2005

Evaluating Kentucky's Investment Tax Credits in Light of Cuno v. DaimlerChrysler, Inc.

Bradford C. Spencer

University of Kentucky

Follow this and additional works at: https://uknowledge.uky.edu/klj

Part of the Taxation-State and Local Commons

Click here to let us know how access to this document benefits you.

Recommended Citation


Available at: https://uknowledge.uky.edu/klj/vol94/iss1/7

This Note is brought to you for free and open access by the Law Journals at UKnowledge. It has been accepted for inclusion in Kentucky Law Journal by an authorized editor of UKnowledge. For more information, please contact UKnowledges@lsv.uky.edu.
Evaluating Kentucky's Investment Tax Credits in Light of *Cuno v. DaimlerChrysler, Inc.*

Bradford C. Spencer*

**INTRODUCTION**

On September 2, 2004, a unanimous three-judge panel of the United States Court of Appeals for the Sixth Circuit* held in *Cuno v. DaimlerChrysler, Inc.* that an Ohio investment tax credit statute was unconstitutional because it violated the dormant Commerce Clause of the Constitution of the United States.* This decision is particularly significant

---

1 J.D. expected 2006, University of Kentucky College of Law; M.S. in Accounting, University of Kentucky, 2002; and B.S. in Accounting, University of Kentucky, 2001. The author would like to thank his wife and parents for all of their love and support.

Long after the final draft of this Note was completed, the Supreme Court on September 27, 2005 granted the defendants' petition for writ of certiorari to the U.S. Court of Appeals for the Sixth Circuit. *DaimlerChrysler Corp. v. Cuno*, 126 S.Ct. 36 (2005). The Supreme Court has also requested that both parties brief and argue whether the plaintiffs have standing to challenge the Ohio investment tax credit at issue. This raises the possibility that the Court may resolve the case on procedural grounds, thereby avoiding the constitutional question of whether state investment tax credits violate the dormant Commerce Clause.

The author, however, believes that this note will be useful regardless of the Court's decision. Should state investment tax credits be held unconstitutional, this Note illustrates some of the potential alternatives that Kentucky may utilize in place of its existing investment tax credit scheme. Conversely, if the Court holds that state investment tax credits are constitutional or avoids the issue by deciding that the plaintiffs lacked standing to bring a claim, then this note discusses how some commentators have concluded that investment tax credits play a minor role in business siting decisions. This point suggests that Kentucky closely examine whether it would be better off utilizing some other type of business incentive that could truly enhance its competitiveness vis-à-vis other states.

2 The Sixth Circuit reviews appeals from the federal district courts in Kentucky, Michigan, Ohio, and Tennessee.


4 The Commerce Clause provides that Congress has the power "[t]o regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." U.S. Const. art. I, § 8, cl. 3. "The commerce clause has been interpreted not only as conferring power on the national government to regulate commerce, but also as limiting the states' power to interfere with commerce. This restriction on state power often is referred to as the 'negative implication of the commerce clause' or as the 'dormant commerce clause' principle." Philip M. Tatarowicz & Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination*
because it was the first time a federal court of appeals addressed the issue of the constitutionality of state investment tax credits. A state will use such credits to induce businesses to (1) keep from relocating their existing operations to another state or (2) make future in-state investments. If the Sixth Circuit’s decision stands,⁴ it could spark a chain reaction in other jurisdictions across the country, as virtually every state uses some form of a state income tax credit or incentive to retain or attract new businesses.⁶ Given the widespread use of state investment tax credits, this decision has ruffled more than a few feathers within the state and local tax community, as well as in Congress.⁷

To many scholars and practitioners of state and local tax law, it was considered only a matter of time before a court would rule that state investment tax credits represented unconstitutional exercises of state power. These scholars and practitioners have long asserted that states’ use of investment tax credits violated the dormant Commerce Clause doctrine.⁸ Accordingly,

---

⁴ Under the Commerce Clause, 39 VAND. L. REV 879, 881–82 (1986). In short, even though Congress has not acted to regulate a given area of interstate commerce, its power to do so lies dormant and the states are prohibited from improperly interfering with this power of Congress.

⁵ On January 18, 2005, the Sixth Circuit denied a request to rehear the case en banc. See Karen Setze, Sixth Circuit Denies Rehearing in Ohio Investment Tax Credit Case, TAX NOTES TODAY, Jan. 19, 2005, at 13–14. The defendants in the case have indicated that they are going to appeal the Sixth Circuit’s decision to the United States Supreme Court. Ohio Tax-Incentive Ruling Stands, COURIER-JOURNAL (Louisville), Jan. 21, 2005, at D1.

As it now stands, Cuno does establish a precedent in the Sixth Circuit with respect to state location investment tax credits. However, the state of Ohio petitioned the Sixth Circuit to postpone putting into effect its decision prohibiting the Ohio Department of Taxation’s administration of the credit. The Sixth Circuit, on January 31, 2005, granted Ohio’s request to “stay the issuance of the mandate” enjoining enforcement of the credit until the state has had the opportunity to file a petition for a writ of certiorari appeal with the United States Supreme Court and the Supreme Court has disposed of the case. See Information Release, Ohio Dep’t of Tax’n, Corporate Revenue Tax Information Release (Sept. 2004, revised Feb. 2005), http://tax.ohio.gov/divisions/communications/information_releases/cft200403.stm. If the Supreme Court denies Ohio’s request for a writ of certiorari, the Sixth Circuit’s decision becomes final. The question that then arises is how broad or narrow of a precedent Cuno will establish on the use of state investment tax credits.


⁷ See infra Part II, Section E.

⁸ See Peter D. Enrich, Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business, 110 HARV. L. REV. 377 (1996) (providing an in-depth analysis of the constitutionality of state investment tax credits and contending that such credits violate the Commerce Clause); Walter Hellerstein & Dan T. Coenen, Commerce Clause Restraints on State Business Development Incentives, 81 CORNELL L. REV. 789 (1996) (examining the restraints imposed by the Commerce Clause on state investment tax credits and concluding that such
this note is not intended to enter the already crowded field of scholarship devoted to analyzing the constitutionality of state investment tax credits under the dormant Commerce Clause doctrine. Rather, the purpose of this note is two-fold. First, this note will examine the potential ramifications that the Sixth Circuit's ruling in *Cuno* may have on Kentucky's investment tax credit scheme. Second, this note will discuss alternative mechanisms less susceptible to constitutional attack that Kentucky could use to encourage economic development within its borders in the event the *Cuno* decision establishes a precedent within the Sixth Circuit.

Part I of this note provides general background information on state investment tax credits, including what they are and why many in the state and local tax arena maintain that they represent an unconstitutional exercise of power by the states. Part II discusses the factual background of the *Cuno* case, as well as the decisions rendered by the district court and the Sixth Circuit. Part III examines the potential impact the *Cuno* decision may have on Kentucky's investment tax credit scheme by comparing and contrasting the investment tax credit at issue in *Cuno* with two of Kentucky's investment tax credits. Finally, Part IV considers other possible economic incentives that Kentucky could offer businesses in place of its investment tax credit scheme.

I. STATE INVESTMENT TAX CREDITS

In general, an investment tax credit is a "tax credit intended to stimulate business investment in capital goods by allowing a percentage of the purchase price as a credit against the taxpayer's income taxes." Typically, states providing investment tax credits have various statutory requirements that must be satisfied in order for a taxpayer to qualify for such credits. For example, the taxpayer's investment may have to meet a specified dollar threshold, or the investment might have to create a certain number of jobs. However, in the case of the *Cuno* decision, the court found that the investment tax credit at issue could not withstand scrutiny under Commerce Clause analysis. It should be noted that Enrich served as lead counsel for the plaintiffs in *Cuno*.

9 See infra notes 13–19 and accompanying text.
10 See infra notes 20–90 and accompanying text.
11 See infra notes 97–118 and accompanying text.
12 See infra notes 119–36 and accompanying text.
13 BLACK'S LAW DICTIONARY 1473 (7th ed. 1999); see also Enrich, supra note 5, at 426 (explaining that an investment tax credit "reduces a business' state income tax liability by a percentage of the new cost of its new plant and equipment located in the taxing state, with the consequence that investment in the state is rendered less costly than an identical investment elsewhere").
14 See, e.g., KY. REV. STAT. ANN. §§ 154.22-040(3), 154.28-080(3) (LexisNexis 2004) (requiring minimum investments of $100,000 in order to qualify for tax credits available under the Kentucky Rural Economic Development Act and the Kentucky Industrial Development Act,
new jobs in a particular locality.\textsuperscript{15} If the business qualifies for the investment tax credit, then the credit may be used to reduce the entity’s corporate income tax or franchise tax liability.\textsuperscript{16}

Regardless of the state-to-state differences in the qualifications for investment tax credits, such credits are employed as an incentive to encourage businesses to locate their new investments in a particular state or municipality. Moreover, the use of location tax incentives by states as a means of spurring in-state economic development is nothing new, as states in the South began offering property tax abatements to businesses in the 1930s.\textsuperscript{17} Today, “[l]ocation incentives [like investment tax credits] have become an ubiquitous feature of the state tax scene, and businesses have come to expect them as a standard part of their siting decisions.”\textsuperscript{18} As one might expect, the fact that nearly all states provide location tax incentives to businesses has created an intense economic battle between the states, with the spoils being the retention or attraction of businesses in or to their respective state. In a bit of an overstatement, one commentator has even characterized this fight among the states as the “second war between the states.”\textsuperscript{19} Nevertheless, the \textit{Cuno} case may be the beginning of the end to this interstate battle, particularly as it relates to states’ use of investment tax credits.

II. The Case of \textit{Cuno v. DaimlerChrysler, Inc.}

\textbf{A. Factual Background of Cuno v. DaimlerChrysler, Inc.}

In 1998, the City of Toledo, Ohio, entered into an agreement with DaimlerChrysler whereby DaimlerChrysler would receive both an invest-
ment tax credit and a property tax exemption, worth a combined $280 million, in return for its investment in a $1.2 billion Jeep Liberty vehicle-assembly plant in Toledo. Clearly, the City of Toledo’s motive in granting these tax incentives to DaimlerChrysler was to provide an economic inducement for the automobile manufacturer to make its substantial capital investment in Ohio, as opposed to another state.

Ohio’s nonrefundable investment tax credit was available to those corporate taxpayers who purchased “new manufacturing machinery and equipment during the qualifying period, provided that the new manufacturing machinery and equipment” were installed in Ohio. The credit ranged from 7.5% to 13.5% of the portion of the investment in new equipment that exceeded the county average for such equipment. The investment tax credit could be used to reduce a taxpayer’s existing Ohio corporate franchise tax liability.

With regard to the property tax exemption received by DaimlerChrysler, the City of Toledo granted DaimlerChrysler a ten-year, 100% property tax exemption. The property-tax exemption was granted pursuant to an Ohio state statute which permits Ohio municipalities to offer property tax exemptions to an enterprise that “agrees to establish, expand, renovate, or occupy a facility and hire new employees, or preserve employment opportunities for existing employees” in economically distressed areas.

B. The District Court’s Dismissal

Subsequent to the agreement, the City of Toledo and DaimlerChrysler (the “defendants”) were both named as defendants in a suit brought by eighteen plaintiffs in the Court of Common Pleas in Lucas County, Ohio. The case was later removed by the defendants to the United States District Court of the Northern District of Ohio, Western Division, pursu-

20 Cuno, 386 F.3d at 741.
23 Many states, including Ohio, commonly impose a corporation franchise tax on for-profit in-state and out-of-state corporations for the privilege of doing business in that state. In Ohio, a corporation’s franchise tax is determined by calculating the value of the entity’s issued and outstanding shares under a net-worth base and a net-income base. See Ohio Rev. Code Ann. § 5733.06(D) (LexisNexis 2005). The taxpayer must pay tax on the base that produces the greater tax, with the total tax liability of any corporation being limited to $150,000 per year. See Ohio Rev. Code Ann. § 5733.06(G) (LexisNexis 2005).
24 See Cuno, 386 F.3d at 741.
26 The plaintiffs were a group of homeowners and small businesses who were encouraged to file suit by Ralph Nader’s Center for the Study of Responsive Law. See Gillis, supra note 6, at 360.
Although the plaintiffs made several allegations involving the legality of the property tax exemption, the primary contention addressed in this Note involves the alleged unconstitutionality of the investment tax credit granted to DaimlerChrysler. More specifically, the plaintiffs contended that "the Ohio statutory scheme permitting the investment tax credit, Ohio Rev. Code § 5733.33, [was] unconstitutional because it violate[d] the Commerce Clause of the United States Constitution and the equal protection clause of the Ohio Constitution."\textsuperscript{30}

In determining whether Ohio's investment tax credit scheme violated the dormant Commerce Clause, the district court judge applied a four-prong test set forth by the Supreme Court in\textit{ Complete Auto Transit, Inc. v. Brady}.\textsuperscript{31} Under the test, "[a] state tax violates the Commerce Clause if: (1) it lacks a 'sufficient nexus with the State;' (2) it 'discriminates against interstate commerce;' (3) it 'is unfairly apportioned;' or (4) 'it is unrelated to services provided by the State.'"\textsuperscript{32} The only disagreement among the parties regarding the outcome of the application of the four elements of the\textit{ Complete Auto} test involved the second element, as the plaintiffs maintained that the investment tax credit violated the dormant Commerce Clause because it discriminated against interstate commerce.\textsuperscript{33} In construing the second element of the test as applied to Ohio's investment tax credit scheme, the district court judge stated:

\begin{quote}
It is well established that states are not precluded from enacting taxation schemes for the benefit of intrastate commerce and industry: "Our decision today does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry. Nor do we hold that a State may not compete with other States for a share of interstate commerce; such competition lies at the heart of a free trade policy. We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State."\textsuperscript{34}
\end{quote}

\textsuperscript{28} \textit{See id.}

\textsuperscript{29} Both the district court and the Sixth Circuit concluded that the property tax exemption did not discriminate against interstate commerce. \textit{See Cuno v. DaimlerChrysler, Inc.}, 386 F.3d 738, 748 (6th Cir. 2004); \textit{Cuno}, 154 F. Supp. 2d at 1203–04.

\textsuperscript{30} \textit{Cuno}, 154 F. Supp. 2d at 1198. This Note will not address the plaintiffs' equal protection argument, as both the district court and the three-judge panel of the Sixth Circuit held that the Ohio investment tax credit statute did not violate the equal protection clause of the Ohio Constitution. \textit{See Cuno}, 386 F.3d at 749; \textit{Cuno}, 154 F. Supp. 2d at 1202.


\textsuperscript{33} \textit{See id.} (quoting \textit{Boston Stock Exch. v. State Tax Comm'n}, 429 U.S. 318, 336–37
The court then noted that the Supreme Court has held unconstitutional two categories of state taxation schemes. The first category rejected by the Supreme Court is a taxation “system that acts as a ‘protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in [the] State’” employing the taxation system. An example of this type of taxation scheme would be where ABC Co., which manufactures its products in State B for sale in State A, is subject to an additional tax, above and beyond what income tax it would normally pay for the privilege of doing business in State A, on those goods it sells in State A. Meanwhile, XYZ Co., which manufactures its products in State A for sale in State A, would not incur any additional tax on those goods it sells in State A. The investment tax credit scheme at issue in Cuno did not operate as a protective tariff or customs duty because it did not place an added taxation burden on goods produced in other states. As the court noted, Ohio’s investment tax credit “is available equally to businesses regardless of their initial location, so long as they increase the amount of their Ohio investment.”

The second category of state taxation held by the Supreme Court as being an unconstitutional violation of the dormant Commerce Clause is a scheme that taxes entities or individuals differently depending on the level of business activity that the taxpayer carries on within a state as compared to business done outside that state. The court discussed the case of Westinghouse Electric Corp. v. Tully, which is the seminal case illustrating this scheme of unconstitutional taxation. In Westinghouse, the Court considered the legality of a state tax credit that New York provided to parent corporations doing business in New York and owning a Domestic International Sales Corporation (“DISC”). New York enacted the state tax credit in response to federal tax legislation that exempted a DISC from federal taxation on its taxable income, but attributed a portion of the DISC’s income to its shareholders. The favorable federal income tax treatment of DISCs was designed to increase the amount of exports from the United States.

As a result of the federal tax legislation regarding the tax treatment of a DISC, New York found itself conflicted. If it followed the lead of the federal government and excluded a DISC from taxation on its income for state
income tax purposes, the state could have lost between twenty and thirty million dollars annually. However, if it taxed a DISC, the state would "discourage their formation in New York and also discourage the manufacture of export goods within the State." Accordingly, New York implemented a taxing scheme that attempted to accommodate both of these interests. Under the legislation, a DISC's income was consolidated with the income of its parent, and the state's franchise tax was imposed on the consolidated taxable income amount reported on the parent corporation's state franchise tax return. A parent corporation would then be accorded a tax credit that would "lower the effective tax rate on the accumulated DISC income reflected in the consolidated return [of the parent corporation] to 30% of the otherwise applicable franchise tax rate." The DISC credit, however, was limited by the "New York export ratio" which was the ratio of the DISC's gross receipts from exports shipped from within New York over the DISC's total gross receipts for all exports.

The discriminatory effect of the New York taxing scheme was clear. A parent corporation conducting business operations in New York, thus subjecting the corporation to state taxation under New York law, and also owning a DISC engaging in export activity within New York would receive a larger tax credit than a parent corporation doing business in New York and owning a DISC that conducted export activity outside of New York. The court recognized the inequitable character of the New York tax credit legislation vis-à-vis companies owning DISCs that conducted export activities outside New York. The court then concluded that such a law that "taxed corporate income but returned a portion of that tax as a credit based on the proportion of total business activity conducted in New York" represented an unconstitutional violation of the dormant Commerce Clause.

Ohio's investment tax credit was analogous to the New York law in that a company could reduce its existing tax liability in Ohio via a tax credit (in this case, an investment tax credit) by increasing its investment of new machinery and equipment in Ohio. However, as the court noted, the New York law had one critical distinction: "an increase in activity conducted out-

43 See id. at 392. At the time of the enactment of the federal legislation exempting DISCs from federal taxation, New York did not "impose its franchise tax on distributions received by a parent from a [DISC] subsidiary." Id. Rather, the DISC subsidiary was taxed directly to the extent it did business in New York. See id. If New York were to enact DISC legislation similar to that enacted by Congress, then New York would no longer be able to collect tax on a DISC doing business in New York, which would result in lost revenues to the state of New York.

44 Id. at 392–93.
45 See id. at 393.
46 Id.
47 Id. at 393–94.
side New York would *decrease* the amount of the credit."\(^{49}\) In contrast to the New York law, an increase in investment outside of Ohio by a corporation already doing business in Ohio would not decrease the amount of the corporation's investment tax credit because the corporation would not qualify for the investment tax credit in the first place (i.e., because its investment would not be made within the state of Ohio).\(^{50}\) Thus, the district court was able to distinguish the Supreme Court's holding in *Westinghouse* from the facts before it and, therefore, concluded that Ohio's investment tax credit scheme fell outside of the second category of taxation declared unconstitutional by the Supreme Court.\(^{51}\)

After finding that Ohio's investment tax credit scheme did not fall within either of the two categories of taxation schemes declared unconstitutional by the Supreme Court, the district court granted the defendant's request to dismiss the case pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure.\(^{52}\) The plaintiffs appealed the district court's decision to the Sixth Circuit Court of Appeals.

**C. The Sixth Circuit's Reversal**

The Sixth Circuit reviewed *de novo* the district court's order dismissing the plaintiffs' claim.\(^{53}\) Like the district court, the three-judge panel of the Sixth Circuit used the four-part *Complete Auto* test.\(^{54}\) More precisely, the court also focused its analysis on the second element of the test by asking whether the tax (or investment tax credit scheme in this case) discriminates against interstate commerce.\(^{55}\) The unanimous panel of the court stated the general rule that a "challenged credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face or if, on the basis of 'a sensitive, case-by-case analysis of purposes and effects,' the provision 'will in its practical operation work discrimination against interstate commerce.'"\(^{56}\) The court noted that the Supreme Court defined the term "discrimination," as used in this context, as "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter."\(^{57}\)

The principal argument set forth by the plaintiffs' on appeal was that Ohio's investment tax credit discriminated

\(^{49}\) *Cuno*, 154 F. Supp. 2d at 1203.

\(^{50}\) *See id.*

\(^{51}\) *See id.*

\(^{52}\) *See id.* at 1203–04.

\(^{53}\) *See Cuno*, 386 F.3d at 742.

\(^{54}\) *See id.*

\(^{55}\) *See id.*

\(^{56}\) *Id.* at 743 (quoting *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 201 (1994)).

\(^{57}\) *Cuno*, 386 F.3d at 743 (citing *Or. Waste Sys., Inc. v. Dep't of Envtl. Quality*, 511 U.S. 93, 99 (1994)).
against interstate economic activity by coercing businesses already subject to the Ohio franchise tax to expand locally rather than out of state. Specifically, any 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.58

To support their argument, the plaintiffs relied on three Supreme Court decisions invalidating state tax schemes that encouraged the "development of local industry by imposing greater burdens on economic activity taking place outside the state."59 While none of these three decisions involved location investment tax credits, they do, however, indicate the relative ease with which the Supreme Court has struck down state taxing schemes that encourage economic activity within a state while simultaneously discriminating against out-of-state activity.

In Boston Stock Exchange v. State Tax Commission,60 the Supreme Court confronted an amendment to New York's transfer tax on securities transactions. The transfer tax applied to "all sales, or agreements to sell, or memoranda of sales and all deliveries or transfers of shares or certificates of stock" made within New York by a corporation.61 Given the fact that New York was, and to this day is, the focal point of the securities industry in the United States, it was highly likely that at least one of these five events would occur within New York during a given security transaction. Under the unamended version of the transfer tax statute, "a transaction involving a sale and a transfer of shares in New York was taxed the same as a transaction involving an in-state transfer but an out-of-state sale."62

However, in the "1960's the New York Stock Exchange became concerned that the New York transfer tax created a competitive disadvantage for New York trading and was thus responsible for the growth of out-of-

58 Cuno, 386 F.3d at 743 (emphasis added).
59 Id.
62 Boston, 429 U.S. at 322.
state exchanges." Since the transfer tax was neutral as to in-state and out-of-state sales, there was no obstacle preventing regional stock exchanges from popping up around the country and expropriating a share of the New York Stock Exchange's business to themselves. Indeed, regional stock exchanges did appear and, in a move designed to protect the New York Stock Exchange, the New York Legislature responded to this undesirable situation by amending the transfer tax statute to provide that "transactions by nonresidents of New York are afforded a 50% reduction in the rate of tax when the transaction involves an in-state sale." Consequently, an individual who sold and transferred a security in New York paid a lower transfer tax than an individual who transferred a security through New York, but sold the security on an exchange outside of New York. Undoubtedly, the effect of this amendment was to reduce out-of-state competition with the New York Stock Exchange, as a significant economic incentive was created for nonresident sellers to sell their stock in New York.

The Supreme Court held that the amendment to the transfer tax statute represented an unconstitutional violation of the dormant Commerce Clause because it discriminated against interstate commerce. The discrimination occurred because the transfer tax amendment imposed a "greater [transfer] tax liability on out-of-state sales than on in-state sales." In doing so, the amendment offended "the very purpose of the [dormant] Commerce Clause [which] was to create an area of free trade among the several States." Indeed, a free trade area with respect to stock sales ceased to exist after the amendment, as it became more expensive to make out-of-state stock sales than it was to make in-state stock sales in New York. The Court summed up the consequences of New York's transfer tax amendment by stating that "[p]ermitting the individual States to enact laws that favor local enterprises at the expense of out-of-state businesses 'would invite a multiplication of preferential trade areas destructive' of the free trade which the [dormant Commerce] Clause protects."

The second Supreme Court opinion relied on by the plaintiffs was *Maryland v. Louisiana*, wherein the Court held unconstitutional a Louisiana statute that imposed a first-use tax on gas extracted from offshore drilling sites in the Gulf of Mexico. As its name implies, the first-use tax was a tax that was imposed "on the 'first use' of any gas imported into Louisiana which was not previously subjected to taxation by another State

63 *Id.* at 323.
64 *Id.* at 324.
65 *Id.* at 332.
66 *Id.* at 328 (quoting McLeod v. J.E. Dilworth Co., 322 U.S. 327, 330 (1944) (internal quotations omitted)).
67 *Id.* at 329 (quoting Dean Milk Co. v. Madison, 340 U.S. 349, 356 (1951)).
or the United States."69 The first-use tax was equal to the severance tax that Louisiana imposed on Louisiana gas producers.70 The motive behind the tax was to "equalize competition between gas produced in Louisiana and subject to the state severance tax of seven cents per thousand cubic feet, and gas produced elsewhere not subject to a severance tax."71

Although this first-use tax may not have been unconstitutional in and of itself, it was accompanied by several tax credits and exclusions that ultimately rendered the statute unconstitutional.72 The principal tax credit at issue in the case was the "Severance Tax Credit," which provided an owner paying the first-use tax on gas drilled offshore a credit in the amount of any state severance tax owed on account of the extraction of natural resources within Louisiana.73 The Court concluded that the Severance Tax Credit discriminated against interstate commerce because it provided a tax savings for those engaged in the production of offshore gas to conduct additional mineral explorations in Louisiana, rather than in another state.74

The third case cited by the plaintiffs as support for their proposition that Ohio's investment tax credit scheme was unconstitutional because it violated the Commerce Clause was Westinghouse Electric Corp. v. Tully.75 The facts of this case were discussed earlier in Part II, Section B.

Although Boston Stock Exchange, Maryland, and Westinghouse did not involve an investment tax credit scheme, they did involve state taxing schemes designed to promote and encourage the development of local industry at the expense of other states. Certainly, one could cabin the Ohio investment tax credit scheme within this unifying feature of these three cases, as the Ohio investment tax credit's ultimate effect is to attract corporations already doing business in Ohio to make future investments in depreciable equipment and real property within the state and not in other jurisdictions.

Perhaps recognizing defeat, the defendants in the case argued that the Supreme Court's holdings in Boston Stock Exchange, Maryland, and Westinghouse should be limited to situations where the tax incentives penalize out-of-state economic activity.76 As has been noted above, Ohio's investment tax credit did not penalize out-of-state economic activity. A corporation already doing business in Ohio that decided to make its investment outside of Ohio would be subject to the same Ohio corporation fran-

69 Id. at 731.
70 See id. at 731. In referring to "Louisiana gas producers" the statute means those gas producers who obtain their gas from within Louisiana, as opposed to the Gulf of Mexico.
71 Id. at 732.
72 See id. at 760.
73 See id. at 732.
74 See id. at 760.
76 Cuno, 386 F.3d at 745.
chise tax that it would pay had it never made the out-of-state investment. According to the defendants:

[T]he only tax credits and exemptions that would run afoul of the Commerce Clause fall into two categories: those that function like a tariff by placing a higher tax upon out-of-state business or products and those that penalize out-of-state economic activity by relying on both the taxpayer's in-state and out-of-state activities to determine the taxpayer's effective tax rate.\textsuperscript{77}

The defendants also made the argument that Ohio's investment tax credit was merely a direct subsidy by the state of Ohio.\textsuperscript{78} The court acknowledged the objective of the defendants' claim by stating that "[t]he majority in \textit{New Energy} noted in dicta that subsidies do not 'ordinarily run afoul of [the Commerce Clause]' because they are not generally 'connected with the State's regulation of interstate commerce.'"\textsuperscript{79} Ultimately, the court rejected both of the defendants' arguments and concluded that Ohio's investment tax credit statute violated the Commerce Clause of the United States Constitution and, therefore, was unconstitutional.\textsuperscript{80}

\textbf{D. Other Significant Supreme Court Cases Dealing with State Tax Incentives}

In addition to the aforementioned Supreme Court opinions relied on by the plaintiffs in \textit{Cuno}, there are two other significant Supreme Court decisions involving the constitutionality of state tax incentives. These cases are \textit{Bacchus Imports, Ltd. v. Dias}\textsuperscript{81} and \textit{New Energy Co. of Indiana v. Limbach},\textsuperscript{82} both of which were cited by the Sixth Circuit in \textit{Cuno}. These two cases further demonstrate the Court's willingness to strike down a discriminatory state tax incentive provision and the incredibly steep, uphill climb a party would likely have in arguing that an investment tax credit like that at issue in \textit{Cuno} does not violate the dormant Commerce Clause.

In \textit{Bacchus}, the Court was called upon to determine the constitutionality of an exemption from a liquor excise tax imposed on the sale of liquor in Hawaii.\textsuperscript{83} The exemption was only applicable to wholesalers who sold

\textsuperscript{77} \textit{Id.}

\textsuperscript{78} \textit{See id.} at 746.

\textsuperscript{79} \textit{Id.} (quoting \textit{New Energy Co. of Indiana v. Limbach}, 486 U.S. 269, 278 (1988) (second alteration in original)).

\textsuperscript{80} \textit{Cuno}, 386 F.3d at 748. "The Ohio Department of Development has issued an open letter explaining that it will 'continue to inform qualified companies of the availability of the credit' while the matter is on appeal." Gillis, \textit{supra} note 6, at 362 (quoting Open Letter from Ohio Dept' of Dev.) (Sept. 15, 2004)).

\textsuperscript{81} \textit{Bacchus Imps., Ltd. v. Dias}, 468 U.S. 263 (1984).

\textsuperscript{82} \textit{New Energy Co. of Ind. v. Limbach}, 486 U.S. 269 (1988).

\textsuperscript{83} \textit{See Bacchus}, 468 U.S. at 265.
alcoholic beverages containing certain ingredients indigenous to Hawaii.\(^8\)

This meant that liquor wholesalers who sold beverages that did not contain these locally produced ingredients paid higher taxes than their competitors selling drinks containing these ingredients. This was not an unintended result, as the legislators enacted the exemption to "encourage development of the Hawaiian liquor industry."\(^8\) The Court struck down the Hawaii liquor tax exemption, concluding that it "violated the [dormant] Commerce Clause because it had both the purpose and effect of discriminating in favor of local products."\(^8\)

*Limbach* involved the constitutionality of an Ohio state tax credit that could be used to offset the motor vehicle fuel sales tax paid by dealers on the sale of gasohol (a mixture of gasoline and ethanol) in Ohio.\(^8\) The point of contention was that the credit was only available to fuel dealers selling gasohol containing ethanol produced in Ohio or in a state that provided a similar tax credit for the sale of gasohol containing ethanol produced in Ohio.\(^8\) The Court summed up the discriminatory effects of the Ohio tax credit provision by noting that it "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."\(^8\) As a result of the motor vehicle fuel tax credit's discrimination toward interstate commerce, the Court held that the tax credit was unconstitutional because it violated the dormant Commerce Clause.\(^9\)

E. Congressional Response to the Sixth Circuit's Decision

in *Cuno v. DaimlerChrysler*

After the Sixth Circuit panel's decision in *Cuno*, Senator George V. Voinovich, R-Ohio, introduced legislation on October 1, 2004, intended to overrule the court's decision by clarifying "that State tax incentives for investment in new machinery and equipment are a reasonable regulation of commerce and not an undue burden on interstate commerce, and for other purposes."\(^9\) In addition, Representative Ben Chandler, D-Kentucky, introduced similar legislation on December 6, 2004.\(^9\) Both bills were referred to com-

\(^8\) See id.  
\(^8\) Id.  
\(^8\) Id. at 273.  
\(^8\) See *Limbach*, 486 U.S. at 271.  
\(^8\) See id.  
\(^8\) Id. at 274.  
\(^8\) Id. at 280.  
mittees and no further action was taken on either bill before the end of the 108th Congress, meaning that they would have to be reintroduced in the following session of Congress to be enacted.

On May 18, 2005, Representative Patrick J. Tiberi, R-Ohio, introduced the Economic Development Act of 2005, which would allow states to provide tax incentives for economic development purposes "that otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause of the United States Constitution." Senator Voinovich introduced an identical version of the House bill in the Senate on the same date. Both versions of the Economic Development Act of 2005 would operate retroactively in that they would insulate previously enacted state investment tax credit statutes from constitutional attack on dormant Commerce Clause grounds. The two bills do, however, provide that a number of state tax incentives would not qualify for the Act’s protections, including those incentives that are dependent upon the taxpayer’s state of incorporation or domicile; require the taxpayer to acquire or use property or services produced in the state; are reduced or eliminated as a direct result of an increase in out-of-state activity; require other taxing jurisdictions to offer reciprocal taxing benefits; or can only be used to reduce a tax burden on a tax that is not imposed on apportioned interstate activities. To date, aside from being referred to their respective committees, no further Congressional action has occurred on either bill.

III. Cuno v. DaimlerChrysler’s Impact on Kentucky’s Investment Tax Credit Scheme

A. Location Investment Tax Credits in Kentucky

Before we can evaluate the repercussions that the Sixth Circuit’s decision in Cuno could potentially have in Kentucky, we must first gain a basic understanding of the types of tax incentives available to businesses desiring to make qualifying investments within Kentucky. Although there are a number of business tax incentives available in Kentucky, this Note will specifically focus on the investment tax credits established under the Kentucky Rural Economic Development Act (KREDA) program and the

93 H.R. 2471, 109th Cong. (2005). The bill defines “economic development purposes” as “all legally permitted activities for attracting, retaining, or expanding business activity, jobs, or investment in a State.” Id.
96 Id.
Kentucky Industrial Development Act (KIDA) program. 98 KREDA and KIDA are two of the major programs through which investment tax credits are made available to businesses making investments in Kentucky. 99 Under KREDA, businesses must establish new manufacturing plants or expand existing manufacturing operations in Kentucky counties meeting certain unemployment rates in order to qualify. 100 In contrast, there is no such requirement for businesses seeking to take advantage of the KIDA tax incentive program when establishing new manufacturing facilities.

The main qualifications that businesses must meet in order to take advantage of either the KREDA or KIDA tax incentive programs are that (1) their new economic development project(s) must involve a minimum investment of $100,000 and (2) create at least fifteen new full-time jobs. 101 Assuming a business meets the qualifications for the respective tax incentive program, the business may receive up to a 100% credit against the Kentucky income tax imposed on the taxable income generated by the project during the business' fiscal year. 102 The duration of the tax incentives granted under either program will vary with the program, but the maximum amount of the credit available will be limited to the business' total expenditures for the project. 103


99 A business seeking to take advantage of the tax credit incentives offered under either of these two programs must obtain approval from the Kentucky Economic Development Finance Authority, which was established within the state's Cabinet for Economic Development to "encourage economic development, business expansion, and job creation by providing financial support through an array of financial assistance and tax credit programs." Kentucky Cabinet for Economic Development, Business Incentives, http://www.thinkkentucky.com/kyedc/kybizince.asp (last visited Aug. 15, 2005) [hereinafter Kentucky Business Incentives Website].

100 In 2003 alone, 32 companies received preliminary approval and 24 businesses received final approval under the KREDA program, with their investments in Kentucky estimated to be $269 million and $161 million, respectively. 2003 Ky. Cabinet for Econ. Dev. Ann. Rep. 17, available at http://www.thinkkentucky.com/kyedc/annual_reports/2003%20annual%20report.pdf (last visited Aug. 15, 2005). In addition, those companies receiving preliminary approval were expected to create 2,482 new jobs in Kentucky while those companies receiving final approval generated 1,750 additional jobs. Id.

Under the KIDA program in 2003, 53 companies received preliminary approval and 30 businesses received final approval, with their investments in Kentucky estimated to be $625 million and $821 million, respectively. Id. at 16. Those companies receiving preliminary approval were expected to create 3,533 new jobs in Kentucky, while those completing their KIDA transactions generated 3,464 additional jobs. Id.


103 See Ky. Rev. Stat. Ann. §§ 154.22-050(8), 154.28-090(7) (LexisNexis 2004) (indicating how the KREDA and KIDA credits, respectively, are applied against the income generated by the economic development projects).

104 Under the KREDA program, the duration of the tax incentive credit will "terminate
B. Constitutionality of Investment Tax Credits Granted Under KREDA and KIDA

One of the ways in which we can analyze the constitutionality of the investment tax credits granted under the KREDA and KIDA programs is to compare and contrast them with the investment tax credit deemed unconstitutional by the Sixth Circuit in Cuno. Clearly, any similarities between Kentucky's location investment tax credits and the Ohio investment tax credit at issue in Cuno will lend support to the argument that the credits made available under the KREDA and KIDA programs are unconstitutional in light of the Sixth Circuit's holding in Cuno. Correspondingly, any distinctions that can be drawn between Kentucky's investment tax credits and the Ohio investment tax credit found unconstitutional in Cuno will strengthen the argument that the KREDA and KIDA tax credits would not be subject to the precedent established by the Sixth Circuit's ruling in Cuno.

The most obvious characteristic shared by these three tax credits is the fact that they are location investment tax credits. As such, they are only available to businesses making investments in the state where the investment tax credit is granted. This inherent qualifier means that these "location incentives facially distinguish between in-state and out-of-state activities in specifying the parameters of their applicability." This conclusion is significant because the Cuno court stated that "[i]n general, a challenged [state tax] credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face ... against interstate commerce." One could reasonably conclude that all KREDA and KIDA tax credits discriminate against interstate commerce, as the Cuno court interpreted the term "discrimination" in this context as meaning "differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." Certainly, a business choosing to expand or locate new operations in Kentucky may enjoy a reduced tax burden vis-à-vis a business choosing to invest in a state not offering a similar tax credit. Assuming equal corporate tax rates between the two states, the latter business could

upon the earlier of the full receipt of the maximum amount of inducements by the approved company or fifteen (15) years after the activation date [of the project]." Ky. Rev. Stat. Ann. § 154.22.050(4) (LexisNexis 2004). The duration of the tax incentive credit under the KIDA program will "terminate upon the earlier of the full receipt of the maximum amount of inducements by the approved company or ten (10) years from the activation date [of the project]." Id. at § 154.28-090(4) (LexisNexis 2004).

105 Enrich, supra note 8, at 433.

106 Cuno, 386 F.3d at 743 (internal quotations omitted). Neither the district court nor the Sixth Circuit, however, concluded that the Ohio investment tax credit statute at issue in Cuno facially discriminated against interstate commerce.

107 Id. (citing Or. Waste Sys., Inc. v. Dep't of Envtl. Quality, 511 U.S. 93, 99 (1994)).
incur a higher tax burden on the incremental income generated from the new project because the state in which it located its new investment does not offer a credit similar to the KREDA or KIDA tax credits.

Another, but less important, feature shared by these tax credits is their respective state’s motive in making them available to businesses for certain qualifying investments. Ohio and Kentucky consciously devised these tax credits as a means of inducing businesses to make future investments within their borders, at the expense of other states. In essence, these location investment tax credits represented a tradeoff to Ohio and Kentucky, as they would forego tax revenue in exchange for the economic growth expected from investment in their state.

There are, however, a number of distinguishing characteristics between Kentucky’s investment tax credits under the KREDA and KIDA programs and the investment tax credit deemed unconstitutional in Cuno. While many of these differences merely involve the threshold requirements that must be met before a business qualifies to take advantage of the investment tax credits, they do differ in at least one potentially significant respect. The Ohio investment tax credit at issue in Cuno functions as a credit against a corporation’s “existing tax liability.” In contrast, the tax credits available under the KREDA and KIDA programs may be used to reduce income generated by the new economic development project.

Based on this distinction, one could argue that Cuno may be limited to those matters involving investment tax credits that reduce a business’ “existing tax liability” as opposed to tax credits that operate against the incremental income generated by a new investment or project. The Cuno decision provides some support for this argument, although it did so in the context of discussing its rationale for holding that the personal property

108 See Cuno v. DaimlerChrysler, Inc., 154 F. Supp. 2d 1196, 1201 (N.D. Ohio 2001) (noting that the purpose of the enactment of the investment tax credit was to “encourage industrial investment and development in Ohio, particularly in economically troubled areas”); Kentucky Business Incentives Website (indicating that these credits further “the Commonwealth’s goals of achieving long-term economic growth and full employment for its citizens”).

109 Cuno, 386 F.3d at 743 (emphasis added); see Ohio Rev. Code Ann. § 5733.33(B)(1) (LexisNexis 2005) (indicating that the investment tax credit is allowed against the corporation franchise tax imposed on taxpayer corporation). Ohio Rev. Code Ann. § 5733.33(C)(4) provides that the credit must be taken evenly over this tax return and the following six returns, beginning in the tax year immediately following the calendar year in which the new manufacturing machinery and equipment is purchased.

110 See Ky. Rev. Stat. Ann. §§ 154.22-050(8)(a), 154.28-090(7)(a) (LexisNexis 2005) (indicating that the KREDA and KIDA credits, respectively, may be used against the Kentucky income tax that would be owed “on the income of the approved company generated by or arising from the economic development project”).

111 But see Edward A. Zelinsky, Cuno v. DaimlerChrysler: A Critique, 105 Tax Notes 225, 226 (2004) (questioning the Cuno court’s suggestion that an investment tax credit that reduces pre-existing income tax liability is unconstitutional while the same credit would not be unconstitutional when issued in the form of a property tax exemption).
tax exemption did not discriminate against interstate commerce. The court noted that

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 to the Ohio tax regime or its failure to reduce current property taxes.... Every new investment, no matter where undertaken, would be exempt from a [Ohio] tax. Thus, businesses that desire to expand are neither discriminated against nor pressured into investing in Ohio.112

The Sixth Circuit's approach in Cuno appears to have come from the reasoning advanced by Professors Hellerstein and Coenen who argue that there is a distinction between exemptions or reductions that merely reduce a business' existing tax liability and those that reduce "additional state tax liability to which the taxpayer would be subjected only if the taxpayer were to engage in the targeted activity in the state."113 Professors Hellerstein and Coenen note that the effect of the latter types of exemptions or reductions differ from the effect of the tax incentives at issue in the cases the Supreme Court has dealt with in the past.114 According to the two professors, in the prior tax-incentive cases that the Supreme Court addressed, the states were basically telling businesses:

You are already subject to our taxing power because you engage in taxable activity in this state. If you would like to reduce your tax burdens, you may do so by directing additional business activity into this state. Should you decline our invitation, we will continue to exert our taxing power over you as before, and your tax bill might even go up.115

Under Hellerstein and Coenen's test, location investment tax credits that reduce a business' existing tax liability discriminate against interstate com-

112 Cuno, 386 F.3d at 747-48.
113 Hellerstein & Coenen, supra note 8, at 807.
114 See id.
115 Id. at 808.
merce because they favor in-state over out-of-state activity and involve the "coercive power of the state."\(^{116}\)

On the other hand, Hellerstein and Coenen argue that location investment tax credits that reduce additional state tax liability that would be generated from the project do not "favor in-state over out-of-state investment ... nor do they rely on the coercive power of the state to compel a choice favoring in-state investment."\(^{117}\) In the context of a property tax exemption, Hellerstein and Coenen note that the states would, in effect, be saying: "Come to our state and we will not saddle you with any additional property tax burdens. Moreover, should you choose not to accept our invitation, nothing will happen to your tax bill—at least nothing that depends on our taxing regime."\(^{118}\)

Presumably, this same line of thinking could be extended to investment tax credits like those under the KREDA and KIDA programs that reduce the incremental income generated by the new investment or project.

### IV. Alternative Economic Development Mechanisms for Kentucky

#### A. Need for Alternative Economic Development Mechanisms

Based on the above discussion, it is not clear whether the *Cuno* decision, should it stand, would render the investment tax credits made available under the KREDA and KIDA programs unconstitutional. It would appear that under a literal reading of the Sixth Circuit's decision in *Cuno*, the KREDA and KIDA investment tax credits, while equally available to in-state and out-of-state businesses, could be said to facially discriminate against interstate commerce because the credits are only given to businesses making in-state investments. However, it may be that *Cuno* only applies to investment tax credits that reduce a taxpayer's pre-existing tax liability. If so, the KREDA and KIDA credits would probably not fall under *Cuno*.

This inability to accurately predict how *Cuno*, or Congress for that matter, will ultimately affect Kentucky's investment tax credits under the KREDA and KIDA programs raises a significant problem if one subscribes to the notion that tax incentives, such as investment tax credits, factor into a business' investment location decision. As pointed out by Michigan, Kentucky, and Tennessee in their *amici curiae* brief, this uncertainty may have a chilling effect on all states within the Sixth Circuit, as businesses may be wary of undertaking future investments in these states for fear that the investment tax credits granted to them may be rendered unconstitu-
Accordingly, it is useful to discuss some alternatives that Kentucky could employ in place of the investment tax credits under the KREDA and KIDA programs.

B. State Subsidization of Business

One constitutional alternative that could be employed by Kentucky would be the less glamorous, old-fashioned state subsidy. The approach here would be for Kentucky to induce businesses to make their investments within the state in exchange for a direct cash subsidy. One may reasonably question whether a distinction can be drawn between an investment tax credit and a direct cash subsidy, as both provide favorable economic treatment only to businesses making in-state investments. Nevertheless, state subsidies differ from investment tax credits in that subsidies come from existing state revenues and must be appropriated by the legislature, while investment tax credits constitute foregone tax revenues. Consequently, subsidies are by nature a more visible and political means of providing location incentives to businesses than investment tax credits.\textsuperscript{120}

The primary authoritative support for the constitutionality of state subsidies comes from the relatively recent Supreme Court decision in *West Lynn Creamery, Inc. v. Healy.*\textsuperscript{121} In this case, the Court confronted a Massachusetts tax that required every milk dealer in the state to pay a “monthly ‘premium payment’ into the ‘Massachusetts Dairy Equalization Fund.’”\textsuperscript{122} Thus, the “premium payment” or tax itself was nondiscriminatory, as it was imposed regardless of where the milk was produced, such that both in-state and out-of-state milk producers selling milk in Massachusetts were subject to the tax. The revenue generated from this tax was then placed into a separate fund. Controversy arose when Massachusetts took the money kept in the fund and, on a monthly basis, distributed it solely to Massachusetts producers.\textsuperscript{123} In effect, the Massachusetts milk producers received a tax rebate or subsidy for the monthly tax for which they were responsible. Meanwhile, the out-of-state milk producers received no such rebate.


\textsuperscript{120} See Enrich, supra note 8, at 442–43. \textit{But see Edward A. Zelinsky, Restoring Politics to the Commerce Clause: The Case for Abandoning the Dormant Commerce Clause Prohibition on Discriminatory Taxation, 29 Ohio N.U. L. Rev. 29, 52 (2002) (arguing that it is “an inaccurate, if commonly invoked oversimplification, that direct subsidies are necessarily scrutinized more frequently than tax incentives,” which are made visible by tax expenditure budgets).}

\textsuperscript{121} West Lynn Creamery, Inc. v. Healy, 512 U.S. 186 (1994).

\textsuperscript{122} \textit{Id.} at 190.

\textsuperscript{123} \textit{Id.} at 191.
As the Court indicated, the premium payments by the out-of-state milk producers, combined with the tax rebates to in-state producers, made "milk produced out of State more expensive." Therefore, the Court held that the Massachusetts scheme discriminated against interstate commerce in violation of the Commerce Clause and struck down the scheme as unconstitutional.

Despite the Court's opinion invalidating the use of state subsidies to in-state milk producers, *West Lynn Creamery* does not stand for the proposition that the use of state subsidies as a means of encouraging local development is always unconstitutional. In fact, Justice Stevens' majority opinion specifically states that "[a] pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business." In addition, the majority went on to say in a footnote that the Court has "never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that 'direct subsidization of domestic industry does not ordinarily run afoul' of the negative Commerce Clause."  

Justice Stevens' opinion indicates that the use of subsidies in this case was unconstitutional because the subsidies paid to the in-state milk producers were "funded principally from taxes on the sale of milk produced in other States." Had the premium payments been paid into Massachusetts' general fund, rather than a segregated fund, and then distributed to the in-state milk producers, the use of state subsidies likely would not have been declared unconstitutional. Professors Hellerstein and Coenen conclude that courts properly interpreting *West Lynn Creamery* "should not treat state subsidies afforded to local businesses the same as tax breaks that discriminate in their favor; rather, courts should strike down only those subsidies that operate... as discriminatory de facto rebates of an identifiable state tax."  

There are, however, a number of potential drawbacks to Kentucky embarking on the path of using state subsidies as a vehicle for economic development in the state. First, there is the question of funding the subsidies. In order for Kentucky to provide subsidies to businesses, the money would have to be appropriated by the Kentucky legislature and would comprise an item in the state's annual budget. Consequently, *ceteris paribus*, funds would have to be allocated away from other state projects currently receiving state funding. One can imagine the heated political battles that would
ensue with this practice of taking state funds away from an existing recipient (e.g., a state university) and giving them to a business in the form of a direct cash subsidy.

Second, the Court has yet to provide a bright-line rule that all cash subsidies are constitutional. Since investment tax credits and direct cash subsidies have virtually the same effect, subsidies could very well be on shaky constitutional ground.¹³⁰

Third, it may well be that both investment tax credits and direct cash subsidies are completely unnecessary mechanisms for increasing state economic development in Kentucky. Many state tax scholars and commentators contend that it is futile for states to use state taxes and tax incentives as means of spurring economic development, as businesses choose the location of their investments largely independent of tax considerations.¹³¹ These scholars point out that state taxes represent a very small cost to businesses because of their deductibility for federal income tax purposes,¹³² and that there are other, more significant factors that determine where businesses establish their investments. Some of these considerations include the skill level and cost of labor, the proximity of the location to customers and suppliers, and utility costs.¹³³ Assuming that state taxes and tax incentives play little or no role in a business’ investment decision, then it is logical to conclude that a state offering a cash subsidy or an investment tax credit as a way of furthering economic development would merely be wasting its resources, or foregoing additional tax revenue in the case of an investment tax credit, and would be better served using the funds for another purpose.¹³⁴

C. Lowering Corporate Income Tax Rates

Another potential method by which Kentucky could enhance the state’s attractiveness as a location for economic development would be to lower its corporate income tax rates. Several state tax commentators have noted

¹³⁰ See Zelinsky, supra note 111, at 46 (maintaining that, “[s]ince virtually any tax incentive can, in design and economic effect, be recast as a direct expenditure program [like a subsidy], there is no compelling basis” for a distinction between investment tax credits and direct cash subsidies).


¹³² See I.R.C. § 164(a)(3) (West 2004), which provides businesses with a federal income tax deduction for state and local income taxes paid.

¹³³ See Enrich, supra note 8, at 392; Pomp, supra note 131, at 522–23.

¹³⁴ Note that in the event a business has identified two potential sites, each in a different state, that are equal in all respects other than the fact that one state does not grant investment tax credits, it is logical that investment tax credits could serve as a tie breaker.
that it would be unlikely for the Supreme Court to hold that state corporate income tax rate reductions would violate the dormant Commerce Clause.\textsuperscript{135} Support for their view is buttressed by the Supreme Court’s indication that “the appropriate level or rate of taxation is essentially a matter for legislative, and not judicial, resolution.”\textsuperscript{136} Presuming that reductions by a state in its corporate income tax are constitutional, the exact rate reduction for Kentucky would be a matter for its legislature to determine.

Although there are numerous considerations that Kentucky would have to address before it enacted legislation providing for the reduction of its corporate income tax rates, there are two that are pertinent to this discussion. First, like the use of investment tax credits, a state’s decision to reduce its corporate income taxes would likely be grounded, in part, on its desire to attract in-state economic development. Based on the Court’s dormant Commerce Clause jurisprudence, one could make the reasonable argument that since rate reductions ultimately are indistinct from investment tax credits with respect to their economic result (i.e., businesses wind up facing lower state income tax burdens), they too discriminate against interstate commerce. And second, if it is true that businesses largely do not make their siting decisions based on state taxes and tax incentives, then Kentucky would unnecessarily be giving up tax revenue by lowering its corporate income tax rates.

\textbf{Conclusion}

The Sixth Circuit’s decision in \textit{Cuno} has definitely created a stir within the state and local tax community with respect to the constitutionality of creating investment tax credits as a means of promoting and encouraging in-state economic development. Unfortunately, the court’s decision makes it far from clear whether the investment tax credits granted by the KREDA and KIDA programs represent unconstitutional violations of the dormant Commerce Clause. A broad reading of the \textit{Cuno} court’s opinion tends to support the notion that these tax credits are unconstitutional because they appear, in one respect, to facially discriminate against interstate commerce, as the credits may only be taken advantage of by taxpayers making in-state investments in Kentucky. However, as the court pointed out, the Ohio investment tax credit at issue reduced the taxpayer’s existing tax liability.\textsuperscript{137}

\begin{itemize}
\item \textsuperscript{135} See Enrich, \textit{supra} note 8, at 459 (stating that “it would be a shocking development if state choices about uniformly applied tax rates were to become objects of Commerce Clause scrutiny”); Zelinsky, \textit{supra} note 111, at 228 (arguing that it would be “anomalous to conclude that states cannot reduce their corporate [income] tax rates without violating the nondiscrimination test of Complete Auto”) (emphasis added).
\item \textsuperscript{137} See \textit{Cuno}, 386 F.3d at 743.
\end{itemize}
In contrast, the investment tax credits granted under the KREDA and KIDA programs only reduce the incremental income associated with the new investment. It is uncertain whether or not this distinction between the two states' investment tax credits is significant enough to preclude *Cuno* from serving as a precedent for attacking Kentucky's investment tax credits. Should the Supreme Court grant the *Cuno* petitioner's request for a writ of certiorari, we may someday have clearer guidance as to the tax incentives a state can constitutionally enact without violating the dormant Commerce Clause.

Even if the investment tax credits granted pursuant to the KREDA and KIDA programs are deemed unconstitutional, there are other mechanisms less vulnerable to constitutional attack that Kentucky could enact that would help it attract investment within the state. Two such alternatives include the use of direct cash subsidies and/or the reduction of the state's corporate income tax rates. There are disadvantages associated with each of these alternatives. Even if not using either of these mechanisms, Kentucky should consider, before deciding on a particular course of action, the possibility that state taxes and tax incentives play a very minor role in a business' siting decision and that the state would be better off focusing on those considerations that carry more significance.