

**ECONOMIC DEVELOPMENT AND THE DORMANT  
COMMERCE CLAUSE: THE LESSONS OF CUNO  
V. DAIMLERCHRYSLER AND ITS EFFECT ON  
STATE TAXATION AFFECTING INTERSTATE  
COMMERCE**

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**JOINT HEARING**  
BEFORE THE  
SUBCOMMITTEE ON THE CONSTITUTION  
AND THE  
SUBCOMMITTEE ON  
COMMERCIAL AND ADMINISTRATIVE LAW  
OF THE  
COMMITTEE ON THE JUDICIARY  
HOUSE OF REPRESENTATIVES  
ONE HUNDRED NINTH CONGRESS  
FIRST SESSION

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**TUESDAY, MAY 24, 2005**

HOUSE OF REPRESENTATIVES,  
SUBCOMMITTEE ON THE CONSTITUTION,  
COMMITTEE ON THE JUDICIARY,  
*Washington, DC.*

The Subcommittees met jointly, pursuant to notice, at 10:14 a.m., in Room 2141, Rayburn House Office Building, the Honorable Steve Chabot [Chair of the Subcommittee] presiding.

Mr. CHABOT. The Committee will come to order. Good morning. This morning, the Subcommittees on the Constitution and Commercial and Administrative Law have convened to examine the status of State economic growth and development through tax incentive plans in light of the Sixth Circuit's recent decision in *Cuno v. DaimlerChrysler Inc.*

I'd like to thank Chairman Cannon for agreeing to co-chair this hearing, and to Ranking Members Nadler and Watt for their support for an issue that has implications not just for Ohio, but for all 50 States.

And this morning is a joint hearing of the Subcommittee on the Constitution and the Subcommittee on Commercial and Administrative Law.

I'd also like to thank and welcome our witnesses who are with us today. And I know we have one who's still to arrive, but I know they had weather problems and will be coming from Ohio. We have an expert panel before us, and I know we've put this hearing together on short notice. And I'd like to thank all of you for making yourselves available.

It's especially nice to see fellow "Buckeyes" sitting before us. And thank you, Lieutenant Governor Johnson, who's just entered here—and hope the flight wasn't too bad from Ohio—for all of your hard work for the State of Ohio.

And Mrs. Kuhrt—am I pronouncing it right? Is it Kuhrt? Kuhrt, okay—for traveling from our great State to help us better understand the importance of this issue to States and businesses, and to help identify the future role for Congress.

In the universal quest to expand economic development, States are being asked to assume greater responsibility at a time when budget deficits, job growth, and quality of life concerns are para-

mount. They are being asked to respond in an environment where fewer tools are available to them, and competition for business investment is not just limited to the 50 States, but the entire world.

To stay competitive, States are increasingly turning to tax incentive packages, including investment tax credits and exemptions, as a strategy to encourage business investment. The Ohio Department of Development, like so many other State development offices, relies on investment programs to bring new businesses to areas, which in turn bring new revenue, add new jobs, maintain existing ones, and add immensely to the quality of community life. Approximately 40 other States have similar investment tax credits and rely on them to make their State more attractive to businesses.

Investment tax incentives are used to attract or maintain business in a State. As Ms. Kuhrt will tell us later, these investment tax credits and incentives can also play a large role in business decisions to locate, expand, and remain in the United States.

Last fall, the ability of States—specifically, the States of Ohio, Michigan, Tennessee, and Kentucky—to offer these incentives and remain competitive was dealt a significant blow by the United States Court of Appeals for the Sixth Circuit decision in *Cuno v. DaimlerChrysler Inc.*, which found that portions of Ohio’s tax code were unconstitutional.

At issue were Ohio’s manufacturing and equipment investment tax credit and a related property tax exemption. Although the *Cuno* court upheld the property tax exemption, it found that the machinery and equipment investment tax credit discriminated against out-of-State activity, in violation of the so-called “Dormant Commerce Clause.”

The Dormant Commerce Clause is a judicial construct designed to limit States’ ability to regulate interstate commerce, either expressly or implicitly, because such authority is vested in Congress by Article I, Section A, Clause 3 of the Constitution.

Although the Sixth Circuit stayed its decision until the Supreme Court determines whether it will hear the case, it has left States uncertain as to what their options are for attracting businesses. For example, the *Cuno* court acknowledged that under Supreme Court precedent, if Ohio had chosen to directly subsidize DaimlerChrysler’s purchase of manufacturing equipment, it likely could have done so without violating the Dormant Commerce Clause; even though the net effect to DaimlerChrysler’s business would have been the same.

Similarly, the *Cuno* court upheld Ohio’s personal property tax exemption against a Dormant Commerce Clause challenge, while striking down the investment tax credit; even though both taxes encouraged DaimlerChrysler to purchase manufacturing equipment and locate it in Ohio.

I look forward to hearing from our two legal experts today, Professors Hellerstein and Zelinsky, to see if they can shed some light on the Dormant Commerce Clause distinction between discriminatory, and hence unconstitutional, tax incentives, and non-discriminatory, and thus lawful, tax incentives; as well as the distinction between tax incentives and direct subsidies.

I also look forward to hearing from all of our witnesses views on potential legislative remedies; especially the proposal introduced by



Representative Tiberi of Ohio that would allow States to continue to use the kind of investment tax credits that were invalidated in the *Cuno* decision.

We all recognize that incentive packages for businesses can sometimes be controversial, and this hearing is not intended to lend a stamp of approval to every deal struck by a State or local government. However, we live in an increasingly competitive market for job creation that is no longer limited to the 50 States, but also includes foreign countries. States should have the ability to make their own decisions on these issues, in order to stay competitive.

The Sixth Circuit's *Cuno* decision takes Ohio, Michigan, Kentucky, and Tennessee out of the game, and places them at a distinct disadvantage, both at home and abroad. As an editorial from my home-town paper, the Cincinnati Inquirer, suggested yesterday, "Congress should give more legal certainty to State tax incentives and let States craft tax codes as they think best to attract more jobs."

With that in mind, I think we all look forward to hearing from all of our witnesses today. And again, thank each and every one of you for being here today. And at this time, is there a Democrat—Mr. Scott, did you want to make a statement for your side?

Mr. SCOTT. Mr. Chairman, I would ask unanimous consent that Mr. Nadler and Mr. Watt, when they arrive, be given the opportunity to make a statement.

Mr. CHABOT. Okay. Without objection, so ordered. And the gentleman who is co-chairing this hearing, the Chairman of the Subcommittee on Commercial and Administrative Law, Chris Cannon from Utah, will now make an opening statement.

Mr. CANNON. Thank you, Mr. Chairman. I am pleased to co-chair this hearing with my distinguished colleague from Ohio, Mr. Chabot, on a subject very important to my Subcommittee and one of increasing relevance in an era that has seen the rise in development of technology on a scale unimagined by our forebears.

With the proliferation of international economic competition, the Congress must take an active role to ensure that the United States can and will meet the challenges of the modern world; but also bearing in mind that ours is a Federal system, and States can be our best partners in this critical task.

When States take positive actions to foster economic development, they should be encouraged. When States take reasonable steps to lower the tax burden that might otherwise stifle economic development, they should likewise be encouraged. And when States recognize the importance of emerging technologies to their own economic growth and vitality, they should be encouraged in their efforts to develop those technologies.

This year, the Subcommittee on Commercial and Administrative Law will consider similar proposals dealing with State taxation affecting interstate commerce, one of which will be the legislation relevant to this hearing. In the past, the Subcommittee has considered many issues concerning State taxation, including legislation establishing a moratorium on the imposition of access and discriminatory taxes upon the Internet, legislation defining the venue for purposes of State taxation based upon business activities, legisla-

tion dealing with the taxation of non-residents working incidentally and intermittently in the taxing State, and legislation restricting State taxation of pension income paid to non-residents.

Underpinning our deliberations has always been an appreciation that the Constitution grants authority over interstate commerce to Congress. And that could be no other way. If States were left to their own devices, the nation would long ago have failed, mired in a quagmire of economic and commercial division.

The Founding Fathers granted constitutional authority to Congress over interstate commerce was virtually a self-evident proposition for our Federal nation to succeed. The wisdom of that proposition has been borne out by what we've accomplished as one of the most prosperous nations in the history of the world.

But while Congress has the authority, it also necessarily has the discretion as to when and how best to exercise that authority. As I have noted, when States act consistent with sound principles to encourage positive economic development for the common good, the Congress should first listen and learn before presuming those States have reached beyond the essential self-evident proposition established by the Founding Fathers.

I look forward to the testimony today and the analysis and guidance that such a distinguished panel can provide, and yield back the balance of my time.

Mr. CHABOT. Thank you very much, Chairman Cannon. Are there any other Members on either side that would like to make an opening statement?

[No response.]

Mr. CHABOT. Okay. If not, we will go to the witnesses. And without objection, all Members will have five legislative days to submit additional materials for the hearing record.

And I'd now like to introduce our very distinguished panel of witnesses here this morning. Our first witness is the Honorable Bruce Johnson, the Lieutenant Governor of the State of Ohio. Lieutenant Governor Johnson was appointed to that position by Governor Bob Taft in January 2005.

Prior to becoming Lieutenant Governor, he served in the Ohio State Senate, where he became the youngest Chairman of a Committee in State history when he was appointed to chair the Senate Judiciary Committee.

Lieutenant Governor Johnson is testifying today in his capacity as the Director of the Ohio Department of Development, where he is responsible for coordinating Ohio's economic development efforts, including the administration of the investment tax credits at issue in *Cuno v. DaimlerChrysler, Inc.* And we welcome you here this morning, Lieutenant Governor.

Our second witness is Michele Kuhrt, who is the Director of Taxes and Financial Administration for the Lincoln Electric Company of Cleveland, Ohio. Ms. Kuhrt is a graduate of Case Western Reserve University, also in Cleveland, Ohio, where she earned both a bachelor's and master's degree in accounting.

In her capacity as Director of Taxes and Financial Administration, Ms. Kuhrt is responsible for assessing the impact of various State and municipal tax regimes in determining where Lincoln

Electric should expand its operations. And we welcome you here this morning, Ms. Kuhrt.

Our third witness is Professor William [sic] Hellerstein. Is that correct?

Mr. HELLERSTEIN. Walter Hellerstein.

Mr. CHABOT. Is it "stine" or "steen?"

Mr. HELLERSTEIN. "Stine."

Mr. CHABOT. "Stine." I apologize, professor.

He is the Francis Shackelford Distinguished Professor of Taxation Law at the University of Georgia School of Law. Professor Hellerstein received his bachelor's degree, magna cum laude, from Harvard College, and his law degree from the University of Chicago Law School, where he was editor-in-chief of the Law Review.

Professor Hellerstein teaches State and local taxation, international taxation, and Federal income taxation, and has been published in numerous journals and law reviews. And we welcome you here this morning, professor.

Our fourth and final witness is Professor Edwin [sic] A. Zelinsky, of the Benjamin N. Cardozo School of Law of the Yeshiva University in New York City, where he teaches tax law. Professor Zelinsky is a graduate of the Yale College, where he graduated summa cum laude; as well as the Yale Law School, where he received his law degree; and Yale graduate school, where he earned both a master's degree and a master of philosophy in economics.

Professor Zelinsky has been published in a number of scholarly journals, and has been a visiting professor at several distinguished law schools, including Yale Law School, Columbia Law School, and the NYU School of Law.

Again, we want to welcome all of the witnesses, and we look forward to hearing from each one of you. And it's the practice of this Committee to swear in all witnesses appearing before it, so if you would all please stand and raise your right hands.

[Witnesses sworn.]

Mr. CHABOT. Thank you very much, and you can be seated. And we'll now hear from the first witness. And I might first of all make sure that you're aware of our 5-minute rule. You've probably already been notified by our staff. But we have a lighting system there. The green light will be on for 4 minutes; a yellow light will let you know when there's one remaining; and then the red light will come on. We won't gavel you down immediately upon the red light coming on, but we'd ask that you wrap up your testimony in as short an order as possible. And then we'll be questioning after that.

So Lieutenant Governor Johnson, you're recognized for 5 minutes.

**TESTIMONY OF THE HONORABLE BRUCE JOHNSON,  
LIEUTENANT GOVERNOR OF THE STATE OF OHIO**

Mr. JOHNSON. Thank you, Mr. Chairman, Chairman Chabot and Chairman Cannon, and to the other distinguished Members of this Subcommittee. My name is Bruce Johnson. I do serve as the Lieutenant Governor and the State Development Director of Ohio.

I'm here today to talk specifically about economic development incentives, how they help grow Ohio's economy, and the chilling ef-

fect of recent court—the recent court case has on business development in Ohio.

I am pleased to be the development director. Ohio's access to North American markets, our skilled and dedicated workforce, and our history of innovation provide great selling points as we seek to attract new business to our State, and grow the business that is already located there.

However, the uncertainty created by a recent Federal court decision has made my job more difficult. In September, the U.S. Court of Appeals for the Sixth Circuit struck down one of Ohio's most popular incentive programs, the Ohio Manufacturing Machinery and Equipment Tax Credit. The M&E tax credit, as we call it, encourages companies to invest in new machinery and equipment by offering them a break on their corporate franchise tax bill.

The case came about after a group of taxpayers opposed our involvement in a 1998 expansion of DaimlerChrysler's Jeep facility in Toledo. In order to protect more than 4,000 jobs, we offered this \$1.2 billion expansion project an incentive package that included up to \$96 million in M&E tax credits. In September 2004, in what has become known as the *Cuno* case, the Sixth Circuit Court found that the M&E tax credit portion of our incentive package unconstitutional.

We live in an increasingly global marketplace, where a company's very survival depends on its ability to be lean and efficient. This market demands that I be able to offer incentives in order for Ohio to compete against its regional neighbors; not only with other States, but also countries like Canada and Mexico. Case in point: Ontario, Canada, lists Ohio as one of its chief competitors, and offers at least nine tax incentives to encourage investment. You can find them on their website.

Last year, my department completed projects with more than 193 companies committed to locating or expanding in our State. These companies committed to creating or retaining 53,000 jobs, with an average hourly wage of approximately \$17, representing nearly \$3.4 billion in combined investment in our State. In all, we offered these projects more than \$200 million in various incentives, ranging from tax credits to training grants.

We believe the flexibility to put together aggressive, customized incentive packages is critical to securing these projects. Take for example projects like Lab One's \$18.4 million expansion of its laboratory facilities in Cincinnati, or the United States Enrichment Corporation's decision to invest \$1.1 billion creating 500 high-paying jobs in rural southern Ohio. Ohio won out over facilities in Asia and Mexico when the Whirlpool Corporation chose to invest \$143 million in several Ohio facilities.

The M&E tax credit, available to any company investing in new manufacturing equipment in Ohio, is an important incentive. Since the credit's inception in 1995, the department has received more than 18,000 filings claiming eligibility for the credit.

These filings show that companies invested \$34.2 billion in new machinery and equipment, making them eligible for more than \$2 billion in credits through our system. These investments are critical to the economic prosperity of Ohio because, quite simply, in manufacturing today jobs follow investments.

Is the availability of a single tax credit alone going to bring more jobs to Ohio? Probably not. But a State's right to develop packages may very well be a factor that tips the scale in favor of one investment over another.

In addition, I believe there is a concern that the court's ruling could easily lead to questions on other types of incentives; not only in Ohio, but elsewhere, as well. Jay Biggins, who is a national expert on incentives, says that, "The implications of *Cuno* will spread nationwide," and also, "Some of our clients have already decided to eliminate jurisdictions from the short list because their incentive programs could be at risk under the *Cuno* decision."

Simply put, Ohio's ability to secure economic prosperity for our citizens is being hampered. And therein lies the bigger issue. I firmly believe that it's a State's right, a State's duty, to pursue prosperity for its citizens. And by striking down the M&E tax credit, the Sixth Circuit has infringed upon that right. I believe the court has come to the wrong conclusion in attempting to interpret congressional silence on this matter. The good news is that the issue does not need to be—continue to remain dormant.

Congress has the authority to weigh in on the matter, and I would encourage this panel to do so. I appreciate the Chairman's supportive comments. To help secure the prosperity of Ohio's citizens and the citizens of all States, legislation should be enacted that returns the power to regulate these credits to the States.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Johnson follows:]

PREPARED STATEMENT OF BRUCE JOHNSON

Good Morning. My name is Bruce Johnson and I serve as Lt. Governor and State Development Director of Ohio. I am here today to talk specifically about economic development incentives, how they help grow Ohio's economy and the chilling effect a recent court case has on business.

I am blessed to be the Development Director. Ohio's access to the North American market, our skilled and dedicated workforce, and our history of innovation provide great selling points as we seek to attract new business to our state.

However, the uncertainty created by a recent federal court decision has made my job more difficult. In September, the U.S. Court of Appeals for the Sixth Circuit struck down one of Ohio's most popular incentive programs, the Ohio Manufacturing Machinery and Equipment Tax credit. The M&E tax credit, as we call it, encourages companies to invest in new machinery and equipment by offering them a break on their corporate franchise tax bill.

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We live in an increasingly global market place, where a company's very survival depends on its ability to be lean and efficient. This market demands that I be able to offer incentives in order for Ohio to compete, not only with other states but also with countries like Canada and Mexico. Case in point-Ontario, which lists Ohio as a chief competitor, offers at least nine tax incentives to encourage investment. (<http://www.2ontario.com/software/brochures/Taxation.asp>)

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LabOne's \$18.4 million expansion of its laboratory facilities in Cincinnati or the United States Enrichment Corporation's decision to invest \$1.1 billion to create 500 high-paying jobs in rural, Southern Ohio. And Ohio won out over facilities in Asia and Mexico when the Whirlpool Corporation chose to invest \$143 million in several Ohio facilities.

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Is the availability of a single tax credit alone going to bring more jobs to Ohio? Probably not. But a state's right to develop incentive packages may very well be the factor that tips the scale. In addition, I believe there is concern that the court's ruling could easily lead to questions on other types of tax incentives, not only in Ohio, but elsewhere as well. Jay C. Biggins, national expert in incentives states, "the implications of *Cuno* also will spread nationwide," and also, quote "Some of our clients already have decided to eliminate jurisdictions from the 'short list' because their incentives programs could be at risk under *Cuno*."

Simply put, Ohio's ability to secure economic prosperity for our citizens is being hampered. And therein lies the bigger issue. I firmly believe that it is a state's right, and duty, to pursue prosperity for its citizens, and by striking down the M&E Tax Credit, the Sixth Circuit has infringed upon that right. I believe the court has come to the wrong conclusion in attempting to interpret Congressional silence on this matter. The good news is that this issue does not need to continue to remain dormant.

Congress has the authority to weigh in on the matter and I encourage this panel to do so. To help secure the prosperity of Ohio's citizens, and the citizens of all states, legislation must be enacted that returns the power to regulate tax credits to the states.

Mr. CHABOT. Thank you very much, Lieutenant Governor Johnson. And before we get to our second witness, we will recognize the Ranking Member of the Subcommittee on the Constitution, Congressman Nadler, for the purpose of making an opening statement.

Mr. NADLER. A very brief opening statement. Thank you, Mr. Chairman. I want to welcome the panel, and especially Professor Zelinsky, who teaches in my district.

This issue is especially vexing to Members of this Committee who are trying to make sense of the current state of the law. As the witnesses made clear, there is nothing clear about the court's current jurisprudence. Each one of us has been involved in local matters for years, and we all have strong views on the advisability of various business tax incentives—various business incentives, including tax incentives. That's probably a debate for another day.

I hope that our witnesses will be able to shed some light on the current state of the law, such as it is, and the options that Congress may have in considering what actions, if any, to take.

I told you the opening statement would be brief. That's it. Thank you, Mr. Chairman.

Mr. CHABOT. Thank you very much, Mr. Nadler.

Ms. Kuhrt, you're recognized for 5 minutes.

**TESTIMONY OF MICHELE R. KUHRT, DIRECTOR OF TAXES AND FINANCIAL ADMINISTRATION, THE LINCOLN ELECTRIC COMPANY, CLEVELAND, OH**

Ms. KUHRT. Thank you. Good morning Chairmen Cannon and Chabot and Members of the Subcommittees. I'm Michele Kuhrt, Director of Taxes and Financial Administration at the Lincoln Electric Company in Cleveland, Ohio. I'm pleased today to have the op-

portunity to testify about my company's experience with the Ohio manufacturer's tax credit and how it's impacted our business planning.

First, let me say, for those of you when you hear the name "Lincoln Electric," we're not a utility company. Lincoln Electric is a 110-year-old Cleveland-based manufacturing company, and the world leader in design, development, and manufacturing of arc welding and cutting products. Our major operations and headquarters are in Cleveland, Ohio. We employ over 3,200 people. We also have manufacturing sites in California and Georgia, and 26 international manufacturing locations.

Lincoln has a strong track record of providing excellent-paying, secure manufacturing jobs for generations of workers in the Cleveland area. Unlike many manufacturers, Lincoln Electric has never laid off an employee. Our guaranteed lifetime employment policy provides that after 3 years of continuous employment our workers can rest assured that the tides of the business cycle will not leave them without work. Our piece-work and company-wide bonus programs allow Lincoln employees to take a great deal of their personal fortune into their own hands. This incentive management philosophy has been the basis of a number of business studies and one of the most widely used studies at the Harvard Business School.

The Ohio manufacturer's tax credit has played an important role in determining where Lincoln deploys its capital. Without this credit, our investments in Ohio certainly would have been less. Since 1995, when the Ohio manufacturer's credit began, Lincoln's capital expenditures in Ohio have exceeded a quarter of a billion dollars.

In recent years, we have added significant manufacturing capacity, physical expansion to our buildings, knocked down walls, added space to our plants in Ohio, including new lines to manufacture welding equipment, consumables, filler rods, flux cored welding wire, and expanded our steel processing abilities.

Each of our investment decisions is evaluated based on a number of return-on-investment criteria; taxes being one of them. In many analyses we prepare, taxes are a significant and sometimes deciding factor on where we locate our capital. The Ohio manufacturing credit is an important benefit to Lincoln Electric, and one that has tipped the scales in many of our investment decisions.

Another thing to think about is that the global economy also forces us to consider investment opportunities outside the U.S., particularly in low-cost manufacturing locations. Many of these locations offer exceptional tax incentives, low wages, and no litigation costs. For a company with a culture like Lincoln Electric, our preference is to create jobs in the U.S. Frankly, we excel at manufacturing here. However, the economic factors present in many of the other jurisdictions can make an investment decision to locate outside the U.S. overwhelming.

Keep in mind, too, that from the State of Ohio's perspective, I think the Ohio manufacturer's credit is ingenious from the State's perspective, because Lincoln investments in Ohio actually create revenue as well as new jobs in Ohio. Our Ohio investments increase the State's revenue from personal property tax, corporate in-

come tax, and what I believe most significantly is the individual income taxes that those jobs create when those employees are paid.

In this respect, the State's tax incentives are by no means a give-away. They're a calculated, wise, one-time investment made by the State, with an unusually high rate of return, given the recurring nature of the tax revenues that they generate.

For example, some of the expansions I spoke of earlier allowed Lincoln to hire 481 new employees in Ohio. It added payroll of \$42 million year over year in Ohio. And I estimated, in using some very conservative calculations, a recurring individual income tax revenue of a million dollars for the State of Ohio.

In return, Ohio gave Lincoln Electric a \$250,000-a-year credit for 7 years—not a bad deal for Ohio. In the end, Ohio made a very wise choice in investing in Lincoln Electric. And remember, this does also not include other income taxes and personal property taxes that the State of Ohio received, as well as the municipal income tax for the city of Euclid, at 2.85 percent, that that municipality received on those wages, as well.

As we speak, Lincoln is planning a \$20 million expansion of our consumable manufacturing capabilities, and evaluating locations in Ohio, Mexico, and Canada. The tax liability associated with operating in each of these jurisdictions is vastly different. And we currently cannot rely on the manufacturing credit in Ohio, given the *Cuno* decision.

We do like doing business in the U.S., and in Ohio. All other economic factors being close, we prefer it. But we can't afford to stay without the cooperation of Federal, State, and local governments. Our jurisdictions—other jurisdictions are in competition for corporate investment dollars, and these governments see our weaknesses and have been aggressive in pursuing those investment dollars outside the U.S.

State tax incentives like the Ohio manufacturer's credit are in many cases a critical factor for companies like Lincoln Electric to construct new facilities, buy equipment, and hire additional workers.

Thank you for your interest in this issue and supporting legislation that would ensure that States can continue to provide tax relief that spurs economic development. Thank you again, and I look forward to any questions you might have.

[The prepared statement of Ms. Kuhrt follows:]



PREPARED STATEMENT OF MICHELE R. KUHRT

**Testimony of  
Michele R. Kuhrt  
Director of Taxes and Financial Administration  
The Lincoln Electric Company  
Cleveland, Ohio**

**Before the  
House Judiciary Subcommittees on Commercial and Administrative  
Law and the Constitution**

**May 24, 2005**

Good morning, Chairmen Cannon and Chabot and members of the subcommittees. I am Michele Kuhrt, Director of Taxes and Financial Administration at The Lincoln Electric Company in Cleveland, Ohio.

I am pleased to have the opportunity to testify today about my company's experience with the Ohio manufacturer's tax credit and how it has impacted our business planning.

Lincoln Electric is a 110-year old Cleveland-based manufacturing company and the world leader in the design, development and manufacture of arc welding and cutting products. Our major operations and headquarters are located in Ohio, where we employ over 3,200 people. Lincoln also has U.S. manufacturing sites in California and Georgia, and 26 international manufacturing locations.

Lincoln has provided excellent-paying, secure manufacturing jobs for generations of workers in Greater Cleveland. Unlike many manufacturers, Lincoln has never laid-off an

employee. Our guaranteed lifetime employment policy provides that after three years of employment, our workers can rest assured that the tides of the business cycle will not leave them without work. Our piece-work and company-wide bonus programs allow Lincoln employees to take a great deal of their personal fortune in their own hands. This incentive management philosophy has been the basis for a number of business case histories studied in business schools around the world and is one of the most widely used case studies at the Harvard Business School.

The Ohio manufacturer's tax credit has played a major role in determining where to deploy our capital. Without this tax credit, our investments in Ohio would certainly have been less. Since 1995 when the Ohio manufacturing credit began, Lincoln Electric's capital expenditures in Ohio have exceeded one-quarter of a billion dollars. In recent years, we have added significant manufacturing capacity and physical expansion to our plants in Ohio, including new lines to manufacture welding consumables, such as filler rod and flux cored welding wire, and new equipment to expand our steel processing capabilities.

Each investment decision was evaluated based on a number of return-on-investment criteria, including taxes. In many of the investment analyses we prepare, taxes are a significant and, in some cases, a deciding factor on where to locate our capital. The Ohio manufacturing credit is an important benefit to Lincoln Electric, one that has "tipped the scales" in several investment evaluations.

The global economy also forces us to consider investment opportunities outside the United States, particularly in low-cost manufacturing locations. Many other locations offer exceptional tax incentives, low wages and no litigation costs. For a company with a culture like Lincoln Electric, our preference is to create jobs inside the United States – we excel in manufacturing here. However, the economic factors presented by many other jurisdictions can make an investment decision to locate outside the United States overwhelming.

Keep in mind that, from a State of Ohio perspective, Lincoln's investments create tax revenue as well as new jobs. Our Ohio investments increase the State's revenue from personal property tax, corporate income tax, and, what I believe most significant for the state, the individual income tax generated from the new job creation. In this respect, the state's incentives are by no means a "give-away" – they are a calculated and wise one-time investment made by the State with an unusually high return given the recurring nature of the tax revenues they generate.

For example, the expansions I mentioned earlier allowed Lincoln to hire 481 new employees in Ohio. This added Ohio payroll of \$42 million year-over-year. I estimate the additional wage base provided Ohio new, recurring individual income tax revenue of \$1 million each year. In return for this new revenue, the State of Ohio gave Lincoln a manufacturer's credit of \$250,000 a year for seven years. In the end, the State of Ohio made a wise investment in Lincoln Electric. And remember this example does not consider the impact of additional State corporate income tax, use tax and personal

property tax related to the same investment. Likewise, the municipality of Euclid earned 2.85% on the additional payroll. In the end, it's an excellent deal for the State of Ohio.

As we speak, Lincoln Electric is planning a \$20 million expansion of our consumable manufacturing capabilities, and evaluating locations in Ohio, Mexico and Canada. The tax liability associated with operating in each of these jurisdictions is vastly different. And we currently cannot rely on the continuation of the manufacturing credit in Ohio given the *Cuno* decision.

We like doing business in the United States and in Ohio – all other economic factors being close, we prefer it. But we can't afford to stay without the cooperation of the Federal, State and Local governments. Other jurisdictions are in competition for corporate investment dollars. They see our government's weakness and have been very aggressive in pursuing those investments outside the United States.

Conclusion:

State tax incentives, like the Ohio manufacturer's tax credit, in many cases are a critical factor for companies like Lincoln Electric to construct new facilities, buy new equipment, and hire additional workers. Thank you for your interest in this issue and for supporting legislation that would ensure that states can continue to provide tax relief that helps spur economic development.

Thank you again for this opportunity and I look forward to answering any questions you may have.

Mr. CHABOT. Thank you very much; appreciate your testimony. Professor Hellerstein, you're recognized for 5 minutes.

**TESTIMONY OF PROFESSOR WALTER HELLERSTEIN,  
UNIVERSITY OF GEORGIA SCHOOL OF LAW**

Mr. HELLERSTEIN. Thank you, Mr. Chairman. I'm honored by the Chairman's and the Ranking Member's invitation to testify, and I'm really grateful to the Subcommittee.

Mr. CHABOT. Could you pull the mike a little bit closer? Thank you.

Mr. HELLERSTEIN. Yes, I was saying that I'm grateful for the Chairman's invitations; honored by them. I also thank the Committee for holding a hearing on this very, very important topic of the viability of State tax incentives.

My testimony is devoted to three questions. First, what was the state of Dormant Commerce Clause law prior to *Cuno*? Was *Cuno* an aberration? And what can Congress do about the present state of affairs?

On the state of the Dormant Commerce Clause before *Cuno*, the fact of the matter is that there was a substantial body of law that invalidated many tax provisions that, broadly speaking, would be considered to be tax incentives.

When New York wanted to attract more sales to the New York Stock Exchange, they wanted to offer it at a lower rate to take it to the exchange. The court said, "That's unconstitutional." When Ohio wanted to develop its ethanol industry and give a credit for the use of Ohio-produced ethanol, the court struck that down as unconstitutional.

When New York and Wisconsin said, "Look, if you invest in New York and Wisconsin, we'll give you the accelerated depreciation, not if you invest somewhere else," kind of analogous to *Cuno*, courts—not the Supreme Court, but lower courts in New York and Wisconsin—struck that down.

So fair to say, we have a broad body of law out there that was invalidating provisions that people would have regarded as State tax credits.

That brings me to *Cuno*. Was *Cuno* an aberration? I have to say, "No." I wrote an article<sup>1</sup> which the court cited to reach its decision. So I think that *Cuno* really fits into the preexisting doctrine.

Is my way the only way of looking at the doctrine? Absolutely not. Professor Zelinsky here has a view that would, I think, suggest that most incentives are constitutional. Professor Enrich, who litigated *Cuno*, has the view that says that all of them are unconstitutional. We kind of came down in the middle.

But the point about which all of us can agree is that the law is a mess. It's indeterminate. And I think it's fair to say that even the court calls it a quagmire.

That brings me to the third question, which I think is the most important one for this panel: What can Congress do about this mess? First, you can do nothing. If you do nothing, what's going to happen? There'll be, I think, years, decades, maybe centuries of un-

<sup>1</sup>See Walter Hellerstein and Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 31 Cornell L. Rev. 789-878 (1996).

certainty, as credits get litigated on this piecemeal basis. Some will be upheld; some will be sustained; some struck down. But I think we'll have continuing uncertainty.

If the court denies certiorari in *Cuno*, I think matters will be even worse. As we've already heard testimony, Ohio and Tennessee and Michigan and Kentucky are now laboring under the yoke of *Cuno*; where maybe in other jurisdictions they'll say, "Gee, this stuff is okay." So you'll have disparate laws in different States.

Even if the court grants cert in *Cuno*, really, the court decides narrow cases. It limits it to the facts. It leaves to another day other issues. So even if they resolve *Cuno* and bring some relief—or maybe not relief—to the taxpayers, depending on what they decide, it's not going to solve the broader problem.

So Congress could do a third—Congress may not do anything. Maybe you'll legislate narrowly. That's a second option for Congress, instead of doing nothing.

Why not just reverse *Cuno*, or if you like *Cuno*, make it the law of the land; but at least make it clear. That would, I think, have some benefit, in that it would clarify the uncertainty. The problem is, as I've suggested earlier, there's a broad range of incentives out there, not just the ITC, the investment tax credit in Ohio, that I think need attention because the uncertainty exists for all of them.

So it seems to me there's a third option, which is for Congress to legislate more broadly, to clarify this area. And I think, frankly, the Voinovich and Tiberi bills really do that. What they do is they—Congress is in effect saying, "There's a certain class of incentives that are acceptable." It makes the law clear.

I think at the same time, it's important for Congress not—for Congress to preserve, or at least not to disturb, the core principle of non-discrimination. I don't think anybody wants to start a new set of trade wars. And again, I think the Voinovich and Tiberi bills do that.

They don't—they leave undisturbed, I think, some types of tax provisions that I think most of us would regard as raising serious constitutional concerns. Georgia shouldn't be able to say that, "We're only going to, you know, tax South Carolina peanuts, but not Georgia peanuts." So some things I think should be left undisturbed.

But I think Congress has a role here to clear up the uncertainty; not to abandon the non-discrimination principle altogether, but to make the law clear, to make it understandable for everyone.

If Congress does nothing, I think you're going to leave it to taxpayers, tax administrators, State legislatures, simply to speculate as to whether, on a case-by-case basis, some court is going to say that this provision is invalid because it, to use the court's terms, forecloses tax-neutral decisions; or that this provision is okay because it's simply an appropriate structuring of State tax law to attract business to the State.

I will be happy to answer questions when the time comes. Thank you.

[The prepared statement of Mr. Hellerstein follows:]

PREPARED STATEMENT OF WALTER HELLERSTEIN

**Testimony of Walter Hellerstein**

**on**

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

**Before the**

**Subcommittee on the Constitution**

**and the**

**Subcommittee on Commercial and Administrative Law**

**Of the**

**Committee on the Judiciary  
United States House of Representatives**

**May 24, 2005**

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

I am honored by the Chairmen's and the ranking minority Members' invitation to testify today. I welcome the opportunity to share with the Subcommittees my views on the restraints that the dormant Commerce Clause imposes on state tax incentives to encourage in-state economic development and on the options available to Congress to modify those restraints. I do not appear here on behalf of any client, public or private, and the views I am expressing here today reflect my independent professional judgment.

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

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

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

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

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



## A. U.S. Supreme Court Precedents

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

1. *Boston Stock Exchange*

In *Boston Stock Exchange v. State Tax Commission*,<sup>3</sup> the Court considered the constitutionality of an amendment to a New York stock transfer tax that created an incentive designed to assist New York stock exchanges. The tax applied to all *transfers* of stock regardless of where the *sale* occurred; because the lion's share of stock transfers was effectuated through New York transfer agents, the tax applied to most stock transfers, even when the sale was effectuated through a non-New York exchange. To encourage stock purchasers to use New York exchanges, the statute was amended to provide reduced rates for certain transfers of stock when the *sale* was made within New York, *i.e.*, on a New York exchange. The Court found that this reduction in tax liability, designed to encourage in-state business activity, offended the Commerce Clause's nondiscrimination principle.

Prior to the statute's amendment, the New York transfer tax was "neutral as to in-state and out-of-state sales"<sup>4</sup> because, regardless of where the sale occurred, the same tax applied to all securities transferred through a New York transfer agent. The amendment, however, "upset this equilibrium"<sup>5</sup> because a seller's decision as to where to sell would no longer be made "*solely* on the basis of *nontax* criteria."<sup>6</sup> Instead, a seller would be induced to trade through a New York exchange to reduce his or her transfer tax liability.

By providing a tax incentive for sellers to deal with New York rather than out-of-state exchanges, the state had, in the Court's eyes, "*foreclose[d] tax-neutral decisions.*"<sup>7</sup> Moreover, it had done so through the coercive use of its taxing authority. As the Court noted, "the State is using its power to tax an in-state operation as a means of requiring other business operations to be performed in the home State."<sup>8</sup>

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<sup>3</sup> 429 U.S. 318, 329 (1977).

<sup>4</sup> *Id.* at 330.

<sup>5</sup> *Id.*

<sup>6</sup> *Id.* at 331 (emphasis supplied).

<sup>7</sup> *Id.* at 331 (emphasis supplied).

<sup>8</sup> *Id.* at 336.

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

## 2. *Bacchus*

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

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

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<sup>9</sup> *Id.* at 336.

<sup>10</sup> 468 U.S. 263 (1984).

<sup>11</sup> *Id.* at 271.

<sup>12</sup> *Id.*

<sup>13</sup> *Id.* at 273.

<sup>14</sup> *Id.* at 271.

<sup>15</sup> *Id.* at 272.

<sup>16</sup> *Id.*

3. *Westinghouse*

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

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

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

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<sup>17</sup> 466 U.S. 388 (1984).

<sup>18</sup> I.R.C. §§ 991-97. In 1984, Congress largely repealed the DISC legislation.

<sup>19</sup> *Westinghouse*, 466 U.S. at 392.

<sup>20</sup> *Id.* at 392-93.

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

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

<sup>23</sup> *Westinghouse*, 466 U.S. at 394.

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

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

#### 4. *New Energy*

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

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

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<sup>25</sup> *Id.* at 406 (quoting *Boston Stock Exch. v. State Tax Comm’n*, 429 U.S. 318, 331 (1977)).

<sup>26</sup> *Id.* at 404.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Id.* at 406.

<sup>30</sup> *Id.* (quoting *Boston Stock Exch. v. State Tax Comm’n*, 429 U.S. 318, 331 (1977)).

<sup>31</sup> 486 U.S. 269 (1988).

<sup>32</sup> *Id.* at 274.

<sup>33</sup> *New Energy*, 486 U.S. at 278.

“direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does.”<sup>34</sup>

#### B. Other Federal and State Court Precedents

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

- The United States Court of Appeals for the Fifth Circuit held that a property tax exemption for new manufacturing establishments, limited to taxpayers maintaining an 80 percent in-state work force and using 80 percent in-state materials, discriminates against interstate commerce.<sup>35</sup>
- The District of Columbia Court of Appeals held that a property tax exemption for personal property used by a telecommunications company to produce taxable gross receipts and a sales tax exemption for property purchased by a telecommunications company for use in producing services subject to gross receipts tax discriminate against interstate commerce.<sup>36</sup>
- The Florida Supreme Court held that a tax preference for alcoholic beverages made from citrus fruits and other agricultural products grown primarily, though not exclusively, within the state discriminates against interstate commerce.<sup>37</sup>
- The Florida Supreme Court held that a corporate income tax credit for fuel taxes limited to Florida-based air carriers discriminates against interstate commerce.<sup>38</sup>
- The Illinois Supreme Court held that a tax preference for gasohol made from products that were used by almost all in-state producers but not many out-of-state producers discriminates against interstate commerce.<sup>39</sup>
- The Maryland Court of Special Appeals held that an exemption from state corporate income tax for DISC dividends if at least 50 percent of the net taxable

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<sup>34</sup> *Id.*

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

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

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

<sup>38</sup> *Delta Air Lines, Inc. v. Department of Revenue*, 455 So. 2d 317 (Fla. 1984).

<sup>39</sup> *Russell Stewart Oil Co. v. Department of Revenue*, 529 N.E.2d 484 (Ill. 1988).

income of the DISC is subject to taxation in the state discriminates against interstate commerce.<sup>40</sup>

- The Minnesota Supreme Court held that a tax reduction for gasohol produced in the state discriminates against interstate commerce.<sup>41</sup>
- The Minnesota Tax Court held that an exemption from sales tax with respect to receipts from leases of flight equipment if lessees made three or more flights into the state discriminates against interstate commerce.<sup>42</sup>
- The Missouri Supreme Court held that the requirement that an affiliated group of corporations derive at least 50 percent of its income from sources within the state in order to file a consolidated income tax return discriminates against interstate commerce.<sup>43</sup>
- The Nevada Supreme Court held that a sales and use tax exemption for aircraft leased to air carriers headquartered in Nevada, but not to air carriers headquartered outside the state, discriminates against interstate commerce.<sup>44</sup>
- The New Mexico Court of Appeals held that a gasoline excise tax deduction for ethanol-blended gasoline manufactured exclusively within the state discriminates against interstate commerce.<sup>45</sup>
- The New York Court of Appeals held that a deduction for access charges paid by long-distance telephone companies to local telephone companies, which is reduced only for interstate long-distance companies by their state apportionment percentage, discriminates against interstate commerce.<sup>46</sup>
- The New York Appellate Division held that an accelerated depreciation deduction limited to in-state property discriminates against interstate commerce.<sup>47</sup>

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<sup>40</sup> *Comptroller of the Treasury v. Armco, Inc.*, 521 A.2d 785 (Md. Ct. Spec. App. 1987).

<sup>41</sup> *Archer Daniels Midland Co. v. State ex rel. Allen*, 315 N.W.2d 597 (Minn. 1982).

<sup>42</sup> *Northwest Aerospace Training Corp. v. Commissioner of Revenue*, 1995 WL 221639 (Minn. Tax Ct. 1995).

<sup>43</sup> *General Motors Corp. v. Director of Revenue*, 981 S.W.2d 561 (Mo. 1998).

<sup>44</sup> *Worldcorp v. Nevada Dep't of Tax'n*, 944 P.2d 824 (1997).

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

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

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

- The Wisconsin Supreme Court held that an exemption from an occupation tax on iron ore dock operators for iron ore taxed under the occupation tax imposed on local mineral producers discriminates against interstate commerce.<sup>48</sup>
- The Wisconsin Tax Appeals Commission held that an accelerated depreciation deduction limited to in-state property discriminates against interstate commerce.<sup>49</sup>

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

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

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

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

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

<sup>49</sup> *Beatrice Cheese, Inc. v. Wisconsin Dep't of Revenue*, 1993 WL 57202 (Wis. Tax App. Com. 1993).

<sup>50</sup> 386 F.3d 738 (6<sup>th</sup> Cir. 2004).

<sup>51</sup> *Id.* at 743.

<sup>52</sup> *Id.* at 746.

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

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

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

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

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<sup>53</sup> *Id.*

<sup>54</sup> *Id.* at 746.

<sup>55</sup> *Id.* at 747

<sup>56</sup> *Id.* at 747 (citing Walter Hellerstein & Dan T. Coenen, “Commerce Clause Restraints on State Business Development Incentives,” 81 *Cornell Law Review* 789, 806-09 (1996)).



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

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

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

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

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

<sup>57</sup> Peter D. Enrich, “Saving the States From Themselves: Commerce Clause Restraints on State Tax Incentives for Business,” 110 *Harv. L. Rev.* 377 (1996).

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

would enjoy under the dormant Commerce Clause by imposing additional limitations on state taxing authority. Second, Congress may expand the taxing power the states otherwise would enjoy under existing dormant Commerce Clause restraints by removing those restraints. The Court emphasized both aspects of Congress' power in *Prudential Insurance Co. v. Benjamin*.<sup>59</sup>

The power of Congress over commerce exercised entirely without reference to coordinated actions of the states is not restricted, except as the Constitution expressly provides, by any limitation which forbids it to discriminate against interstate commerce and in favor of local trade. Its plenary scope enables Congress not only to promote but also to prohibit interstate commerce, as it has done frequently and for a great variety of reasons. That power does not run down a one-way street or one of narrowly fixed dimensions. Congress may keep the way open, confine it broadly or closely, or close it entirely, subject only to the restrictions placed upon its authority by other constitutional provisions and the requirement that it shall not invade the domains of action reserved exclusively for the states.<sup>60</sup>

In *Prudential*, the Court sustained a South Carolina insurance premiums tax imposed solely on foreign insurance companies – a levy that clearly would have been struck down under the Commerce Clause if Congress had not consented to such legislation in the McCarran-Ferguson Act. So, given this broad authority, what might Congress do?

#### A. Congress Could Do Nothing

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

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

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

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<sup>59</sup> 328 U. S. 408 (1946).

<sup>60</sup> *Id.* at 434.

Third, even if the U.S. Supreme Court were to grant certiorari in *Cuno*, it is unlikely that it would resolve all or even most of the potential challenges to state tax incentives. The Court decides cases on their particular facts, and it typically is careful to “leave for another day” even questions that are closely related to the particular case before it. As Justice Frankfurter observed nearly 50 years ago:

At best, this Court can only act negatively; it can determine whether a specific state tax is imposed in violation of the Commerce Clause. Such decisions must necessarily depend on the application of rough and ready legal concepts. We cannot make a detailed inquiry into the incidence of diverse economic burdens in order to determine the extent to which such burdens conflict with the necessities of national economic life. Neither can we devise appropriate standards for dividing up national revenue on the basis of more or less abstract principles of constitutional law, which cannot be responsive to the subtleties of the interrelated economies of Nation and State.

The problem calls for solution by devising a congressional policy. Congress alone can provide for a full and thorough canvassing of the multitudinous and intricate factors which compose the problem of the taxing freedom of the States and the needed limits on such state taxing power.<sup>61</sup>

In short, the problem raised by *Cuno* is broader than *Cuno* itself. Failure by Congress to act on the underlying issue raised by *Cuno* will effectively leave us in the “mess” we are in. Wholly apart from the wisdom or effectiveness of state tax incentives or to the defensibility of various competing readings of the dormant Commerce Clause that may be advanced, failure by Congress to act will assure continuing uncertainty and, most probably, inconsistency in judicial determinations of the validity of state tax incentives.

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

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

<sup>61</sup> *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 476 (1959) (Frankfurter, J., dissenting). The Court expressed similar sentiments in *Commonwealth Edison Co. v. Montana*, 453 U.S. 609 (1981) and in *Moorman Manufacturing Co. v. Bair*, 437 U.S. 267 (1978).

<sup>62</sup> 514 U.S. 1995).

<sup>63</sup> Pub. L. No. 104-88, 109 Stat. 803, Dec. 29, 1995, codified at 49 U.S.C. § 14505.

<sup>64</sup> 405 U.S. 707 (1972).

passenger service fee for each passenger boarding a commercial aircraft, Congress enacted legislation preventing any “tax, fee, head charge, or other charge” on air travel.<sup>65</sup>

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

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

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

Without speaking to the merits of the particular proposal, I do believe that the proposal represents a template for the proper approach by Congress. However Congress may resolve the ultimate question of what types of tax incentives represent appropriate measures to encourage economic development, we are all better off if Congress draws a clear line that is discernible to all than if we are left to the vagaries of the judicial process that has created the uncertainty and controversy that we face today.

Having said that, I do not wish to understate the extraordinary complexity of the task facing Congress. One should not lose sight of the fact that one person’s “economic development incentive” is another person’s “discriminatory tax.” New York’s “incentive” to attract sales to the New York exchanges was a “discriminatory tax” to the Boston Stock Exchange that viewed the incentive as diverting economic activity from the Boston exchange, a view with which the U.S. Supreme Court concurred. In the end, however, I believe that we are at the point where it is incumbent upon Congress to draw these lines in a careful, sensible, responsible, and understandable way. In doing so, Congress in my view should be extremely careful to retain the core features of the antidiscrimination principle, which has facilitated growth of a vibrant national common market over the past century and a half. At the same time, while moving cautiously, it seems to me that Congress should act. Otherwise it will be left to taxpayers, tax administrators, and the

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<sup>65</sup> 49 U.S.C. § 40116(b).

<sup>66</sup> See S. 1066, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2005); H.R. 2471, 109<sup>th</sup> Cong., 1<sup>st</sup> Sess. (2005).

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

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<sup>67</sup> *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 331 (1977).

<sup>68</sup> *Id.* at 336.

Mr. CHABOT. Thank you very much.  
And finally, Professor Zelinsky, you're recognized for 5 minutes.

**TESTIMONY OF EDWARD A ZELINSKY, BENJAMIN N. CARDOZO  
SCHOOL OF LAW, YESHIVA UNIVERSITY, NEW YORK, NY**

Mr. ZELINSKY. Thank you, Mr. Chairman. I'm grateful for the opportunity to speak with you this morning concerning a topic which has been of great importance both to Professor Hellerstein and myself, and that is the relationship of State tax policies to the Dormant Commerce Clause.

The most compelling conclusion I can share with you today is the importance of keeping distinct three separate concerns. That is to say, the constitutionality of particular State tax policies; the economic wisdom of those policies; and the propriety of congressional intervention.

Consider in the context of the first issue, constitutionality, two recent controversial decisions: the *Cuno* decision of which there has been much discussion; as well as the decision of the New York Court of Appeals in my own case, in which I challenged under the Dormant Commerce Clause New York's policy of taxing non-resident telecommuters on the days they work at home throughout the nation. I suggest that both of these cases were decided wrongly, under the Commerce Clause.

To take *Cuno* first, there's no principled basis for distinguishing the investment tax credit struck by the Sixth Circuit from other routine tax State spending policies and programs, including the property tax relief which the appeals court sustained. These and other anomalies suggest to me that *Cuno* is incorrectly decided.

Equally troubling is the conclusion of the New York courts under the Commerce Clause that New York can tax non-residents, thousands of us, on days when we never set foot in New York.

Now, it's important to distinguish the constitutional issue from the wisdom of those policies. I have grave reservations, as apparently most of the rest of the panelists do, about *Cuno* as a matter of constitutional law. But I have equally grave reservations as a matter of tax policy about many of the targeted incentives at issue in *Cuno*. And I think that's a distinction that's important for discussion going forward.

In contrast, I think New York's employer convenience rule is both unwise for New York and the country as a whole, as well as unconstitutional.

And there is finally the question of what Congress should do under the Commerce Clause. And allow me to suggest three non-exclusive criteria for congressional intervention.

First, Federal legislation under the Commerce Clause is particularly appropriate when States seek unfairly to tax non-voters. For example, I have no representation in the New York general assembly. And for that reason, I strongly support the legislation sponsored by Senator Dodd and Representative Shays which would preclude any State from taxing a non-resident telecommuter on the day he works at home.

Second, Congress should exercise its Commerce Clause authority when conflicting tax policies impede the interstate mobility of persons, goods, and services. The reality is, the Dormant Commerce

Clause has been one of history's great successes, creating a common market out of this vast continent we are blessed with. And I think that the Dodd-Shays legislation satisfies this criteria, also.

Finally, I think States, in the interest of federalism, should be permitted to pursue tax policies which impact solely within that State. The Commerce Clause is not, and should not be, understood as a barrier to a State implementing tax policies, whatever their wisdom may or may not be, as long as those policies impact only within that State. And for that reason, I am sympathetic to the effort to overturn *Cuno* legislatively, even though I am unsympathetic to most State tax incentives.

Again, I appreciate the opportunity to discuss with you the relationship of State tax policy and the Dormant Commerce Clause, a topic which will, with increasing frequency, find itself on Congress' agenda in the years ahead. \*\*

[The prepared statement of Mr. Zelinsky follows:]

PREPARED STATEMENT OF EDWARD A. ZELINSKY

I am grateful for this opportunity to discuss the relationship between state tax policies and the dormant Commerce Clause. As someone who has written, taught and thought about that relationship, I am both surprised and pleased by the sudden interest in this subject. That interest reflects a variety of causes: the proliferation of state tax incentives; the growth of interstate telecommuting; several controversial court decisions on these subjects; a growing recognition that ultimately the Commerce Clause is a grant of authority to Congress and that, in an increasingly nationalized economy, that authority is likely to be invoked more and more frequently.

The most compelling conclusion I can share with you today is the importance of keeping separate three distinct concerns: the constitutionality of particular state tax policies, the economic wisdom of those policies, and the propriety of federal legislation.

Consider in the context of constitutionality two of the recent and more controversial dormant Commerce Clause decisions, the decision of the Sixth Circuit in *Cuno*<sup>1</sup> and the decision of the New York Court of Appeals in my own case<sup>2</sup> challenging the constitutionality of New York's "convenience of the employer" doctrine for taxing nonresident telecommuters on the days they work at their out-of-state homes.

I suggest that both of these cases were decided wrongly. To take *Cuno* first, there is no principled basis for distinguishing the investment tax credit struck by the Sixth Circuit from other, routine tax and spending programs of state governments including the property tax relief which the appeals court sustained. The Sixth Circuit understands the dormant Commerce Clause as denying DaimlerChrysler an Ohio investment tax credit because of DaimlerChrysler's pre-existing Ohio plant but as permitting a credit for new investment to an otherwise identical competitor without an pre-existing facility in Ohio. In a similar vein, the *Cuno* decision indicates that if Ohio, instead of providing a tax credit, gives DaimlerChrysler a check equal in value to the credit, such a direct subsidy passes Commerce Clause muster even though an economically identical income tax credit does not.

These and other anomalies suggest to me that *Cuno* is doctrinally unsound.<sup>3</sup>

Equally troubling is the conclusion of the New York courts that, notwithstanding the Commerce and Due Process Clauses, New York can tax nonresidents such as me on the days we work at home. New York thus taxes me (as well as thousands of other telecommuters) on days we never set foot in New York. Most recently, the New York Court of Appeals upheld New York's income taxation of a telecommuter

<sup>1</sup> *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th cir. 2004).

<sup>2</sup> *Zelinsky v. Tax Appeals Tribunal of the State of New York*, 1 N.Y.3d 85, 769 N.Y.S.2d 464 (2003), cert. den., 541 U.S. 1009 (2004).

<sup>3</sup>For more detailed elaboration of these themes, see Edward A. Zelinsky, *Cuno v. DaimlerChrysler: A Critique*, 34 STATE TAX NOTES 37 (October 4, 2004), reprinted in 105 Tax Notes 225 (October 11, 2004). For some pre-*Cuno* thoughts along these lines, see Edward A. Zelinsky, *Restoring Politics to the Commerce Clause: The Case for Abandoning The Dormant Commerce Clause Prohibition on Discriminatory Taxation*, 29 OHIO NORTHERN UNIV. L. REV. 29 (2003).

for the days he worked at home in Nashville, Tennessee.<sup>4</sup> It strikes me and virtually all of the prominent commentators that New York, when it taxes thousands of nonresidents on days they work at their out-of-state homes, violates the rule of apportionment which, over the years, has become central to our understanding of the dormant Commerce Clause.<sup>5</sup>

It is important to distinguish the constitutionality of state tax policies from the wisdom of those policies. I have grave reservations, as a matter of constitutional law, about the *Cuno* decision. But I have equally grave reservations, as a matter of tax policy, about the kind of targeted tax incentives at issue in *Cuno*. There is much to commend tax competition benefitting taxpayers generally. The pressure to keep taxes reasonable and efficient for taxpayers in general imposes an important discipline on political decisionmakers and helps taxpayers and voters to monitor, compare and evaluate the performance of state and local governments.

On the other hand, I am skeptical of the kind of targeted tax incentives Ohio gave to DaimlerChrysler. I am doubtful of this kind of market-manipulating industrial policy whether pursued by the federal government, by pension trustees or by states and localities. In short, the fact that tax incentives are constitutional does not make them wise.

In contrast, New York's employer convenience doctrine is as unwise as it is unconstitutional. New York now taxes individuals throughout the nation when they work at home for New York employers. The reported cases indicate that New York has assessed nonresident income taxes against individuals working at home as far from New York as Maine, Florida, New Hampshire and South Carolina. At a time when we should be encouraging telecommuting, New York's overreaching, even if it were constitutional, is bad tax policy for the nation's economy.

There is, finally, the question when Congress should intervene, using its Commerce Clause authority to constrain state tax policies. Allow me to suggest three, nonexclusive criteria for congressional intervention: First, federal legislation under the Commerce Clause is particularly appropriate when states seek to export unfairly their tax burdens to nonvoters. As a Connecticut resident, I have no vote for or representation in the New York legislature. Since I have no political voice in the formation of New York's tax policies aimed at me, it is appropriate for Congress, where I am represented, to intervene on my behalf.

For that reason, I strongly support the legislation sponsored by Senator Dodd and Representative Shays, the Telecommuter Tax Fairness Act, which would preclude any state from taxing a nonresident telecommuter on the day he works at home.

Second, Congress should exercise its Commerce Clause authority when conflicting tax policies impede the interstate mobility of persons, goods and services, thereby hindering the continental common market which is the U.S. economy. Again, I think the Dodd-Shays legislation satisfies this criterion also.

Finally, a state, in the name of federalism, should be permitted to pursue tax policies which impact solely within that single state. The Commerce Clause is not a barrier to a state implementing tax policies however misguided as long as those policies impact only within that state. For that reason, I am sympathetic to the effort to overturn *Cuno* legislatively even though I am unsympathetic to most state tax incentives.

Again, I appreciate the opportunity to discuss the relationship of state tax policy to the dormant Commerce Clause, a topic which will, with increasingly frequency, find itself on Congress' agenda in the years ahead.

Mr. CHABOT. Thank you very much, Professor. I want to thank all the witnesses for keeping very close to the 5 minutes, as well. We appreciate that very much.

We're—I might note that I've been informed that we expect a vote on the floor at approximately 11. It'll only be one vote, so we may be—that may break into our time here.

But I now recognize myself for 5 minutes, in order to ask questions. And I'll begin with you, Lieutenant Governor Johnson, if I can. In your written testimony, you stated that the "flexibility to put together aggressive customized incentive packages was critical"

<sup>4</sup>*Huckaby v. Tax Appeals Tribunal*, 2005 N.Y. LEXIS 497 (March 29, 2005).

<sup>5</sup>See, e.g., Walter Hellerstein, *Reconsidering the Constitutionality of the "Convenience of the Employer" Doctrine*, 2003 STATE TAX NOTES TODAY 91-3 (May 12, 2003); Nicole Belson Goluboff, *Put The Telecommuter Tax Fairness Act in the Passing Lane*, 2004 STATE TAX NOTES TODAY 211-2 (October 6, 2004).



to the 193 projects that Ohio landed last year. Could you please describe the process that your office uses for putting together these packages?

Mr. JOHNSON. Well, thank you, Mr. Chairman, for the question. Unfortunately, it does vary, depending on how the contact is made. Sometimes the contact begins at the local level, and there is a discussion with the local officials before the State gets involved. But generally, what happens is the State has a series of tools to encourage investment.

In 100 percent of the cases in which we encourage investment, the firm has a choice of location. In other words, we don't at the State level choose to subsidize retail outlets that, if they're going to serve the greater Cincinnati marketplace, they must do so from the greater Cincinnati marketplace.

We tend to have an unusually large number of these incentives in the manufacturing industry because manufacturers—because a large percentage of their marketplace is outside the State of Ohio, whom they're selling to. They have choice of location. They could locate either in Indiana, Illinois—China, or Taiwan, for that matter.

So those tend to be the types of firms. So we make sure that they're eligible. Then we utilize job creation tax credits; which, if you could follow the logic in the *Cuno* case, you might come to the conclusion that that tax credit was invalid, as well. That encourages firms to make investments and add Ohio employees. And we credit back to the company a portion of the income tax that is paid to the State of Ohio as a result of that investment over a period of time.

So what we do is we evaluate how much additional payroll is coming to the State, how much additional property investment is coming to the State. And then we do a mathematic qualification, based upon the various tools.

We have a number of tools, including direct incentives and including direct investment ourselves in infrastructure. And so we work with the firm to determine what is appropriate for the facility in the location, and then we make an evaluation on how much money the State actually ought to put in.

In no case does the State not demand a return on its investment. We do tend to assume that the investment wouldn't otherwise happen.

In the case of the M&E tax credit, however, it's not just in incentive packages. This particular credit is available to all qualifying investments in the State, whether they come to the Ohio Department of Development seeking an incentive for a specific investment or not. So to the extent that they qualified, they had investments that exceeded their previous 3-year average, they would be eligible for that particular investment incentive.

Mr. CHABOT. Okay. Thank you very much.

Ms. Kuhrt, let me turn to you, if I can, now. Lincoln Electric has operations in, as you mentioned, Ohio and California and Georgia and 26, I believe, other countries you said. Have you witnessed any so-called race to the bottom among States when you consider building a new operation? Do any of these States offer, in your estimation, tax incentives that do not make economic sense based on

the total investment they bring to an area, including the new jobs that they create?

Ms. KUHRT. Actually, I'd say that most of the State incentives that we see are modest, particularly relative to the international incentives that are offered. The international incentives might be considered a race to the bottom but—however, those are in jurisdictions that are in developing countries, and certainly have many years to recoup their investment. But the States in particular, no, not at all.

Mr. CHABOT. Thank you. Professor Hellerstein, I've only got 1 minute left, so let me move kind of quickly. In your written testimony, you state that the negative, or Dormant Commerce Clause—and I think you said this here, too—“is a mess; albeit a mess that keeps many lawyers and law professors busy.”

In light of the *Cuno* decision and the Supreme Court's other Dormant Commerce Clause jurisprudence, could you as an attorney tell Lieutenant Governor Johnson what sorts of programs that the State of Ohio is allowed to implement in order to attract business and jobs to the States?

Mr. HELLERSTEIN. I could only do so with great difficulty, and with the usual caveats that lawyers make. I think you're right. I think it would be—particularly now after *Cuno*, it would be extremely difficult. We know some things are okay; if Ohio simply wants to pay money, a flat subsidy. But other than a flat subsidy, using the tax system, especially in light of *Cuno*, especially in light of the disparate views across the table of what the Commerce Clause means, I think it would be extremely difficult.

Mr. CHABOT. Okay. Thank you. And my time has expired. I apologize, Professor Zelinsky, I didn't get to you there. But at this time, the gentleman from New York, Mr. Nadler, is recognized for 5 minutes.

Mr. NADLER. Thank you. First, a question, just of curiosity. Professor Hellerstein, are you the “Hellerstein” of the *Hellerstein* case in New York on property tax assessment that ruled the State's politics for about 10 years, a number of decades ago?

Mr. HELLERSTEIN. Yes, I am. And I also think I have a place in your district, if you are in 67th Street?

Mr. NADLER. Oh, yes.

Mr. HELLERSTEIN. So, yes, it's my father—my father's case. He didn't make a lot of friends.

Mr. NADLER. He certainly kept the legislature and a couple of governors busy for about a decade and a half.

Professor Zelinsky, you said that States shouldn't unfairly tax non-voters; for example, non-resident telecommuters. Do you make a distinction—I mean, I'm trying to figure out what you meant by that. So a commuter tax for people who work in the city of New York, let's say, or the State of New York, and live in New Jersey; or do you distinguish that from telecommuters? And what do you mean by “telecommuters?”

Mr. ZELINSKY. Yes, I am in favor of a commuter tax, when you commute. A telecommuter is someone who doesn't commute, someone who stays at home. And the phrase “telecommuting” has become accepted to refer to people who are able to conduct their work one, two, 3 days a week at home. And so, yes, I do distinguish—

Mr. NADLER. Well, how do you get any nexus to even constitutionally tax that?

Mr. ZELINSKY. Well, I think you have two different issues here. One is the typical telecommuter, such as myself, is someone who spends some days in New York and some days out of New York. That was my case.

Mr. NADLER. So the State is claiming that the days you spend in New York give you the nexus to constitutionally tax the State?

Mr. ZELINSKY. And I agree with that. The question is the day when I am not in New York—

Mr. NADLER. Right.

Mr. ZELINSKY.—the day when I'm at home in New Haven, is the day when they want to tax. And that's the issue for myself and thousands of other people.

If I can, they just projected their taxing power into Nashville, Tennessee. Mr. Huckaby, whose taxation was upheld, is someone who spent over 80 percent of his time in Nashville, Tennessee, and New York taxed him for those days.

Mr. NADLER. I see. Thank you. Ms. Kuhrt, you said that you thought that most—this isn't my time, I hope. We have these beepers. I don't know why we still need the bells.

You said that most of the tax incentives that you see are modest, except internationally. You seem to imply that they don't really affect—well, let me ask you this. Obviously, you think that the tax incentives do affect locational decisions.

Ms. KUHRT. Yes, they do.

Mr. NADLER. And yet, you don't have a race to the bottom, you said.

Ms. KUHRT. I think that individually the incentives that the various States offer are comparable. There's not any one particular State that I can tell—

Mr. NADLER. All right, but if the incentives the States offer are comparable, then obviously there's competitive pressure on every State to offer what Ohio is offering.

Ms. KUHRT. Uh-huh.

Mr. NADLER. Because otherwise, it would be an advantage to Ohio. In that sense, you get a race, not to the bottom, but lower down.

Ms. KUHRT. Uh-huh.

Mr. NADLER. Why shouldn't—and I'm not talking constitutional law now; I'm talking economics. From the point of view of maintaining the State's tax base, and for that matter, greater prosperity to all the States, why wouldn't it be a good idea, assuming it were constitutional, to say nobody gives tax incentives, and let locational decisions be made on extrinsic economic factors?

Ms. KUHRT. It certainly is a possible way to look at it. But many of the State tax incentives target particular industries. There are some States that offer R&D credits, trying to attract technology jobs. Ohio offers investment tax credits.

Mr. NADLER. Right, but my question is, let's assume that nobody offered an R&D credit. I mean, we don't like R&D credits. Let's assume nobody offered the R&D credit. Would the R&D get done someplace; albeit maybe in Tennessee and not in Georgia? Or would that R&D not happen?

Ms. KUHRT. Or it would happen in Ontario, Canada, or in Singapore, or in Poland.

Mr. NADLER. Okay. So you're saying that there's competitive pressure from abroad to do this.

Ms. KUHRT. Absolutely.

Mr. NADLER. And everybody's got to participate in the race.

Ms. KUHRT. Absolutely.

Mr. NADLER. How do you distinguish—I'll ask one of the professors. On what rational basis can you distinguish a tax incentive from a non-tax incentive from a straight cash grant? Let's assume that the State of New York said, "If you invest in New York, we'll write a check to you for \$100,000." On what basis can you rationally distinguish that from a tax incentive worth \$100,000? And should you?

Mr. HELLERSTEIN. I don't—by rational—I mean, an economist would think it's irrational. I think a lot of what lawyers do is irrational. But it seems to me what the Court has said in making that distinction, you know, "This is the hand we were dealt, right? We didn't make this one up." It is simply that a subsidy is less coercive. "Here's some money. Come to Georgia. Here's \$100." Rather than saying, "Well, you know, if you come, we'll reduce your tax base, which is already there and we've already got our grip on you."

But I agree with you. I think it's not a sensible distinction. And I think that it would be one that would be fine to eliminate.

Mr. ZELINSKY. Representative, I think this is the rare occasion when you're hearing the same thing from two law professors. We agree. I don't think that the distinction that exists in the Court's case law between direct and tax subsidies makes any sense at all. And I think that the Court is going to find itself over the years under increasing pressure, and is going to find it increasingly difficult to maintain that distinction. And of course, since this is the Dormant Commerce Clause, this Congress has the ability to legislate this.

Mr. NADLER. Do you think it should on that subject?

Mr. ZELINSKY. I'm in favor of very broad legislation. I think for a hundred years the Court has been doing Congress' job. I don't want to be undiplomatic, but the reality is that the law in this country would be much better if at the turn of the century—that is, the prior century—Congress had adopted some very broad rules and begun the process of creating a framework for the knitting of our economy.

I don't think the Court's happy about the role it's been forced to do. And, yes, I think there is a very broad role for this Congress to adopt extremely comprehensive rules, instead of responding episodically to particular incidents, which has been the pattern over the last 50 years.

Mr. NADLER. Thank you very much, sir.

Mr. CHABOT. The gentleman's time has expired. I think the Lieutenant Governor wanted to—was chomping at the bit there to get in.

Mr. JOHNSON. Well, I agree with the comments from counsel. And I just wanted to kind of bring light to the fact that the Administration is considering, in response to the *Cuno* case, what we call

“the loop”; which is to take what we call in the budget process “tax expenditures,” credits given to individual companies, and changing them specifically into grants.

So the following year, after you made your investment, after you demonstrated some Ohio tax liability, you would receive a grant in proportion, exact proportion, to what you would have been eligible for under the M&E tax credit. It, under the logic in this case, does not fly in the face of the United States Constitution, as I would read it.

Mr. NADLER. It comes to exactly the same thing.

Mr. CHABOT. Okay. We have a vote on the floor, so we’re going to be in recess here for a short period of time. We’re probably looking at 10 minutes or so. And then we’ll—I’d encourage the Members to come back as quickly as possible, so we could finish up the questioning. So we are in recess.

[Recess.]

Mr. CHABOT. The Subcommittee will now come to order. Take your seats, please. Okay.

The gentleman from Virginia, Mr. Scott, is recognized for 5 minutes.

Mr. SCOTT. Thank you, Mr. Chairman. Mr. Chairman, I think there is a constitutional recognition that labels count. We had a hearing on the gay marriage constitutional amendment, and it was clear that if you called it a “marriage,” you’d have one effect, and if you—like for Massachusetts. But the same thing coming out of Vermont with a “civil union” label on it would have a different application.

And here we have something, if you call it a “subsidy,” you get one result, and if you call it a “tax credit,” you get something else. I’ve always been interested. You know, if you have a \$15 cash—a \$15 credit card price, and a \$10 cash price, if you call that a surcharge for using your credit card, it’s somehow evil, sinister, and illegal; but if you call it a discount for cash, the same differential is okay.

Let me just ask the two professors, is it accurate to say that, whether it makes any sense or not, the Supreme Court recognizes the labels as important?

Mr. ZELINSKY. The answer is “Yes.” And I also agree with you that, substantively, this is a situation where I think the label in fact shouldn’t make sense. Sometimes lawyers, of course, like labels, in the interest of administrability and in order to make categories that are workable.

But I certainly agree with your observation that, in this situation, the way policies are, if not labeled, the way they’re structured, even though the economic effect is the same, the Court has drawn distinctions that I don’t think ultimately are sustainable.

Mr. SCOTT. Well, sustainable, but they have drawn the distinction.

Mr. ZELINSKY. Most certainly.

Mr. SCOTT. Do you agree, Professor Hellerstein?

Mr. HELLERSTEIN. Again, Professor Zelinsky and I find ourselves in violent agreement. [Laughter.]

You know, the distinction makes no economic sense, but it’s there. I guess the only thing I would say in defense of it, I think

that if you look at where it came from, the idea that there is a difference between spending money and—simply giving money away, I think—and using a tax mechanism, something that is coercive perhaps, and giving a little bit of what you would normally take from somebody, and giving it back, I think that at the extremes you might find some distinction. But I think in the end it does evaporate, and it's not a sensible way to distinguish between valid and invalid ways of attracting business.

Mr. SCOTT. Well, we're kind of caught in a situation, then. If the courts have recognized the constitutionality of the difference, whether it makes any sense or not, how do we, as the Legislative Branch, get off trying to overrule what the courts have said? I know we frequently act as an alternative court of appeals.

Mr. ZELINSKY. No, here let me make it very clear. You are the authority, under the Commerce Clause. The Dormant Commerce Clause is simply the Court acting in the absence of congressional legislation. But anything that the Court does under the Dormant Commerce Clause, or has done over the last hundred years, can be, and I think in this case should be revisited by Congress.

This is not like the Due Process Clause, which is ultimately Congress' to—or the Court's to decide. The Commerce Clause is yours, and their Dormant Commerce Clause decisions are provisional, always subject to revision by the Congress of the United States.

Mr. SCOTT. And so if Congress passed a statute authorizing the distinction, or authorizing the tax incentives, that would be constitutional?

Mr. ZELINSKY. Absolutely.

Mr. SCOTT. Do we get violent agreement again?

Mr. HELLERSTEIN. Not only violent agreement, but the Court, the U.S. Supreme Court has again and again told Congress, in its opinions where it's, somewhat reluctantly perhaps, striking down a case under the Commerce Clause, that in the end these really are matters for Congress. It is begging Congress to act.

Mr. SCOTT. Now, do we have to do—can we just do a kind of a blanket permission to let States do their own things? Would that be sufficient? Or do we have to pass each one individually?

Mr. ZELINSKY. Well, historically, Congress has intervened in some situations. There is a very well known law, 86–272, for example, under which Congress intervened to deal with some nexus issues. You can choose to legislate however you want. The Constitution gives you the right to regulate interstate commerce, and the Court is only intervening in those situations where it believes that there is no legislative answer and the States may be overstepping their boundaries.

So whether you want to continue the pattern, which has been the historic pattern, of responding episodically, or whether it is now time for there to be a comprehensive project on legislative solutions and a legislative framework, that's ultimately your call. I would be in favor of something comprehensive.

Mr. SCOTT. But from a constitutional point of view, either one would be okay?

Mr. ZELINSKY. Yes.

Mr. CHABOT. The gentleman's time has expired.

Mr. SCOTT. But could we have the same to you?

Mr. HELLERSTEIN. Just one brief—I think the best analogy—Professor Zelinsky referred to cases where Congress was basically restraining the States from doing something; here, you’re authorizing.

The best example of that is when the Court said that the insurance industry was interstate commerce, this Congress passed the McCarran Act which said, no, it’s not affected by the Commerce Clause; basically, withdrew the Commerce Clause, the negative Commerce Clause, from the insurance industry. You would be doing the same thing. There’s historical precedent for this.

Mr. CHABOT. The gentleman’s time has expired.

The gentleman from Utah, who is co-chairing the hearing, Chairman Cannon, is recognized for 5 minutes.

Mr. CANNON. Thank you, Mr. Chairman.

Ms. Kuhrt, I’m a big fan of Lincoln Electric, and have followed you for a long time. Can you give me just a little bit of background on the company? How many employees do you have?

Ms. KUHRT. We have 3,200 in the U.S., and over 7,000 around the world.

Mr. CANNON. How many States do you have operations in?

Ms. KUHRT. We currently pay income tax in 32 States.

Mr. CANNON. And how many do you have actual manufacturing operations in?

Ms. KUHRT. Oh, sorry, sorry. California and Georgia, as well as Ohio.

Mr. CANNON. And how many different countries do you have operations in?

Ms. KUHRT. We have manufacturing locations in 26 countries, and we do business in over 40.

Mr. CANNON. But your equipment is used in every country on earth, I’m quite certain. And every State.

Ms. KUHRT. Absolutely. Absolutely. And especially in countries that are developing, and building bridges and buildings and pipelines.

Mr. CANNON. Exactly. Sort of like Utah.

Ms. KUHRT. Exactly.

Mr. CANNON. Developing country. [Laughter.]

Ms. KUHRT. Exactly. You own a Red welding machine, right?

Mr. CANNON. Actually, I don’t own a welding machine; which really bugs me, because I have some welding to do on my little property there.

Ms. KUHRT. Oh, go buy one.

Mr. CANNON. So I have to go out and hire somebody. But, you know, I don’t have time to do it anyway, myself. But if we had one, it would be—in fact, I have owned one in the past in my life.

Ms. KUHRT. The only one to own.

Mr. CANNON. That’s right. That’s right. You know, you have an interesting environment, where you have a very simple hiring process. And you have that simple process of not ever firing people, because it gives the company a huge benefit. And then, on the other hand, I suspect that your position is the most difficult of all the positions in the company, because you’re dealing with these complex State tax laws. Would you like to see simplification?

Ms. KUHRT. Oh, absolutely. I might be out of a job, if we simplified it too much but—

Mr. CANNON. Not with your company, I suspect.

Ms. KUHRT. No, that's—very good, very good point. Guaranteed lifetime employment. No, I mean, certainly. And not just Lincoln Electric, but corporations across this country invest a lot of money simply administering tax laws. I mean, a company like Lincoln files, you know, over 2,000 pieces of paper a year to State and local governments. I mean, that's a lot of paper to push, and that's just for one little Lincoln Electric.

Mr. CANNON. And that's under your direction, right?

Ms. KUHRT. Under my direction.

Mr. CANNON. How many people do you have working for you?

Ms. KUHRT. I have eight people.

Mr. CANNON. Mr. Johnson, this is an income tax credit, right? It's not a sales tax reduction? Or how does it actually work?

Mr. JOHNSON. The credit is placed on the corporate franchise tax, which would apply to the income tax if it were an S-corporation, for example.

Mr. CANNON. Okay, so it's actually—what if a company doesn't owe taxes? Do they still get money back under the credit?

Mr. JOHNSON. No, this particular credit, the M&E tax credit, is a non-refundable tax credit. So they can carry it forward, but they can't get a refund check from the State.

Mr. CANNON. Okay. Great. All right. Well, thank you very much for those particular points.

Professors Hellerstein and Zelinsky, I've got to say, it's great to have some violent disagreement—or violent agreement. We have the scenario where my Subcommittee is going to pursue this aggressively, and I suspect we'll be working together. If you have any additional comments on the particulars of where we ought to go, I'd love to hear that from either or both of you.

Mr. HELLERSTEIN. Well, you know, without completely repeating my testimony, I would say two things. I would say that it does seem to me that the bills, the Voinovich-Tiberi bills, are excellent, in the sense that they both authorize what I think everyone believes—at least, people who are not—don't spend their life buried in the Commerce Clause—think makes sense; the kind of incentive that, if somebody comes to Ohio, you give them some money, effectively, in the form of a tax credit or a subsidy, that seems to be okay.

At the same time, I think we need to preserve the national common market that we have. You don't want to, I think, authorize—you don't want to authorize tariffs. You don't want Georgia to be able to say that, you know, "We're going to bar any product sold in the State if it's manufactured in South Carolina."

And I think the bill does that, too, because it doesn't touch that. So it seems to me we have here the kind of—you know, on the one hand, authorizing what ought to be authorized; on the other hand, not disturbing the vibrant—the Commerce Clause that has really worked quite well—although I think, as Professor Zelinsky correctly points out, perhaps from the wrong body; that it should have come from Congress. But the court did okay, did the best it could on the case-by-case basis, in trying to preserve the core principle



that States shouldn't be able to blatantly discriminate against, say, products from out of State. So that would be my—

Mr. CANNON. Thank you. I walked over to the vote with Pat Tiberi, and invited him to join us if he has a chance. And I think that he was going to try, but that depends upon how long we're here. But Professor Zelinsky, do you have any further comments?

Mr. ZELINSKY. Yes. I would make two observations. One is, again, I would separate out the question of constitutionality from wisdom. I respectfully disagree with those who think that these tax incentives are necessarily good. I think they have their costs and their down sides. On the other hand, I believe that, constitutionally, States should be allowed to pursue policies, whether I agree with them or not.

And so I would very much recommend that you focus not on the economic wisdom, but rather on the question of the federalist autonomy of the States.

Second of all, I think you ought to consider the possibility that this is an opportunity to really think about and legislate some of these broader issues. The historic pattern over the last hundred years has been that Congress episodically has responded to particular incidents where the Court has made rulings Congress wants to overturn.

So as Professor Hellerstein says, there was the McCarran Act, dealing with insurance. There was 86-272, dealing with some corporate issues. During the second Clinton term, there was additional legislation dealing with the question of retirees and people being taxed on waterways.

It is possible for you to respond to this particular issue of *Cuno*; but I think it may be time for Congress, after 200 years, to think more broadly about assuming its full-throated responsibility under the Commerce Clause, rather than just responding to particular decisions of the Court.

Mr. CANNON. Thank you, Mr. Zelinsky. I yield back, Mr. Chairman.

Mr. CHABOT. Thank you. The gentleman's time has expired.

The gentleman from Arizona, Mr. Franks, is recognized for 5 minutes.

Mr. FRANKS. Well, thank you, Mr. Chairman. And thank you, members of the panel here. It's always nice when you see all this violent agreement that the gentleman talks about, and I wanted just to play off of that a moment.

There seems to be general consensus on the Committee that, in terms of the Commerce Clause in the Constitution, that that is not really the major issue here. My first question would be directed to Professor Zelinsky. Do you think that there are any State tax credits that would be diametrically in conflict with the Constitution? I mean, other than those that, you know, would be so esoteric that—

Mr. ZELINSKY. The simple answer is: I don't know. As Professor Hellerstein says, the Court's interpretation, as it has developed over a hundred years, is very indeterminate. It's unclear. I could make a very good argument, under the Court's existing case law, that just about any State tax provision is unconstitutional.

When I criticize the Sixth Circuit, I have to say at some level I also sympathize with these folks, because I think they were given a very difficult hand to play by the Supreme Court of the United States, and it's fairly incoherent tax law. The Court, itself, on occasion has said that its own tax law is a quagmire.

So I have to say to you, we really don't know in many ways what the Dormant Commerce Clause means; which is a strong argument for this Congress legislating to give us some rules.

Mr. FRANKS. So it's your testimony, essentially, that the Court's confusion is based on the omission of Congress, rather than the commission?

Mr. ZELINSKY. Correct. The reality is that the Framers thought, I believe, from my reading of historic evidence—expected Congress to be an active regulator of interstate commerce. For a variety of reasons, which I'm not sure we totally understand, the pattern which developed largely after the Civil War, and then accelerated during the 20th century, was the Court acting as the Dormant Commerce Clause decision-maker.

And I'm suggesting that I do think that it is inevitable that more and more of these issues are going to have to be dealt with legislatively.

Mr. FRANKS. Thank you, professor. Lieutenant Governor Johnson, I know, as someone who is an executive in State government, you have to essentially balance the economic interests of your State; doing everything that you can to enhance productivity, and still be able to sustain the needs and the revenues to run government. And those things are quite often, you know, in a dynamic crucible.

So I guess my question to you, if Congress did pass legislation comprehensively, as an executive of state, what would be two or three of the seminal, foundational principles that you think should be involved?

Mr. JOHNSON. Well, thank you, Mr. Chairman, to the Member. The State is currently reviewing in a comprehensive way its tax code. And I would leave it to the States to make determinations about what are the issues that are in the best interests of the people of that State, as it relates to the tax code; without allowing the State to unduly discriminate against out-of-State products. I think that is the issue.

Our tax provisions and our credits apply to activity in the State, regardless of whether or not the company itself is an in-State resident or an out-of-State corporation. And I think that's critically important.

I think there are a number of items in Senator Voinovich's bill and Representative Tiberi's bill that kind of outline those areas which most of us would consider to be out of bounds, in terms of permitting discrimination that would raise tariffs, for example, for the interstate transportation of goods; which we don't support, either.

So the fact that we do compete against some folks in our neighboring States does not mean that we want to intentionally discriminate. We just want to encourage investment in our State. Investment in our State means that the economy of the United States

grows. Investment in our State means that the job base in the United States of America is growing.

And some of our most critical competitors are not the States of Indiana or Michigan; it's China and Mexico, and even Ontario, Canada, which has become incredibly aggressive in these issues.

Mr. FRANKS. Mr. Chairman, last question. Mr. Johnson, if you could write legislation that would correct the problem as far as you're concerned in this present case, what would you rifle-in on? What would be the principal—

Mr. JOHNSON. Thank you, Mr. Chairman, to the Member. I'm reading now from—this is the second page of Senator Voinovich's piece. And it says that, "Authorize the State to provide any person for economic development—" any State "—development purposes, tax incentives that would otherwise be cause or a source of discrimination against the Interstate Commerce Clause."

And then it lists kind of the exceptions, which I think is where you're headed, what types of things. In other words, it would generally provide States the authority to do this, to provide economic development incentives. And then it would say, "Then there are some exceptions. Can't be dependent upon the State or the country of incorporation." I think that's important. "Commercial domicile or residence requires the recipient of the tax incentive to acquire, lease, or use, or provide services or property produced in State." In other words, if somebody uses the M&E tax credit in Ohio, they don't have to use an Ohio manufacturer for that equipment. They can buy their equipment any place, so long as they install it in the State of Ohio.

It's reduced or eliminated as a result of an increase in out-of-State activity. In other words, I can't penalize Lincoln Electric for investing in Michigan—God forbid—or India. [Laughter.]

There's still a little rivalry between Ohio and Michigan.

And so I think we worked with Representative Tiberi and with Senator Voinovich in the development of the legislation. And we think that it preserves those elements of the Dormant Commerce Clause that ought to be preserved and, at the same time, it kind of sets out some guidance for State tax administrators.

Mr. FRANKS. Thank you, Mr. Chairman.

Mr. CHABOT. Thank you. The gentleman's time has expired.

That concludes—unless the gentleman from Virginia has any other questions or anything, that concludes the questions from the Members of the panel here.

I want to thank—and I know Chairman Cannon also shares in this and wants to thank the very distinguished panel for your testimony here this morning. It's been very helpful. I think each of you has contributed immensely to this issue.

And we will take all of your testimony today in consideration as we deal with this in this Committee, and ultimately probably on the floor of the House of Representatives. So thank you for your testimony this morning.

If there's no further business to come before the two Committees, we're adjourned. Thank you.

[Whereupon, at 11:42 a.m., the joint Subcommittees were adjourned.]

