

# Casenote

## ***DaimlerChrysler v. Cuno*: The Supreme Court Hits the Brakes on Determining the Constitutionality of Investment Incentives Given by States to Corporate America**

### I. INTRODUCTION

In *DaimlerChrysler Corp. v. Cuno*,<sup>1</sup> the United States Supreme Court, under the pen of Chief Justice Roberts, unanimously held that state taxpayers did not have Article III standing to challenge local property tax abatements and investment tax credits given to DaimlerChrysler Corporation (“Daimler”).<sup>2</sup> Claiming standing as municipal and state taxpayers, the plaintiffs challenged the City of Toledo and the State of Ohio’s decisions to offer Daimler certain exemptions from and reductions of its local property and state franchise taxes.<sup>3</sup> The Court held that the plaintiffs failed to satisfy the injury-in-fact and redressability requirements of standing because their alleged injury was too “conjectural or hypothetical.”<sup>4</sup> As a result, the Court never reached the merits of the

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1. 126 S. Ct. 1854 (2006).

2. *Id.* at 1859.

3. *Id.*

4. *Id.* at 1862-63.

case where the plaintiffs had claimed that the tax breaks violated the dormant, or negative, Commerce Clause.<sup>5</sup> Therefore, whether state tax incentives to corporations violate the dormant Commerce Clause is a question that will remain unanswered for now. This note (1) considers the broader implications of the Court's refusal to reach the merits of dormant Commerce Clause analysis as it relates to states granting investment incentives to big businesses and (2) analyzes several scholarly options for a better dormant Commerce Clause analysis of state tax incentives. Ironically enough, *DaimlerChrysler* is noteworthy for what it did not decide.<sup>6</sup>

## II. FACTUAL BACKGROUND

In an effort to encourage the large automobile conglomerate, "Daimler," to expand its manufacturing facilities, the City of Toledo and the State of Ohio offered Daimler local and state tax breaks for new investment within the state.<sup>7</sup> The Ohio Franchise Tax Credit allowed businesses to receive credit against the state franchise tax for qualifying investments of "new manufacturing machinery and equipment" used within the state.<sup>8</sup> Additionally, municipalities in Ohio have authority to waive property taxes for businesses who invest in certain areas so long as the local school districts consent.<sup>9</sup> In 1998 Daimler received the benefit of both tax breaks when it contractually agreed to expand its Jeep assembly plant in Toledo.<sup>10</sup> Daimler's proposed investment in the state was valued at \$1.2 billion, and the conglomerate was forecasted to provide the region with several thousand jobs.<sup>11</sup> Because of the tax break, Daimler saved approximately \$280 million in taxes.<sup>12</sup>

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5. *Id.* at 1864; U.S. CONST. art. I, § 8, cl. 3.

6. See generally Brandon P. Denning, *DaimlerChrysler Corp. v. Cuno, State Investment Incentives, and the Future of the Dormant Commerce Clause Doctrine*, 2006 CATO SUP. CT. REV. 173 (2006). The Supreme Court dodged the long-awaited resolution of constitutional questions surrounding subsidies and tax incentives as they relate to the negative Commerce Clause. However, this decision is an important milestone in the development of Commerce Clause jurisprudence, signaling the true difficulties in determining the Court's use of the term "discrimination" in deciding whether a law contravenes interstate commerce and the policies underlying the Framers' intent to prevent economic Balkanization. *Id.* at 194.

7. *DaimlerChrysler Corp. v. Cuno*, 126 S. Ct. 1854, 1859 (2006).

8. OHIO REV. CODE ANN. § 5733.33(B)(1) (West 2006).

9. OHIO REV. CODE ANN. § 5709.62(D)(1) (West 2006).

10. *DaimlerChrysler*, 126 S. Ct. at 1859.

11. *Cuno v. DaimlerChrysler*, 386 F.3d 738, 741 (6th Cir. 2004).

12. *Id.*

Taxpayers in Toledo sued in state court, alleging that the tax benefits violated the Commerce Clause.<sup>13</sup> Specifically, the plaintiffs claimed that the Ohio Franchise Tax Credit discriminated against interstate economic activity by coercing businesses already subject to the franchise tax to expand in-state rather than out-of-state.<sup>14</sup> The plaintiffs claimed they had standing because the tax breaks diminished the pool of funds available to the city and state, causing the plaintiffs to suffer a disproportionate tax burden because the government had less revenue and thus had to forego other expenditures.<sup>15</sup> These taxpayers essentially argued that they would have to make up the difference in this deficit with future taxes.<sup>16</sup>

While the action was pending in state court, the defendants successfully removed the case to the United States District Court for the Northern District of Ohio.<sup>17</sup> The plaintiffs filed a motion to remand the case to state court because they doubted they satisfied the constitutional standing requirements imposed by Article III's "case or controversy" limitation.<sup>18</sup> The district court rejected the plaintiffs' motion to remand, stating that the plaintiffs had proper standing under the "municipal taxpayer standing" rule laid down in *Massachusetts v. Mellon*.<sup>19</sup> In analyzing the merits, the district court held that neither tax benefit violated the Commerce Clause.<sup>20</sup> On appeal, the Sixth Circuit agreed with the district court regarding the municipal property tax exemption, but held that the state franchise tax violated the Commerce Clause.<sup>21</sup> The court of appeals, however, wholly failed to consider whether the plaintiffs had standing.<sup>22</sup> The Supreme Court granted certiorari to consider whether the Ohio Franchise Tax Credit violated the Commerce Clause but failed to reach this issue.<sup>23</sup>

### III. LEGAL BACKGROUND

The Commerce Clause—found in Article I, Section 8, Clause 3, of the Constitution—is an affirmative grant of power to Congress "[t]o regulate Commerce with foreign Nations, and among the several States, and with

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13. *Id.*; U.S. CONST. art. I, § 8, cl. 3.

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

15. *DaimlerChrysler*, 126 S. Ct. at 1862.

16. *Id.* at 1862-63.

17. *Id.* at 1860.

18. *Id.*; U.S. CONST. art. III.

19. *DaimlerChrysler*, 126 S. Ct. at 1860; 262 U.S. 447, 486 (1923).

20. *DaimlerChrysler*, 126 S. Ct. at 1860; U.S. CONST. art. I, § 8, cl. 3.

21. *DaimlerChrysler*, 126 S. Ct. at 1860; U.S. CONST. art. I, § 8, cl. 3.

22. *DaimlerChrysler*, 126 S. Ct. at 1860.

23. *Id.*

the Indian Tribes."<sup>24</sup> Since the United States' early beginnings as an independent nation, the government has sought to prevent states from waging economic war on one another.<sup>25</sup> To help deter states from using protectionist measures against one another, the Supreme Court interpreted, and continues to interpret, the Commerce Clause such that states cannot discriminate or unduly burden interstate commerce "to benefit in-state economic interests by burdening out-of-state competitors."<sup>26</sup> In applying the dormant Commerce Clause to investment incentives given by states to big businesses, the Court has caused incredible confusion both in the scholarly and judicial world.<sup>27</sup> Nevertheless, the Supreme Court has used the dormant Commerce Clause to invalidate two basic areas of state tax law: (1) taxes—mostly transactional taxes—that act like tariffs, and (2) taxes that penalize in-state businesses for engaging in out-of-state activities.<sup>28</sup>

*A. The Dormant Commerce Clause As Applied to Taxes and Subsidies: The Doctrine's Moorings*

The dormant Commerce Clause, as applied to taxes and subsidies, has been developed and refined over many years. In *Complete Auto Transit, Inc. v. Brady*,<sup>29</sup> the Supreme Court outlined its most celebrated test for determining the constitutionality of state tax laws under the dormant Commerce Clause.<sup>30</sup> In applying the *Complete Auto* test, a state tax provision satisfies the dormant Commerce Clause so long as (1) a substantial nexus exists between the taxing state and the taxed activity; (2) the tax is fairly apportioned to income; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to the benefits the state provides.<sup>31</sup>

In *Complete Auto* the State of Mississippi assessed a sales tax against a Michigan corporation engaged in the business of transporting

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24. U.S. CONST. art. I, § 8, cl. 3.

25. See *Gibbons v. Ogden*, 22 U.S. 1, 224 (1824).

26. *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 192 (1994) (quoting *New Energy Co. Of Ind. V. Limbach*, 486 U.S. 269, 273 (1988)); see also *Hughes v. Oklahoma*, 441 U.S. 322, 326 (1979); *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 534-35 (1949).

27. See generally Edward A. Zelinsky, *Restoring Politics to the Commerce Clause: The Case for Abandoning the Dormant Commerce Clause Prohibition on Discriminatory Taxation*, 29 OHIO N.U. L. REV. 29 (2002) (observing that legal scholars in this area have labored extraordinarily hard to try to find workable rules).

28. See Philip M. Tatarowicz & Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause*, 39 VAND. L. REV. 879 (1986).

29. 430 U.S. 274 (1977).

30. *Id.* at 279.

31. *Id.*

automobiles to Mississippi dealers.<sup>32</sup> The Michigan corporation argued that its operations were part of a large interstate movement and that the sales tax as applied to the interstate movement violated the dormant Commerce Clause.<sup>33</sup> The Supreme Court held that because the corporation failed to allege that the tax lacked a substantial nexus, that the tax discriminated against interstate commerce, or that the tax was unrelated to the services provided by the state, it was not per se unconstitutional.<sup>34</sup> Instead of arguing the absence or presence of any of the four factors—substantial nexus, discrimination, fair apportionment, or that the tax is fairly related to the services provided by the state—the Michigan corporation relied solely on Supreme Court decisions that held that “a tax on the ‘privilege’ of engaging in an activity in the State may not be applied to an activity that is part of interstate commerce.”<sup>35</sup> The antidiscrimination principle stated in *Complete Auto* has been the most important principle in the development of dormant Commerce Clause jurisprudence because courts have had the hardest time developing, defining, and refining it.<sup>36</sup>

*B. Development of the Antidiscrimination Principle—Some Problems Along the Way*

Courts have had a tough time developing the antidiscrimination principle because it lacks mutuality in application when comparing taxes with subsidies. To help illustrate some of the problems that the Supreme Court’s dormant Commerce Clause jurisprudence—as applied to state tax laws—has caused, consider the holding in *New Energy Co. of Indiana v. Limbach*.<sup>37</sup>

In *New Energy* an Ohio statute awarded a tax credit against its motor vehicle fuel sales tax for each gallon of ethanol sold by fuel dealers. However, the credit only applied if the ethanol was produced in the state or, if it was produced in another state, the credit applied only to the extent that the other state granted similar tax credits to companies who produce ethanol in Ohio.<sup>38</sup> Under the law, New Energy Company

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32. *Id.* at 275-76.

33. *Id.* at 277.

34. *Id.* at 287-89.

35. *Id.* at 278.

36. See generally Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 426 (1996).

37. 486 U.S. 269 (1988).

38. *Id.* at 271. Ethanol or ethyl alcohol is made from corn and used as an automotive fuel. *Id.* It is mixed with gasoline in a ratio of one to nine to produce what is called gasohol. *Id.* In recent years, due to rising gas prices and fluctuations in the petroleum market, ethanol has become a widely produced form of fuel. *Id.*

benefited from Ohio's tax credit for the ethanol it produced in Indiana because Indiana granted Ohio producers of ethanol similar tax credits. Indiana, however, subsequently repealed its tax credit and replaced it with a direct subsidy to Indiana ethanol producers, making New Energy Company ineligible for Ohio's tax credit.<sup>39</sup> New Energy argued that the tax credit violated the dormant Commerce Clause because it discriminated against out-of-state ethanol producers to the advantage of in-state producers by favoring the latter in granting tax breaks.<sup>40</sup>

The Supreme Court held that because the Ohio tax credit violated the dormant Commerce Clause's cardinal rule of nondiscrimination, it was unconstitutional.<sup>41</sup> The Court did note, however, that New Energy Company received a direct subsidy from Indiana, which was potentially no less discriminatory than the Ohio tax credit.<sup>42</sup> The Court further stated in dicta that direct subsidization does not run afoul of the dormant Commerce Clause but that discriminatory taxation of out-of-state manufacturers does.<sup>43</sup> Therefore, because Indiana converted its prior discriminatory tax scheme into a direct expenditure program, its effect seemingly became innocuous under dormant Commerce Clause jurisprudence, whereas Ohio's tax credit violated the dormant Commerce Clause because it ran afoul of the antidiscrimination principle.<sup>44</sup>

### C. Taxes that Act Like Tariffs

The area in which the Court has invalidated most state statutes is where the state tax operates like a tariff. As an illustration of the Court's interpretation of the dormant Commerce Clause's applicability to state tax incentives, consider *Boston Stock Exchange v. State Tax Commission*.<sup>45</sup>

In *Boston Stock Exchange* stock exchanges located outside of New York brought a lawsuit to challenge an amendment to a New York statute that imposed a transfer tax on securities transactions.<sup>46</sup> In effect, the transfer tax statute taxed out-of-state transactions more heavily than

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39. *Id.* at 272-73. A subsidy, in economic terms, is a direct monetary payment given by the government to lower the prices faced by a consumer or producer. In its economic effect, a subsidy operates just like a negative tax. HARVEY S. ROSEN, PUBLIC FINANCE 293 (6th ed. 2002).

40. *New Energy Co.*, 486 U.S. at 273.

41. *Id.* at 274.

42. *Id.* at 278.

43. *Id.*

44. *See id.*

45. 429 U.S. 318 (1977).

46. *Id.* at 319.

most in-state transactions.<sup>47</sup> The purpose of the amendment was clearly protectionist.<sup>48</sup> The Court stated that the purpose of the dormant Commerce Clause was to create one economic unit.<sup>49</sup> But the Court noted its own deficiencies in dormant Commerce Clause analysis, stating that “[the] case-by-case approach [of our dormant Commerce Clause jurisprudence] has left ‘much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.’”<sup>50</sup> Despite the inconsistencies, controversies, and confusion, the Court further stated that “[n]o State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.’”<sup>51</sup> Although the Court held the New York transfer tax unconstitutional,<sup>52</sup> the Court expressly stated that its decision did not prevent states from structuring their tax systems to encourage the growth of intrastate commerce and industry.<sup>53</sup> But more importantly, the Court finally realized and declared that its own dormant Commerce Clause jurisprudence was a “quagmire.”<sup>54</sup>

*D. Taxes that Benefit In-State Businesses but Also Penalize Those Businesses for Out-of-State Investment*

The other circumstance in which the Court has generally applied the antidiscrimination principle is where a state imposes a tax that benefits in-state business if it continues to invest and grow within the state, but penalizes the same business if it decides to invest outside the state. In *Westinghouse Electric Corp. v. Tully*,<sup>55</sup> the Supreme Court held that a New York franchise tax violated the dormant Commerce Clause’s antidiscrimination principle because it allowed parent corporations to receive a greater tax credit as their subsidiaries moved a greater percentage of their shipping activities into New York.<sup>56</sup> In effect, the New York tax created a positive incentive for parent companies to increase their subsidiary’s shipping activities in the State of New York, but penalized Domestic International Sales Corporations (“DISC”) for

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47. *Id.*

48. *See id.* at 326-28.

49. *See id.* at 328.

50. *Id.* at 329 (quoting *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 457 (1959)).

51. *Id.* (quoting *Northwestern*, 358 U.S. at 457) (omission in original).

52. *Id.* at 337.

53. *Id.* at 336.

54. *Id.* at 329 (quoting *Northwestern*, 358 U.S. at 458).

55. 466 U.S. 388 (1984).

56. *Id.* at 400-01, 407.

increasing their shipping activities outside of New York.<sup>57</sup> The New York Tax Commission argued that the tax credit was not designed to increase the flow of shipping activities to New York, but to prevent existing DISC from moving shipping activities out of New York.<sup>58</sup>

The Court held that it did not matter whether the tax was designed to increase new shipping activities in New York or to prevent the existing DISC from moving their subsidiaries' shipping activities out of New York, stating that under either purpose it is a discriminatory tax that "forecloses tax-neutral decisions and . . . creates . . . an advantage' for firms operating in New York by placing a 'discriminatory burden on commerce to its sister States."<sup>59</sup> The Court further noted that the New York tax violated the antidiscrimination principle because it encouraged business operations that could be performed more efficiently in other states to be performed in-state.<sup>60</sup> Therefore, whenever a tax incentive encourages in-state business activity at the expense of out-of-state business activity, thereby creating a discriminatory economic impact, it is unconstitutional under the dormant Commerce Clause.<sup>61</sup>

In *Camps Newfound/Owatonna, Inc. v. Town of Harrison*,<sup>62</sup> the Supreme Court held that a Maine property tax exemption limited to charitable organizations incorporated in Maine violated the dormant Commerce Clause.<sup>63</sup> The petitioner, a Maine nonprofit organization, operated a church camp for children, most of whom were nonresidents.<sup>64</sup> The statute at issue did not allow as large of an exemption for institutions whose primary clientele were nonresidents.<sup>65</sup> Therefore, because the petitioner provided services mostly for out-of-state clients, it was taxed more heavily than other camp operators who primarily served in-state clients.<sup>66</sup>

The Court observed that "[a]s a practical matter, the statute encourages affected entities to limit their out-of-state clientele, and penalizes the principally nonresident customers of businesses catering to a primarily interstate market."<sup>67</sup> The Court held that the statute was discriminatory on its face and applied the "virtually per se invalid" standard as

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57. *Id.* at 400-01.

58. *Id.* at 405-06.

59. *Id.* (citing *Boston Stock Exchange*, 429 U.S. at 331) (omissions in original).

60. *Id.* (citing *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145 (1970)).

61. *See id.* at 406-07.

62. 520 U.S. 564 (1997).

63. *Id.* at 572.

64. *Id.* at 567.

65. *Id.* at 568.

66. *Id.* at 576.

67. *Id.*

opposed to “Pike balancing,”<sup>68</sup> a standard that is usually applied when the statute treats in-state and out-of-state residents the same.<sup>69</sup> More important to this Article, the Town of Harrison argued that its tax exemption constituted a legally discriminatory subsidy.<sup>70</sup> The Court responded, “We find these arguments unpersuasive. Although tax exemptions and subsidies serve similar ends, they differ in important and relevant respects . . . .”<sup>71</sup> Although the Court declared that there is a difference between tax exemptions and subsidies, they have failed to identify such a distinction, leaving lower courts and states at sea.

*E. The Constitutional Hurdle: Article III Standing*

Before reaching constitutional questions, such as dormant Commerce Clause questions, the Court requires a plaintiff to have standing to prosecute his claim. Article III, Section 2, of the United States Constitution provides that “judicial Power shall extend” to certain enumerated categories of “Cases” and “Controversies.”<sup>72</sup> Regarding the inherent limits of Article III, Section 2, a party must have standing to prosecute actions in federal court.<sup>73</sup>

Standing has two essential components: “[1)] Article III standing, which enforces the Constitution’s case or controversy requirement; and [(2)] prudential standing, which embodies ‘judicially self-imposed limits on the exercise of federal jurisdiction.’”<sup>74</sup> Generally, Article III standing requires (1) injury-in-fact; (2) causation; and (3) redressability.<sup>75</sup> For taxpayers to satisfy the injury-in-fact element of standing, they must show that they have suffered a particularized and concrete injury distinct from that suffered by the general public.<sup>76</sup> This same principle applies with equal force to state taxpayers.<sup>77</sup>

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68. *Pike*, 397 U.S. at 142. Pike Balancing is a mid-level scrutiny level the Court applies when the statute regulates in-state and out-of-state participants even-handedly. *Id.* Where the state can show a legitimate local interest and that the effects on interstate commerce are only incidental, the statute will be upheld unless the burden imposed on interstate commerce is “clearly excessive in relation to the putative local benefits.” *Id.*

69. *Id.*; *Camps Newfound/Owatonna, Inc.*, 520 U.S. at 581.

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

71. *Id.* at 589.

72. U.S. CONST. art. III, § 2.

73. *Elk Grove Unified Sch. Dist. v. Newdow*, 542 U.S. 1, 11 (2004).

74. *Id.* (citations omitted).

75. See *Allen v. Wright*, 468 U.S. 737, 751 (1984).

76. *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992).

77. *Doremus v. Bd. of Educ. of Hawthorne*, 342 U.S. 429, 434 (1952).

In *Frothingham v. Mellon*, decided with *Massachusetts v. Mellon*,<sup>78</sup> the plaintiff sued, challenging the constitutionality of a federal statute designed to "reduce maternal and infant mortality and protect the health of mothers and infants."<sup>79</sup> The plaintiff alleged that because the effect of the statute would increase her future tax burden, it constituted a taking of her property without due process of law.<sup>80</sup> The Supreme Court held that the federal taxpayer's interest in the moneys of the treasury is shared with every other taxpayer, thereby making it "comparatively minute and indeterminable, and the effect upon future taxation, of any payment out of the funds, so remote, fluctuating and uncertain," that there can be no standing.<sup>81</sup>

The only exception to the Article III standing requirement was laid down in *Flast v. Cohen*,<sup>82</sup> where the Court held that "a taxpayer will have standing consistent with Article III to invoke federal judicial power when he alleges that congressional action under the taxing and spending clause is in derogation of [the Establishment Clause]."<sup>83</sup> In *Flast* the plaintiffs challenged an education act that funneled tax revenues to religious institutions for education in reading, arithmetic, and other subjects.<sup>84</sup> As such, the expenditures violated the Establishment and Free Exercise Clauses of the First Amendment,<sup>85</sup> which specifically limits Congress's taxing and spending powers conferred by Article I, Section 8, of the Constitution.<sup>86</sup> Therefore, the taxpayers had standing to prosecute their claim in federal court.<sup>87</sup> Nonetheless, this case reinforced the principle that before a court will reach the constitutional issues of a case, it must establish that the parties have sufficient standing to enter the federal domain.<sup>88</sup>

#### IV. COURT'S RATIONALE

In *DaimlerChrysler Corp. v. Cuno*,<sup>89</sup> the Court did not reach the issue of whether Ohio's Franchise Tax Credit<sup>90</sup> violated the dormant Com-

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78. 262 U.S. 447 (1923).

79. *Id.* at 479.

80. *Id.* at 486.

81. *Id.* at 487.

82. 392 U.S. 83 (1968).

83. *Id.* at 105-06; U.S. CONST. amend. I.

84. *Flast*, 392 U.S. at 85-86.

85. U.S. CONST. amend. I.

86. *Flast*, 392 U.S. at 105.

87. *Id.* at 88.

88. *DaimlerChrysler Corp. v. Cuno*, 126 S. Ct. 1854, 1859 (2006).

89. 126 S. Ct. 1854 (2006).

90. OHIO REV. CODE ANN. § 5733.33(B)(1) (West 2006).

merce Clause because it determined the plaintiffs did not have standing to prosecute their claim in federal court.<sup>91</sup> Chief Justice Roberts began the majority's opinion by discussing the case or controversy requirement of Article III,<sup>92</sup> noting its importance in maintaining the "tripartite allocation of power" set forth in the Constitution.<sup>93</sup> As to the plaintiffs' assertion that the franchise tax depleted the available funds in the treasury, thereby increasing their tax burdens, the Court held that such injury was not "concrete and particularized," but instead a grievance the taxpayer 'suffers in some indefinite way in common with people generally.'<sup>94</sup> Specifically, the Court noted that it is unclear whether the Ohio tax credit actually depleted the treasury; the general purpose of a tax break is to stimulate economic growth, which in turn supposedly fills the public coffers.<sup>95</sup> For the plaintiffs to show injury, they have to speculate that government officials will increase their tax burden to make up for the alleged deficit arising out of the tax credit; to establish redressability, the plaintiffs must speculate that the officials will reduce their tax burden by the increase in revenue if Daimler pays the franchise tax.<sup>96</sup> According to the Court, it is this type of speculation the Article III standing limitations seek to prevent.<sup>97</sup>

Furthermore, the Court held that the same logic and precedent that has denied federal taxpayer standing in these types of cases applied with equal force to state taxpayers.<sup>98</sup> Regarding the plaintiffs' attempt to invoke the exception laid down in *Flast v. Cohen*,<sup>99</sup> the Court held that if the *Flast* exception were extended to include the dormant Commerce

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91. *DaimlerChrysler*, 126 S. Ct. at 1859.

92. U.S. CONST. art. III, § 2.

93. *DaimlerChrysler*, 126 S. Ct. at 1861.

94. *Id.* at 1862 (citations omitted).

95. *Id.*

96. *Id.* at 1862-63 (citing *ASARCO, Inc. v. Kadish*, 490 U.S. 605, 614 (1989)). Essentially, there was no true way to know whether the tax credit increased or diminished the plaintiffs' tax burdens. *See id.* It is common expansionary fiscal policy to decrease taxes to increase economic growth. *Id.* at 1862-63. Additionally, there is no principled way of knowing that the legislature will take the increased moneys from the franchise tax and reduce the taxpayer's burdens. *Id.* at 1863. The Court noted that any decision to allocate the savings from the franchise tax to a reduction in taxpayer's burden is within the discretionary power of the legislature. *Id.* The Court further noted that because state budgets oftentimes have many provisions for spending and taxes, allowing a taxpayer standing merely because they pay taxes would give the courts power to continually monitor states' fiscal decisions. *Id.* at 1864.

97. *See id.* at 1862-64.

98. *Id.* at 1863 (citing *Doremus v. Bd. of Educ. of Hawthorne*, 342 U.S. 429, 434 (1952)). The Court has likened state taxpayers to federal taxpayers for standing purposes.

99. 392 U.S. 83, 105-06 (1968).

Clause, there would be no way of distinguishing other constitutional provisions that limit governments' taxing and spending decisions.<sup>100</sup> In short, federal courts would become subject to suits for taxpayers' "generalized grievances."<sup>101</sup>

In their last attempt to prove standing, the plaintiffs argued that their status as municipal taxpayers gave them standing to challenge the franchise tax.<sup>102</sup> First, the plaintiffs argued that because the law required revenues from the franchise tax to be distributed to municipalities, the award of the credit to Daimler depleted the funds of their municipality.<sup>103</sup> Second, the plaintiffs relied on *United Mine Workers v. Gibbs*<sup>104</sup> to argue that supplemental jurisdiction extended to all of their claims once the district court determined that they had standing on the property tax exemption claim.<sup>105</sup>

In rejecting the first theory, the Court held that the plaintiffs' challenge was nonetheless a challenge to a state law and a state decision, and that by arguing from the standpoint of a municipal taxpayer, the plaintiffs' argument for injury became more attenuated.<sup>106</sup> In rejecting the second theory, the Court held that the plaintiffs' reading of *Gibbs* would destroy the doctrines of mootness, ripeness, and political question, and therefore, the plaintiffs' interpretation of *Gibbs* was incorrect and misguided.<sup>107</sup> Due to the plaintiffs' failure to prove Article III standing, the Supreme Court vacated the lower court's ruling in part and remanded the case for dismissal of the plaintiffs' challenge to the state franchise tax.<sup>108</sup>

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100. *DaimlerChrysler*, 126 S. Ct. at 1865.

101. *Id.* (quoting *Flast*, 392 U.S. at 106).

102. *Id.*

103. *Id.* at 1866. The plaintiffs tried to claim standing under the "municipal taxpayer standing rule" recognized in *Frothingham*, which allows municipal residents "to enjoin the illegal use of moneys of a municipal corporation." 262 U.S. 447, 486 (1923).

104. 383 U.S. 715 (1966). *Gibbs* was the seminal case in establishing supplemental jurisdiction, which is now codified at 28 U.S.C. § 1367 (2000).

105. *DaimlerChrysler*, 126 S. Ct. at 1866.

106. *Id.*

107. *Id.* at 1867. The Court noted that it had never used *Gibbs* to allow a federal court to authorize supplemental jurisdiction over a claim that itself fails to satisfy constitutional standing. *Id.* The plaintiffs read *Gibbs* to mean that "federal jurisdiction extends to all claims sufficiently related to a claim within Article III to be part of the same case, regardless of the nature of the deficiency that would keep the former claims out of federal court if presented on their own." *Id.* at 1866.

108. *Id.* at 1868.

A. *Justice Ginsburg's Concurrence (concurring in part and concurring in the judgment)*

Justice Ginsburg wrote a brief concurring opinion to expressly note her agreement with the "nonjusticiability of *Frothingham*-type federal and state taxpayer suits,"<sup>109</sup> but to also note her reservations with the limitations on standing set forth in a number of cases, such as *Valley Forge Christian College v. Americans United for Separation of Church & State, Inc.*<sup>110</sup> and *Allen v. Wright*,<sup>111</sup> in which dissenting opinions argued that the parties had sufficient standing.<sup>112</sup>

V. IMPLICATIONS

Throughout history, state governments have utilized every weapon in their economic arsenals to encourage businesses to invest and grow within their respective states.<sup>113</sup> As a result, the Court developed the dormant Commerce Clause to mitigate the protectionist measures that naturally flowed from this type of competition.<sup>114</sup> Some of states' economic weapons include tax abatements, tax credits, below-market leases, loan forgiveness, land giveaways, and direct outlays in the form of subsidies.<sup>115</sup> The most common weapon is the one Ohio gave to Daimler: a credit against its taxes.<sup>116</sup> Although the Court did not reach the constitutional issue in *DaimlerChrysler Corp. v. Cuno*,<sup>117</sup> the case is still important to dormant Commerce Clause jurisprudence because it left an important issue unresolved. As a result, scholarly debate on the constitutionality of state tax incentives has blossomed. In effect, the Supreme Court merely postponed a decision that scholars have long awaited and that will eventually have to be made.<sup>118</sup> As the

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109. *Id.* at 1869 (Ginsburg, J., concurring).

110. 454 U.S. 464 (1982).

111. 468 U.S. 737 (1984).

112. *DaimlerChrysler*, 126 S. Ct. at 1869 (Ginsburg, J., concurring); *see Allen*, 468 U.S. at 766-83 (Brennan, J., dissenting); *Allen*, 468 U.S. at 783-95 (Stevens and Blackmun, JJ., dissenting); *Valley Forge Christian College*, 454 U.S. at 490-513 (Brennan, Marshall, and Blackmun, JJ., dissenting); *Valley Forge Christian College*, 454 U.S. at 513-15 (Stevens, J., dissenting).

113. Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 790, 857, 860 (1996).

114. *See id.* at 790-92.

115. *Id.* at 790, 855.

116. OHIO REV. CODE ANN. § 5733.33(B)(1) (West 2006); Hellerstein & Coenen, *supra* note 113, at 817.

117. 126 S. Ct. 1854.

118. Denning, *supra* note 6, at 173.

case law above indicates, the Court's dormant Commerce Clause jurisprudence has left state governments with no real dividing line between constitutional and unconstitutional investment incentives. Some scholars argue that these incentives create bidding wars, forcing states into a "race to the bottom."<sup>119</sup> There are, however, several different ideas and approaches that scholars in this area have expounded upon as solutions to the problem.<sup>120</sup> Again, the central issues are whether incentive packages violate the dormant Commerce Clause, and derivatively, whether the incentives are truly helpful to the states that employ their use.

A. *Zelinsky: Throw the Anti-Discrimination Principle In the Garbage or Give it Teeth*

Edward Zelinsky argues that because there is no principled way of distinguishing between a discriminatory and a nondiscriminatory tax, and because the tax versus subsidy distinction recognized by the Court does not fully account for the dormant Commerce Clause's declared purpose of ridding the Union of economic Balkanization, the Supreme Court should either "jettison" the antidiscrimination principle or extend it to include direct outlays.<sup>121</sup> Because a direct outlay, such as a subsidy, has exactly the same impact as a negative tax,<sup>122</sup> Ohio could simply restructure its Investment Tax Credit as a direct expenditure program<sup>123</sup> and avoid running afoul of the dormant Commerce Clause like the Indiana company in *New Energy Co. of Indiana v. Limbach*.<sup>124</sup> Thus, the tax/subsidy distinction is unworkable.<sup>125</sup> Zelinsky, on the other hand, would preserve the other three elements from *Complete Auto Transit, Inc. v. Brady*<sup>126</sup> and would retain the nondiscrimination

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119. Enrich, *supra* note 36, at 380.

120. See generally Enrich, *supra* note 36; Dan T. Coenen, *Business Subsidies and the Dormant Commerce Clause*, 107 YALE L.J. 965 (1998); Denning, *supra* note 6, at 192; Zelinsky, *supra* note 27; Hellerstein & Coenen, *supra* note 113.

121. See Zelinsky, *supra* note 27, at 79-80. Economic Balkanization is a term that has been used to highlight the constitutional framers' fear of high trade barriers that generally prevent the free flow of commerce among the states. See *H. P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, 554 (1949) (Black, J., dissenting). Economic Balkanization is often considered one of the main factors that caused problems with the Colonies and the Articles of Confederation. See *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979).

122. ROSEN, *supra* note 39, at 293.

123. See Zelinsky, *supra* note 27, at 46.

124. 486 U.S. 269, 278 (1988).

125. See Zelinsky, *supra* note 27, at 46.

126. 430 U.S. 274, 279 (1977).

principle for dormant Commerce Clause analysis outside of the tax context.<sup>127</sup>

*B. Coenen & Hellerstein: It's Time for Change*

Professor Coenen and Professor Hellerstein also recognize the issue facing the Supreme Court in cases like *DaimlerChrysler*. That is, “how is a constitutionally benign incentive designed to attract industry to a state to be distinguished from an unconstitutionally discriminatory incentive designed to do the same thing?”<sup>128</sup> The dilemma in the Court’s case law is that the antidiscrimination principle allows subsidies issued from the general revenues to survive constitutional challenge, but disallows tax programs that have the same effect and purpose.<sup>129</sup> The true problem lies in the Court’s internal consistency doctrine, which looks only to the structure of the incentive to see whether mass application of the incentive by all of the states in the Union would disadvantage interstate commerce, not at the economic reality of the incentive.<sup>130</sup>

These two professors propose a new test. First, the tax incentive must favor in-state activity over out-of-state activity; and second, the incentive must implicate the coercive power of the state.<sup>131</sup> Both elements of the constitutional inquiry must be violated before a court could declare the tax incentive unconstitutional.<sup>132</sup> This test has an exception: if the state is not exempting or reducing a business’s existing tax liability, but is merely reducing additional tax liability that the business would incur if it engaged in the targeted activity within the state, the incentive should survive constitutional challenge.<sup>133</sup> Therefore, for the tax incentive in *DaimlerChrysler* to survive constitutional challenge under this test, Daimler would have to either (1) engage in a new targeted activity/industry, which would cause it additional tax liability, or (2) not have been doing business in Ohio in the first place.

*C. Enrich: Save the Antidiscrimination Principle*

Professor Enrich, the attorney for the plaintiffs in *DaimlerChrysler*, strongly believes in the antidiscrimination principle.<sup>134</sup> He explains,

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127. See Zelinsky, *supra* note 27, at 46.

128. Hellerstein & Coenen, *supra* note 113, at 791.

129. See *New Energy*, 486 U.S. at 278; Hellerstein & Coenen, *supra* note 113, at 791.

130. Hellerstein & Coenen, *supra* note 113, at 807-08.

131. *Id.* at 806.

132. *Id.*

133. *Id.* at 806-07.

134. Enrich, *supra* note 36, at 426.

"[T]he primary focus in determining whether a particular tax provision runs afoul of the antidiscrimination principle is a practically oriented analysis of the provision's purposes and effects."<sup>135</sup> Noting the inherent defects in the Court's dormant Commerce Clause case law,<sup>136</sup> Enrich argues that the Court should revamp the antidiscrimination principle to focus on "whether a particular tax provision distorts economic decisionmaking in favor of in-state activity, not whether it treats in-state and out-of-state actors disparately."<sup>137</sup> Under Enrich's revamped discrimination analysis, "business location incentives would be virtually per se unconstitutional."<sup>138</sup> Arguing against some scholars who say that the real purpose behind the dormant Commerce Clause is political union and the prevention of interstate friction, Enrich believes the central purpose behind the dormant Commerce Clause is to prevent states from impeding the free flow of the national economy—that is, free trade.<sup>139</sup> Enrich argues that by shifting the focus to an incentive's distortions on economic decision making, the "functional similarities between . . . [Investment Tax Credits] and property tax abatements become more prominent, and their formal differences fade in import."<sup>140</sup>

*D. When Do the Costs Outweigh the Benefits—New Jobs and Investment v. Revenue Reduction*

An important question that seems to be ignored is whether state tax incentives actually produce the results they are intended to produce.<sup>141</sup> In other words, does the job growth and the postulated increase in revenue outweigh the cost of the incentive program?<sup>142</sup> If the answer is no, then state tax incentives do create a "race to the bottom" because governments are involved in a competitive bidding war in which states suffer greater economic ramifications as competition increases.<sup>143</sup> Specifically, the opponents of Economic Development Incentives ("EDI") suggest that with increased competition among states for corporate investment, states have to give such an enormous tax incentive that they

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135. *Id.* at 432.

136. *Id.* at 449-53.

137. *Id.* at 456.

138. *Id.* at 458.

139. *Id.* at 453.

140. *Id.* at 457.

141. Sherry L. Jarrell et al., *Law and Economics of Regulating Economic Development Incentives*, 41 WAKE FOREST L. REV. 805, 822-24 (2006).

142. *Id.* at 822.

143. *Id.* at 809, 834.

never fully recover their so-called investment, resulting in net losses.<sup>144</sup> Yet, if granting tax incentives stimulates the local economy and increases revenue, it makes logical sense to allow the incentives.<sup>145</sup>

The surprising thing is that states have not measured the impact that EDI has on their local economies, and studies that have been conducted tend to show that EDI has a “statistically significant negative impact on economic growth of a region at the extremes—very high taxes or very low taxes.”<sup>146</sup> Nonetheless, most results from these studies are unhelpful because it is hard to find the exact variables to measure.<sup>147</sup> Even with uncertainty about the true economic impact of EDI, forty-seven of forty-eight states that Meyer and Hassig surveyed between 1991 and 1993 adopted at least one tax incentive to encourage business to invest and grow within their respective states.<sup>148</sup> Without knowledge of the true economic impact that EDI has on state economies, it is difficult to gauge whether incentive packages are worth the resulting revenue reductions they cause.

Furthermore, as the holding in *New Energy*<sup>149</sup> suggests, there is no principled way of distinguishing a discriminatory tax from a discriminatory subsidy, yet the Court allows subsidies to exist without intervention.<sup>150</sup> The Court’s reasoning in maintaining the tax/subsidy distinction presents an inherent flaw in its analysis—either showing its misunderstanding of public sector economics, which is highly unlikely, or a desire to keep dormant Commerce Clause analysis out of the subsidy arena—because in reality, a subsidy is simply a negative tax, and a state’s discriminatory purpose can hide behind both.<sup>151</sup> Jettisoning the antidiscrimination principle, as Professor Zelinsky suggests, completely removes the issue from the judiciary and places discriminatory taxes within the sole responsibility of a highly partisan legislature, which, even armed with the economic knowledge that EDI is bad for

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144. See generally *id.* at 822-24, 834.

145. See generally *id.* at 824.

146. *Id.* at 822-24.

147. Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 452 (1997).

148. James R. Rogers, *The Effectiveness and Constitutionality of State Tax Incentive Policies for Locating Businesses: A Simple Game Theoretic Analysis*, 53 TAX LAW. 431, 431 (2000).

149. 486 U.S. 269.

150. This generalization, of course, presumes that subsidies are funded from general revenues. The Court has struck down subsidies that merely rebate preexisting tax liability—that is, where tax revenues fund the subsidy instead of general revenues. See *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 199 (1994).

151. Zelinsky, *supra* note 27, at 34-35; ROSEN, *supra* note 39, at 293.

states, would unlikely react for political reasons. To put it differently, a politician looks good when he can boast to his constituency that he added five hundred new jobs and claim, albeit hypothetically, that he has stimulated the local economy. Therefore, change must come so the dormant Commerce Clause is given what it has lacked for many decades now: mutuality in application.

At this time, Professor Coenen and Hellerstein's test seems to best take into account the concerns of the proponents and opponents of EDI—economic Balkanization versus allocating scarce resources efficiently. Their test accomplishes both goals of ridding the nation of discriminatory incentives. By focusing on the in-state versus out-of-state favoritism rationale and the coercive power that a state exerts when adding a tax incentive to its taxing regime, Hellerstein and Coenen's test acts as a switchboard, discarding discriminatory incentives while allowing those that simply say, "Come to our state and we will not saddle you with any additional tax burdens or at least not with the same tax burdens that we would ordinarily impose upon taxpayers engaging in such activity. Moreover, should you refuse our invitation, nothing will happen to your tax bill . . ." <sup>152</sup> Thus, states can continue to use their taxing regimes to encourage local growth in new industry without running afoul the dormant Commerce Clause. Although the Court in *DaimlerChrysler* avoided the long-awaited resolution of states' power to use their taxing regimes for alleged growth and development, there will surely come another day when the plaintiffs make it over the constitutional hurdle of standing, forcing the Court to finally decide the issue. Until that day, the "race to the bottom" or the "race to the top," whichever is the true result of tax incentives, will continue.

JONATHAN EDWARDS

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152. Hellerstein & Coenen, *supra* note 113, at 809.