

## CUNO V DAIMLERCHRYSLER:

### WILL THE SUPREME COURT STRIKE DOWN BUSINESS TAX INCENTIVES?

BY JOSHUA S. SMITH AND JOHN D. MILLER

*The following article is an update on a case first discussed in the October 2005 issue of Law and Business. That article, "Michigan Tax Incentives in Jeopardy After Recent Court Ruling", can be found at [www.fraserlawfirm.com](http://www.fraserlawfirm.com). Click on the Law and Business link.*

On October 19, 2004, a federal court issued a ruling that may affect Michigan's business and investment tax incentives in *Cuno v DaimlerChrysler, Inc.* At issue in *Cuno* was a system of tax credits and property tax exemptions offered to DaimlerChrysler to expand its facilities in Toledo, Ohio. Specifically, Ohio's investment tax credit (ITC) credited DaimlerChrysler approximately \$280,000,000 against its franchise taxes for purchasing new manufacturing machinery and installing it in Ohio. Several local taxpayers and property owners, including some from Michigan, filed suit, arguing that the tax breaks violated the Commerce Clause of the U.S. Constitution. The trial court held that the tax credits and exemptions were completely lawful, but the appellate court reversed.

All of the parties appealed the ruling. DaimlerChrysler and the State of Ohio appealed the Commerce Clause ruling; the plaintiffs appealed the property tax ruling. The U.S. Supreme Court decided to take the Commerce Clause appeal, hearing arguments on March 1, 2006. A decision is expected by July. This article summarizes and analyzes the parties' arguments.

DaimlerChrysler and Ohio both argued that Cuno and the other taxpayers lacked standing to bring their claim. In order to bring suit in a federal court, a party has to show that it suffered an actual or imminent injury that is concrete and specific, that the conduct complained of caused the injury and that a favorable decision will redress the injury. The plaintiffs argued that they had standing as taxpayers relying

on a specific constitutional provision, the Commerce Clause.

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At oral arguments, the Court apparently showed skepticism regarding the plaintiffs' standing to bring suit. According to *The Wall Street Journal*, "several justices expressed doubts that the taxpayers . . . established

that the incentives caused a financial injury." Thus, it could be that the Court reverses the case based on the standing issue.

A reversal on standing, however, poses several problems. Plaintiffs may be able to raise the same issues in state courts, meaning that the issue would remain active. Moreover, instead of being susceptible to a uniform rule, it would potentially be subject to 50 different rules. On the other hand, for Michigan observers, any such ruling in *Cuno* would apply only to Ohio and Michigan's own standing rules, which mirror those of the federal courts, would likely prevent such a claim from being raised in Michigan courts.

DaimlerChrysler and Ohio also argued that the Commerce Clause did not prohibit the ITC. The Commerce Clause prohibits states from erecting protectionist barriers

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continued

against goods and services from other states or from otherwise engaging in discriminatory economic conduct. They argued that in order for the Commerce Clause to prohibit the activity, it must place an actual financial burden on out-of-state commerce and it must unfairly discriminate against interstate commerce by placing a greater burden on out-of-state entities.

The ITC they argued, did none of these things. First, the ITC constitutes a subsidy, which does not violate the Commerce Clause. Second, no discrimination could have occurred because any entity investing outside of Ohio will likely *decrease* its Ohio tax burden while one investing in Ohio will likely *increase* its Ohio tax burden, even with the ITC. Nor are the two companies comparable, because they would be investing in different states and subject to different tax regimes. In addition, the tax laws of other states will also factor into any investment decision, making the ITC merely

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one factor among many. Moreover, other states can compete with Ohio by offering similar incentives.

The plaintiffs present a somewhat weak Commerce Clause argument. They state that the purpose of the Commerce Clause is to create a national common market, thus prohibiting discrimination or other distortions through preferential tax schemes. States cannot give direct advantage to in-state companies through discriminatory taxes. Because the ITC creates a system in which taxes will always fall heavier on non-Ohio companies, it discriminates in favor of Ohio companies and violates the Commerce Clause. This contention forms the crux of the plaintiffs' argument.

The plaintiffs provided an example to buttress their claim. The Ohio franchise tax is levied at 7.5%, apportioned as follows: 60% based on sales in Ohio, 20% based on Ohio property and 20% based on Ohio payroll. According

to the plaintiffs, two companies with \$10,000,000 in Ohio sales would pay \$850,000 per year. If one of those companies invests \$100,000,000 in Ohio, it would receive a credit of 7.5% of the investment, divided evenly over seven years. The company investing in Ohio would pay no franchise taxes and the tax burden would fall disproportionately on firms failing to invest in Ohio.

The example, however, contains deep flaws. First, it fails to account for the fact that only 60% of the franchise tax is based on Ohio sales; thus, the relevant tax on Ohio sales of \$10,000,000 is actually \$510,000. Second, it ignores that the ITC applies only to investment *above the baseline investment for previous years*. Third, it is easily refuted.

Using the above examples, assume both companies have \$50,000,000 worth of property and a \$50,000,000 payroll, but that the Ohio-investing company has it all in Ohio and the other company has it all elsewhere. Also assume that the Ohio company has a baseline prior investment of \$25,000,000. If the Ohio company invests \$100,000,000 in Ohio and the other company invests a similar amount elsewhere, the Ohio company ends up paying franchise taxes of approximately \$1,400,000 per year and the non-Ohio company would pay approximately \$510,000 per year. Clearly, in this situation, the ITC offers no "unfair advantage" to Ohio firms.

The plaintiffs asserted a predominately policy-based argument. They convincingly argued that the proliferation of business-oriented tax breaks of various states imposed a high costs on citizens – in the form of higher taxes and diminished services. The ultimate result is a "race to the bottom," in which states compete to offer the biggest tax breaks, leading to vastly diminished revenues which must be balanced by budget cuts and increased taxes on citizens. For instance, the plaintiffs noted that the property tax exemptions cost Toledo schools approximately \$13.7 million annually; across Ohio, the cost is in excess of \$100 million, while the ITC decreases revenue by \$120 million per year.

Although these assertions could be countered by showing that those costs ultimately lead to greater tax revenue through increased economic growth, the larger question is whether the courts are the proper forum for such a policy argument. Although none of the parties addressed this issue, such policy debates are seemingly best left to the political branches of government; courts are ill-equipped to handle

such policy issues. Nor is it advisable to take such questions out of the hands of the electorate.

In conclusion, the United States Supreme Court could decide this case several ways. First, the Court could hold that the tax incentives at issue are unconstitutional. This would place a considerable legal barrier a state attempting to remediate their slumping local economies. Second, the Court could hold that the tax incentives are constitutional. A state government would then need to carefully examine the issues in the Court's ruling to make sure its incentives comply with the opinion. Lastly, the Court could conceivably ignore the merits of the Cuno case, and rule only on the procedural issues. If that occurs, the constitutionality of a state's economic incentive plan will remain uncertain and will have to be addressed within the context of another case.



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#### ATTORNEY ACTIVITIES OF NOTE

■ Fraser Law Firm, with a team led by Jonathan Raven, won a hard-fought battle through the Court of Claims and the Court of Appeals. The win resulted in the implementation of a preliminary injunction against the State of Michigan arising out of a claim of breach of promise on behalf of a Michigan food distributor that had contracted with the State to deliver food commodities to school districts throughout the State.

■ Bob Nelson will speak at Michigan State University's Institute of Public Utilities "Regulatory Fundamentals for Utility Personnel and Analysts" on June 5 at the Kellogg Center. The topic will be video franchising.

■ Gary Rogers recently obtained very favorable results in three cases where he was representing defendants in lawsuits. In one case, the Plaintiff voluntarily dismissed his lawsuit after discovery was undertaken by Mr. Rogers regarding the alleged claim. In the second case, the Michigan Court

of Appeals affirmed the trial court's dismissal of a personal injury lawsuit. The third case was a veterinarian malpractice lawsuit which was also dismissed by the Plaintiff after Mr. Rogers undertook discovery. None of the defendants in the above three cases paid anything toward settlement.

#### MICHIGAN GAMING PUBLICATION ADDS NEW REPORTER

The *Michigan Gaming Law Newsletter*, which is published by the Fraser Trebilcock Davis & Dunlap, P.C. law firm, added Ms. Lauren Jacobs to its editorial staff. Ms. Jacobs will serve as a reporter for the *Michigan Gaming Law Newsletter*. The *Newsletter* is a fax, e-mail and Internet based publication that reports on expansion and regulatory developments involving Michigan's casino, lottery, and horse racing industries. The *Newsletter* is in its 12th year of publication and is subscribed to by financial analysts, casino operators, suppliers, regulators, and city and state officials located throughout the world. The *Newsletter* is available to everyone on the Internet at [www.michigangaming.com](http://www.michigangaming.com).



"The addition of Ms. Jacobs will allow the *Michigan Gaming Law Newsletter* to expand the number of gaming related issues the *Newsletter* will be able to report on," said David Waddell, editor, *Michigan Gaming Law Newsletter*, and chairman of the Fraser Law Firm's Gaming Practice Group. "Ms. Jacobs will also assist with circulation and distribution matters, and developing additional Michigan Gaming related products. We look forward to giving our *Newsletter* subscribers additional information on Michigan's gaming industry and building on the foundation created during the last 12 years."

Prior to joining the *Newsletter*, Ms. Jacobs worked in Communications for Jackson National Life Insurance Company® and the City of East Lansing. In both positions, she was responsible for writing, editing and distributing various external and internal publications. Her professional work experience also includes an in-depth involvement in marketing, advertising and event planning. Ms. Jacobs earned her bachelor's degree in journalism from Michigan State University and is well-versed in Spanish as a second language. In 2005, Ms. Jacobs was part of a team that received a County Communications and Marketing Association "2005 Savvy Award for Recreation Catalog

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