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FEATURE CASE

Dormant Commerce Clause Ruling Topples Tax Incentives

Tax Credits Unconstitutional, but Tax Exemptions Okay in Sixth Circuit

Justice Scalia has called the Court's jurisprudence under the dormant Commerce Clause a "quagmire." His point is illustrated well by the Sixth Circuit's recent ruling in *Cuno v. DaimlerChrysler*, *Inc.,* 2004 Fed. App. 0293P (6th Cir.). In *Cuno*, the court overturned the state of Ohio's investment tax credit, which protected Ohio jobs by giving companies that installed new machinery in their Ohio operations a credit against the state's corporate franchise tax. The court held that the tax credit violated the dormant Commerce Clause by discriminating against out-of-state commerce. But the court upheld the state's personal property tax exemption, which applies to companies that create or expand facilities in distressed areas in the state. Yet this exemption would also seem to discriminate against interstate commerce since it too applies only to investment in Ohio.

Ohio's investment tax credit was designed to encourage unusually expensive capital investments in its communities. The Sixth Circuit found that this tax credit looked like other tax schemes that the Supreme Court has invalidated in the past. The Sixth Circuit ruled that not extending the tax credit to out-of-state equipment installations was tantamount to discrimination against interstate commerce.

However, the court upheld Ohio's personal property tax exemption scheme, which allows municipalities to waive personal property taxes for companies that invest in Ohio's enterprise zones and maintain their level of employment there. The court explained that the tax exemption "contains no restriction on the individuals employed or served," meaning, presumably, that if Kentucky residents were employed in and Michigan residents shopped in these depressed areas (which seems unlikely), the Ohio investors received the exemption anyway.

To the Sixth Circuit, the difference between a tax credit and tax exemption was crucial. "Unlike an investment tax credit that reduces pre-existing income tax liability, the personal property exemption … merely allows a taxpayer to avoid tax liability for new personal property put into first use in conjunction with a qualified new investment." The court concluded that, in the case of exemptions, "businesses that desire to expand are neither discriminated against nor pressured into investing in Ohio," and thus found no dormant Commerce Clause violation. But is the difference really that clear? If a business can get a 100 percent personal property tax exemption in an Ohio enterprise zone, but no exemption in, say, Illinois, won't that business be more likely to locate in the Ohio enterprise zone? How, exactly, is this situation different from the disallowed corporate franchise tax credit, which also sought to encourage investment in Ohio rather than Illinois or elsewhere?

These fine distinctions between tax credits and tax exemptions make it hard for state and local officials to craft future tax policies. Until the Supreme Court clarifies its dormant Commerce Clause jurisprudence, expect this judicial hair-splitting to continue.

REDEFINING FEDERALISM

If federalism is about protecting the states, why not listen to them? That question is at the heart of an upcoming book by Community Rights Counsel called *Redefining Federalism: Listening to the States in Shaping "Our Federalism."* In the last decade, the Supreme Court has reworked significant areas of constitutional law with the professed purpose of protecting the dignity and authority of the states, while frequently disregarding the states' views as to what federalism is all about. According to the amicus briefs filed by the states in Supreme Court federalism cases over the past decade, the Court is protecting federalism too much and too little: too much, by striking down federal law where even the states recognize that a federal role is necessary to address a national problem; too little, by inappropriately limiting state experimentation.

Redefining Federalism takes the positions advanced in state amicus briefs and turns them into a roadmap for a federalism jurisprudence that reaffirms Justice Louis Brandeis's vision of states and localities as the laboratories of democracy. Scheduled to be published in October 2004 by the Environmental Law Institute, *Redefining Federalism* explains why empowering state and local governments is both constitutionally appropriate and a promising avenue for advancing the public good.

EYE ON WASHINGTON

Federal Circuit Marks Shift in Takings Jurisprudence

Bass Enters. Prod. Co. v. United States, 2004 WL 1925615 (Fed. Cir. Aug. 31, 2004)

The Federal Circuit's latest ruling rejecting a mining company's claim for compensation for a forty-five month delay in issuing a permit signals an important shift in the court's takings jurisprudence and demonstrates the impact of the landmark *Tahoe-Sierra* ruling.

In 1996, Bass Enterprises won an $8.9 million judgment in the Court of Federal Claims after alleging that the Bureau of Land Management's delay in approving an application to drill for oil and gas near Carlsbad, New Mexico constituted a permanent taking under *Lucas*. BLM originally denied the permits pending an EPA decision on whether drilling would conflict with a plan to create a storage facility for nuclear waste in the area, but later granted the company a permit to drill. In light of the approval, the Federal Circuit reversed the decision in 1998, but remanded for consideration of whether the forty-five month delay constituted a temporary taking. Just prior to the Supreme Court's ruling in *Tahoe,* the trial court held that the permit delay was a temporary taking. On reconsideration after *Tahoe*, the court reversed itself and rejected the claims.

The Federal Circuit's decision last month acknowledged the necessity of a significant change in its jurisprudence as well. "Based on *Palazzolo* and *Tahoe-Sierra,* our recent decisions mark a return to the pre-*Lucas* evaluation of the 'character of the Government actions' factor. We therefore consider the purpose of the regulation and its desired effects in determining whether a taking has occurred." Importantly, the court also distanced itself from its prior takings rulings in *Loveladies Harbor v. United States* and *Palm Beach Isles Assocs. v. United States*, which held inapplicable under *Lucas* the "weighing of public versus private interests in determining whether a taking has been effected."

By recognizing the important public interests that may underlie regulatory delays, the court has handed the government an important victory.

QUOTE OF THE MONTH

Municipal institutions constitute the strength of free nations. Town meetings are to liberty what primary schools are to science; they bring it within the people's reach, they teach men how to use and how to enjoy it. A nation may establish a free government, but without municipal institutions it cannot have the spirit of liberty.

Alexis de Tocqueville, *Democracy in America* (Chapter V)

ON THE HORIZON

Smoke Did Not Cause a Taking, Idaho Court Rules

Moon v. North Idaho Farmers Assoc., 2004 WL 1717533 (Idaho, Aug. 02, 2004)

The Idaho Supreme Court rejected a takings challenge last month to a state law that limited the liability of grass seed growers who burn crop residue to recharge the soil in the late summer. Anti-burning advocates alleged that smoke from the seasonal burns impaired the use of their property and claimed that a new state law designed specifically to shield grass growers from damages claims worked a taking of their property rights.

In June 2003, a trial court ruled that the measure violated the state constitution and worked a taking of private property rights because for two months "the burning invades and destroys two of the three fundamental aspects of the plaintiff's property rights … possession and use." The Idaho Supreme Court disagreed, ruling 4-1 that the smoke at issue is not a taking because it does not impact access or complete use of the property. The court distinguished this case from *Bormann v. Board of Supervisors*, 584 N.W.2d 309 (Iowa 1998), which held that the right to maintain a nuisance action is an easement under Iowa law, finding no similar authority in Idaho law.

While we have sympathy for those who are harmed by the seasonal burns, regulatory takings doctrine is a blunt and dangerous implement to use to seek redress. Given that the state constitution permits the legislature to modify common law remedies, this takings challenge faced an uphill battle from the start. Anti-burning advocates are considering whether to file a petition for certiorari with the U.S. Supreme Court and may bring a new action asking a federal district judge to enjoin the burning as a health hazard, according to press reports. But if *Moon* is any indication, we can expect other states to enact similar legislation in the future, as well as accompanying takings challenges by property owners to defeat such measures.

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