

# Quick Takes

September 2004

Quick Takes- The Ohio case: Constitutional attacks on investment tax credits and other incentives

Date: September 13, 2004

Newspaper reports last week highlighted a federal case out of Ohio in which the State's investment tax credit was ruled unconstitutional under the U.S. Constitution. This matter is serious enough to merit a special edition of *Quick Takes*. The case is *Cuno v. DaimlerChrysler, Inc.*, 6th Cir., No. 01-3960 (Sept. 2, 2004). It has been called a "test case" that was brought deliberately to challenge state incentives programs as such (a law school professor argued the plaintiffs' case before the appeals court).

Here's what happened. (unless otherwise indicated, quotations are from the court's opinion)

"In 1998, DaimlerChrysler entered into an agreement with the City of Toledo to construct a new vehicle-assembly plant near the company's existing facility in exchange for various tax incentives. DaimlerChrysler estimated that it would invest approximately \$1.2 billion in this project, which would provide the region with several thousand new jobs. In return, the City and two local school districts agreed to give DaimlerChrysler a ten-year 100 percent property tax exemption, as well as an investment tax credit of 13.5 percent against the state corporate franchise tax for certain qualifying investments. The total value of the tax incentives was estimated to be \$280 million."

The incentives were challenged in court by 18 plaintiffs (including 3 businesses), who lost in federal district court, but won in the federal court of appeals when the investment tax program (but not the property tax program) was ruled unconstitutional.

The plaintiffs ultimately won their attack on the investment tax credits, because the appeals court thought Ohio's program violated the "Commerce Clause" of the U.S. Constitution. Under Article I, Section 8, Clause 3 of the U.S. Constitution, Congress is

authorized: "To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes".

Among other grounds given by the appeals court for its decision, it said:

“[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.”

Of course, that's what incentives are all about- a state or community is trying to get a company to invest there, instead of somewhere else!

In order for the court to have reached a contrary decision (that is, that the investment tax program was valid), it could have taken the position that tax incentives offered in one state are just part of its tax regime and are therefore permissible. In other words, if the *Cuno* decision is overruled (see below), it might be through an opinion that the Commerce Clause prohibits burdening interstate commerce, but one state's incentives do not burden other states.

In upholding the property tax abatement program, among other things the appeals court made a distinction between a tax credit and a tax exemption.

“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.”

What does this mean for our incentives programs in Georgia? First, Georgia is in the Eleventh Circuit Court of Appeals (which also includes Alabama and Florida), not in the Sixth Circuit with Ohio (the Sixth Circuit also includes, among other states, Tennessee and Kentucky). The *Cuno* decision is not now binding in Georgia. Next, the Governor of Ohio has asked his Attorney General to appeal the *Cuno* decision, either to the full Sixth Circuit bench, or by trying to bring it before the U.S. Supreme Court. Hopefully, *Cuno* will end up in the dustbin of other bad ideas. Finally, there are ways to “design around” *Cuno*. From the decision, it looks like substituting a direct subsidy program, under which the company pays full taxes but gets a grant in return, may be constitutional (under the U.S. Constitution), even under *Cuno*. I can think of some other “design arounds”, as well.

We are still in the early stages of analyzing this case's consequences, and there may be more judicial activity that affects this decision. However, one thing is already clear-economic development, which is already hard, just got harder.

If you would like a copy of the *Cuno* case (no charge), just email me a request.

Dan

September 13, 2004 interest rates on IDBs (variable rate demand bonds; AMT; 7 day general markets; rates are market extracted and approximations):

Interest Rates:  
tax-exempt 1.48%  
taxable 1.86%

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