to conform their tax systems and levy identical taxes on an identical base with identical rates. *See* Shaviro, 90 MICH. L. REV. at 910 (locational neutrality unattainable in a system with separate tax jurisdictions). In our federal system, there are 50 states, over 3,100 counties,[3] over 18,000 cities,[4] and over 16,000 school districts.[5] Many of these jurisdictions have the authority to levy income, sales, and property taxes (or some combination of all three). And yet, economists would only say that we had achieved pure interstate neutrality if all these tax jurisdictions chose the same mix of taxes and levied each tax on the same base at the same rate.[6] Interstate tax distortion can only be cured by resorting to respondents' demand for tax conformity among these 37,000 separate tax jurisdictions.

C. The Commerce Clause does not require tax neutrality.

This Court has never interpreted the Commerce Clause to require state tax conformity. In fact, on numerous occasions this Court has said precisely the opposite. *See Trinova Corporation v. Michigan Department of Treasury*, 498 U.S. 358, 385 (1991) ("It is a laudatory goal in the design of a tax

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[3] United States Geological Survey, *Welcome to the USGS: How many counties are there in the United States?*, *at* http://interactive2.usgs.gov/faq/list_faq_by_category/get_answer.asp?id=785 (last accessed Nov. 9, 2005).

[4] National League of Cities, *About the National League of Cities*, *at* http://www.nlc.org/Inside%5FNLC/About%5FNLC (last accessed Nov. 9, 2005).

[5] National Center for Education Statistics, *Characteristics of the 100 Largest Public Elementary and Secondary School Districts in the United States, 1999-2000*, *at* http://nces.ed.gov/pubs2001/100_largest/discussion.asp#tableA (last accessed Nov. 9, 2005).

[6] Of course, even in a perfectly harmonized state tax system, business location decisions would still be distorted by different legal regimes, regulatory policies, access to ports, weather, and a host of other factors. *See*, *e.g.*, Enrich, 110 HARV. L. REV. at 463 ("[E]conomic decisions are … influenced by wide range of governmental policies, such as levels of services, intensity of regulation, and prevailing tax burdens …").

system to promote investment that will provide jobs and prosperity to the citizens of the taxing State."); *see also West Lynn Creamery*, 512 U.S. at 199 n.15 (approving state provisions that create "an environment conducive to economic activity, as by maintaining good roads, sound public education, or low taxes"); Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 448 (1997) (affirming that state competition affirms the goals behind the Commerce Clause). This Court has always approved of state tax sovereignty and interstate tax competition, and has never required that these principles yield to interstate tax neutrality.

And yet, adopting respondents' view of tax neutrality would make it very difficult, if not impossible, for States to create a competitive business tax climate. It would also open the doors of state and federal courts to lawsuits concerning the propriety of a host of measures that encourage investment. Low corporate tax rates, favorable apportionment formulas, and targeted tax credits are among the many differences in state tax systems which certainly impact where a corporation chooses to invest.

For this reason, commentators across the spectrum have argued that tax neutrality cannot be the Commerce Clause standard for discrimination. *See*, *e.g.*, Edward Zelinsky, *Restoring Lost Politics to the Commerce Clause*, 29 OHIO N.U.L. REV. 29, 48 (2002) (arguing that the distortion test as articulated by respondents' counsel does not satisfactorily distinguish between discriminatory and nondiscriminatory taxation); Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 804 (1996) ("The astonishing implications of a literalistic reading of the Court's pronouncements [on neutrality] give us pause."); Shaviro, 90 MICH. L. REV. at 975 (arguing for a narrower principles than distortion in our federalist system); Phillip M. Tatarowicz & Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 VAND. L. REV. 879, 931 (1986) ("[T]he Court's emphasis on the foreclosure of tax neutral decisions in *Boston Stock Exchange* creates complex problems.") (emphasis added).

Substituting distortion for a discrimination test would also eschew the sensitive, case by case analysis this Court has favored under the dormant Commerce Clause.

> On various occasions when called upon to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers, the Court has counseled that the result turns on the unique characteristics of the statute at issue and the particular circumstances in each case.

Boston Stock Exch., 429 U.S. at 329. A distortion test would replace this Court's favored approach with a *per se* rule against any state tax provision that distorted business decision-making. Indeed, why would the courts stop with state tax provisions, if other state regulatory schemes also distort business investment decisions?[7]

Finally, the Constitution clearly contemplates a great deal of state sovereignty in the design of tax systems. *See, e.g., Washington v. Confederated Tribes of Colville Indian Reservation,* 447 U.S. 134, 181 (1980) (discussing the wide latitude States have in their taxing powers); *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 526 (1959) (affirming that States have a wide degree of discretion in their taxing powers); *McCulloch v. Maryland*, 4 Wheat. (17 U.S.) 316, 425 (1819) ("That the power of taxation is one of vital

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[7] *See* Enrich, 110 HARVARD L. REV. at 453-58.

importance; that it is retained by the states; that it is not abridged by the grant of a similar power to the government of the Union; that it is to be concurrently exercised by the two governments—are truths which have never been denied.”). Tax competition is a function of this sovereignty, as some States will choose to create a low-tax environment and others will choose to maintain higher levels of taxes and public services. A true economic distortion test—like that urged on this Court by respondents—would forbid States from using their tax system to promote investment and ultimately require conformity and harmonization in state tax systems.

D. At most, the Commerce Clause requires competitive neutrality.

While the Commerce Clause cannot require economic tax neutrality in state tax systems—at least, not if the States are going to retain their sovereign tax powers—it does require competitive neutrality. The principle of competitive neutrality, as opposed to economic tax neutrality, can be seen in three cases decided by this Court.

In all three cases, the taxpayer was subject to the State’s tax jurisdiction based on activities other than those favored by the State’s tax scheme at issue in the case. In *Boston Stock Exchange*, taxpayers were subject to the New York stock transfer tax based on the transfer of stocks in New York; the challenged provision of the tax was an amendment that provided a reduced rate for only those transfers that utilized a New York-based broker. 429 U.S. at 317. In *Westinghouse*, the taxpayer was subject to franchise tax in New York based on doing business in New York; the challenged provision was a tax credit for exports made from a place of business in New York, calculated by comparing exports from New York with exports from other States. 466 U.S. at 393. In *Maryland v. Louisiana*, taxpayers were subject to first-use tax in Louisiana because they shipped oil and gas extracted from the Outer Continental Shelf (OCS) through Louisiana; the challenged provision provided a credit against the first-use tax if the gas was consumed or used in Louisiana or if the taxpayer was engaged in severance-tax-liability-generating activities in Louisiana. 451 U.S. 725, 732-33 (1981).

In these three cases, the States did two things wrong. First, in *Boston Stock Exchange* and *Maryland v. Louisiana*, the States essentially exploited a monopoly (or oligopoly) position to extract higher tax burdens from taxpayers who also conducted out-of-state activities. 429 U.S. at 328, n.10 ("While the bulk of stock transfers still funnels through New York, only twelve percent of the Nation's investors are located in the State."); 451 U.S. at 729-30 ("It is estimated that 98% of the OCS gas processed in Louisiana is eventually sold to out-of-state consumers with the 2% remainder consumed within Louisiana.").

Second, in *Westinghouse*, New York forced a taxpayer to pay higher taxes as out-of-state exporting activity increased relative to in-state exporting activity. 466 U.S. at 400. The New York tax directly penalized a New York taxpayer that engaged in more out-of-state activity relative to in-state activity, encouraging a New York taxpayer to engage in more New York activity to lower its tax burden.

These concerns are not in issue in this case. Unlike New York (with respect to stock transfers) or Louisiana (with respect to certain natural resources), Ohio does not have a monopoly or oligopoly position with regard to the type of business activity that is subject to its general franchise tax. Accordingly, Ohio was simply not in a position to effectively coerce DaimlerChrysler to further invest in the State. Moreover, unlike New York (with respect to the credit at issue in *Westinghouse*), the Ohio credit does not increase a company's tax liability as a result of investing out-of-state.

Indeed, the tax schemes in *Boston Stock Exchange*, *Westinghouse*, and *Maryland v. Louisiana* were tariff-like; the Ohio investment tax credit is not. True, Ohio's investment tax credit does affect business investment location decisions, just like any favorable tax provision such as lower rates or favorable apportionment formulas. But it does not do so through tariff-like coercion or punishment of out-of-state activity. Ohio's investment tax credit is not economically neutral, but it is competitively neutral, which is sufficient to satisfy the Commerce Clause inquiry.

It is likely that, to the extent Ohio's investment tax credit gives some taxpayers benefits by burdening others, the burden is borne by Ohio taxpayers who do not invest in capital and machinery at all—not those who choose to invest in interstate commerce. This is certainly a case of intrastate discrimination but the Commerce Clause is only concerned with interstate discrimination. In fact, respondents' state equal protection claim gives them adequate grounds on which to challenge Ohio's investment tax credit if they have been injured by a discriminatory intrastate shift in their Ohio tax burden.

E. This Court should clarify that the Commerce Clause does not require "tax neutrality."

This Court should use this case to clarify its tax neutrality language. In particular, States and taxpayers need guidance to ensure that tax programs that encourage economic investment, such as low tax rates, single sales factor apportionment, and Ohio's investment tax credit, do not discriminate against interstate commerce even though they encourage taxpayers to locate investment in Ohio. This Court should reject the arguments offered by respondents, accepted by the Sixth Circuit, that tax provisions discriminate against interstate commerce simply because they encourage intrastate economic investment. *See Cuno*, 386 F.3d at 745 (summarizing respondents' argument as "the economic effect of the Ohio investment tax credit is to encourage further investment in-state at the expense of development in other states and…the result is to hinder free trade among the states.").

Specifically, this Court should explicitly declare that the States are free to offer tax benefits for intrastate investment and deny those benefits for interstate investment. These types of laws encourage labor and capital mobility and honor the original impetus for the Commerce Clause which was to create a national, integrated market. *See Camps Newfound/Owatonna, Inc. v. Town of Harrison, Maine,* 520 U.S. 564, 596 ("We have often said that the purpose of our negative Commerce Clause jurisprudence is to create a national market."). This Court should not, as affirming the Sixth Circuit would do, require that any encouragement given to Ohio taxpayers should also equally apply to those Ohio taxpayers that invest in another State. *See Hughes v. Alexandria Scrap Corp*, 426 U.S. 794, 815-16 (1976) (Stevens, J., concurring) ("[T]he Commerce Clause surely does not impose on the States any obligation to subsidize out-of-state business…[w]hether the encouragement takes the form of a cash subsidy, a tax credit, or a special privilege intended to attract investment capital, it should not be characterized as a 'burden' on commerce.").

Furthermore, this Court should take this opportunity to clarify that state tax policy decisions do not burden interstate commerce merely because those decisions cause differences among the States that may affect decision making. The Commerce Clause prohibits economic protectionism, not fair encouragement of intrastate investment. *See Boston Stock*

Exchange, 429 U.S. at 336-37 (stating that States are allowed to structure tax system to foster intrastate growth and compete for investment).

Indeed, a classic treatise on political economy finds that these differences are a good thing for our market-based system. *See* Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956) ("The consumer-voter may be viewed as picking that community which best satisfies his preference pattern for public goods."). Consistent with this, the theme of this Court's decisions (aside from the "tax neutrality" rhetoric) is that the States are free to compete for a share of interstate investment. Accordingly, this Court should explicitly declare that the States are free to compete and that "tax neutrality" is not the constitutional standard.

CONCLUSION

For the foregoing reasons, this Court should rule that respondents do not satisfy Article III or prudential standing requirements and should clarify that economic tax neutrality is not the standard imposed by the Commerce Clause.

Respectfully submitted,

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November 2005