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Constitutionality of State Business Location Tax Incentive Programs

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I. INTRODUCTION.

In their February 14, 2019, blog post, Amazon.com, Inc. ("Amazon"), officially announced their decision to withdraw from the HQ2 deal in Long Island City, Queens, New York.[1] Amazon established the HQ2 initiative as an endeavor to locate the most ideal location for a second headquarters.[2] Their efforts in publicly informing states about this endeavor, however, had much to do with acquiring competitive tax incentive offers by the different cities and states under the auspices of catalyzing their respective economies in return.[3] In early November, after two years of searching, Amazon announced their commitment to headquarter part of their second location in the Long Island City Queens location.[4] This was due, in part, to the tax incentive arrangement established between New York and Amazon.[5] To simplify the terms of the HQ2 arrangement with New York, Amazon would create over twenty-five thousand new jobs with an average compensation of $150,000 over the course of 10 years.[6] In return, the Ordinance of New York would provide over $1.2 billion in tax credits and $505 million in upfront capital grants over the same period of time through the Excelsior Investment Program.[7]

Despite the proffered economic boon to be experienced by New York from the HQ2 proposal, Amazon's decision to abandon the arrangement with New York after two years of searching came after much obstruction, resentment, and trepidation by local forces.[8] To many,

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[1] About Amazon, *Update on plans for New York City headquarters* (Feb. 14, 2019), AMAZON.COM, https://blog.aboutamazon.com/company-news/update-on-plans-for-new-york-city-headquarters.
[2] Joseph Pisani, *How Amazon's planned HQ2 in New York became HQ-zero: Incentives, helipad spurred protests*, CHICAGO TRIBUNE, (Feb. 18, 2019, 7:40 AM), https://www.chicagotribune.com/business/ct-biz-amazon-hq2-new-york-behind-the-scenes-20190218-story.html.
[3] Memorandum from the New York State Urban Development Corporation to the Head of WW Economic Development (Nov. 12, 2018) (on file with the author) [hereinafter *Memorandum*].
[4] Jill Disis, *New York mayor says Amazon headquarters debacle was 'an abuse of corporate power'*, CNN (Feb. 17, 2019, 1:12 PM), https://www.cnn.com/2019/02/17/tech/bill-de-blasio-amazon-hq2/index.html.
[5] *Id*.
[6] *Memorandum*, *supra* note 3.
[7] *Id*.
[8] Disis, *supra* note 4.

including Senator Alexandria Ocasio Cortez, Amazon's decision to drop out of the HQ2 deal was a disaster averted.[9] To others, including New York Mayor DeBlasio and Governor Cuomo, the withdrawal of the HQ2 deal was a devastating political and practical defeat to New Yorkers.[10]

Despite the political bruhaha that followed both Amazon's HQ2 announcement of and withdrawal from their decision to headquarter in Queens, there was a dearth of public dialogue regarding the constitutionality in offering such state tax incentive measures in the first place. Virtually all of the several states offer some type of tax incentive programs that aim to influence business locations decisions. New York's tax incentive program is the Excelsior Investment Program.[11] The Excelsior Investment Program is a state-sponsored tax incentive program incorporated by New York aimed at "encourag[ing] businesses to expand in and relocate to New York."[12] The Amazon HQ2 proposal was the largest Excelsior Investment Program offer established since its inception,[13] purporting to add billions to New York's economy.[14] Virtually every state within the United States incorporates similar tax incentive programs expressly aimed at attracting business within the designated state. Given that the policies are created by states and have the potential to impact interstate commerce, there may be Commerce Clause implications. Accordingly, this Note will discuss the constitutionality in offering tax incentive programs under the Commerce Clause.

This Note will first introduce the concept of tax incentive programs, including Business Location Tax Incentives, and their effect on state economies. Next, this Note will introduce the

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[9] *Id.*
[10] *Id.*
[11] EXCELSIOR JOBS PROGRAM, https://esd.ny.gov/excelsior-jobs-program. (last visited Apr. 30, 2019).
[12] *Id.*
[13] Empire State Dev., EXCELSIOR JOBS PROGRAM, https://cdn.esd.ny.gov/businessprograms/data/excelsior/excelsiorjobsprogramoverview.pdf. (last visited Apr. 30, 2019).
[14] *Id.*

constitutional principles that are implicated by such tax incentive programs, particularly the Commerce Clause and the Dormant Commerce Clause. This Note will then analyze whether Business Location Tax Incentives are constitutional under the applicable tests enunciated in Commerce Clause case law. Finally, if BLTIs, as they currently stand, are found unconstitutional, this Note will analyze the possibility of conforming BLTI policies to constitutional requirements.

II. BACKGROUND.

Tax Incentive Programs and Business Location Tax Incentives.

Tax incentives are tax-policy measures implemented by states to "reduc[e] taxes for businesses and individuals" in exchange for the performance of some "desirable economic, aesthetic, [or] social" action.[15] Essentially, tax incentive measures offer credits against otherwise applicable tax obligations to individuals who satisfy certain requirements that are usually catered towards public policy initiatives.[16] The desirable actions that tax incentive programs aim to promote can range from promoting social responsibility to enhancing economic activity of the particular locality.[17] No two tax incentive programs are alike, and "the methods employed by the states offering tax incentives are varied and can differ within and among the taxes levied by other states."[18] "Exclusions, abatements, deductions, deferrals, and credits are all common" features within tax incentive programs.[19]

Beginning in the late 18th and early 19th century, tax incentives were increasingly offered in an effort to encourage economic development within the offering state.[20] These tax incentive

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[15] Phil Rabinowitz, *Using Tax Incentives to Support Community Health and Development,* https://ctb.ku.edu/en/table-of-contents/implement/changing-policies/tax-incentives/main.
[16] *Id.*
[17] *Id.* (e.g., tax deductions for charitable contributions).
[18] Philip M. Tatarowicz, *Federalism, the Commerce Clause, and Discriminatory State Tax Incentives: A Defense of Unconditional Business Tax Incentives Limited to in-State Activities of the Taxpayer*, 60 Tax Law. 835, 839 (2007).
[19] *Id.*
[20] PUBLIC HEALTH LAW CENTER AT MITCHELL HAMLINE SCHOOL OF LAW, STATE UNIFORMITY DOCTRINES

programs offered tax incentives as a means to attract or retain businesses to the offering State, which would subsequently create "more local jobs, more tax revenue (leading to the possibility of more funding for schools and services), [and] an injection of energy into the community."[21] For purposes of this Note, such tax incentive programs will be referred to as Business Location Tax Incentives ("BLTI"). BLTIs have become a means by which a state "compete[s] with other states for limited investment dollars [to] foster its broader economic development goals."[22]

BLTIs are a highly attractive way for municipalities and states to compete in the hunt for big-business because "[p]olicymakers can fine-tune [the] incentive[]" agreement to achieve any desired tax-related offer sought by interested businesses when creating the legislation.[23] The ability to customize the parameters behind BLTI programs renders them readily applicable in any given incentive arrangement and allows states and localities to foster highly-competitive tax-reducing instruments.[24] Given their use as competitive devices, such tax incentives are usually "limited to in-state activities" in order to reap the entire economic benefit.[25]

States implement BLTIs by incorporating them within their respective tax legislation or tax code.[26] The implementation of BLTIs, similar to the implementation of any other tax policy, lies well within the states' authority to tax given the governmental structure of the United States. The United States of America is considered a federation of States.[27] As a federation, "lawmaking

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AND SUGARY DRINK TAXES (Oct. 2017), https://www.publichealthlawcenter.org/sites/default/files/resources/State-Uniformity-Sugary-Drink-Taxes-2017.pdf (discussing the shift in the American economy from primarily focusing on agriculture to more commercial enterprise).

[21] *Id.*

[22] Tatarowicz, *supra* note 18, at 839.

[23] Rabinowitz, *supra* note 15.

[24] *Id*.

[25] Tatarowicz, *supra* note 18, at 839 ("Little is gained by the states in their competition for limited resources if they are required to offer uniform tax incentives, or a single state is required to provide the same tax benefit for activities taking place within and without its borders.")

[26] *See* EXCELSIOR JOBS PROGRAM, https://esd.ny.gov/excelsior-jobs-program. (last visited Apr. 30, 2019).

[27] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 12, (10th ed. 2013).

is decentralized" among the numerous states, at least when federal questions are not concerned.[28] Under the Tenth Amendment of the United States Constitution, "[t]he powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the states respectively, or to the people."[29] Accordingly, state taxation is merely an extension of state authority when not in contravention with the Constitution.[30] As part of their lawmaking sovereignty pertaining to their respective tax codes, states enjoy the "power to provide subsidies to promote certain public policies."[31] The various tax incentive programs in effect today are manifestations of state power to provide such subsidies.[32]

BLTIs and the Commerce Clause of the United States Constitution.

State BLTI policy, just as any other state law, must comport with the U.S. Constitution.[33] Of pertinence to the constitutionality of state tax policy, "the principle sources of federal constitutional limits are the Commerce and Import-Export Clauses of Article 1, the Privileges and Immunities Clause of Article IV, the Due Process and Equal Protection Clauses of the Fourteenth Amendment, and the Supremacy Clause of Article VI."[34] Given the motive behind BLTI policy, which is to garner a competitive advantage in attracting business activity over other states, constitutional concerns potentially arise under the Commerce Clause. Many analysts argue that the rise of BLTI competition has caused a second "war between the states."[35] These analysts have likened the rise of tax competition through BLTI implementation to the economic rivalry between

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[28] *Id.*
[29] U.S. CONST. amend. X.
[30] *See Id.*
[31] Tracy A. Kaye, *The Gentle Art of Corporate Seduction: Tax Incentives in the United States and the European Union*, 57 U. Kan. L. Rev. 93, 94 (2008).
[32] *Id.*
[33] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 12, (10th ed. 2013).
[34] *Id.*
[35] James R. Rogers, *State Tax Competition and Congressional Commerce Power: The Original Prudence of Concurrent Taxing Authority*, 7 Regent U. L. Rev. 103, 104-05 (1996).

states under the Articles of Confederation—a very influential factor in drafting the Commerce Clause of the Constitution.[36]

The Commerce Clause.

The Constitution of the United States, in clause 3, section 8 of Article 1, expressly grants Congress the power to "regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes."[37] This section, known as the Commerce Clause, provides Congress with the exclusive ability to regulate interstate commerce. The incorporation of the Commerce Clause "was meant to quell commercial animosities among the states."[38]

Initially, the Commerce Clause of the United States Constitution was not meant to afford the Federal Government with a "congressional override" on State taxing decisions.[39] Prior to the enactment of the Constitution (and therefore, the enforcement of the Commerce Clause), and during the enforcement of the Articles of Confederation, States had broad and undisturbed latitude in enacting whatever tax policy they deemed fit.[40] At that time, however, states began to enforce taxing measures, such as imports and exports, against their sister states, "resulting in threatened trade wars and worse."[41] The free reign given to the states at the time nurtured an environment of "vicious economic rivalry" among the states through discriminatory tax policies.[42] This unfettered competition among the states "weak[ened] [the] national union" to a point where its existential legitimacy was placed into question on numerous occasions.[43] After recognizing "that economic rivalry between the states was a significant, if not primary, threat to union," the drafters of the

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[36] *Id.*
[37] U.S. CONST. art. I, § 8, cl. 3.
[38] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 117, (10th ed. 2013).
[39] Rogers, *supra* note 35, at 124.
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.* at 125 ("From its beginning, the weak national union organized by the Articles of Confederation threatened to dissolve into three or four separate, even hostile, geographical powers.").

Constitution aimed to unify the nation by granting Congress the ability to regulate interstate commerce.[44] Thus, Congress, under the Commerce Clause, now has expansive powers to regulate interstate commerce even if it interferes with state taxing sovereignty. [45]

The Dormant Commerce Clause.

Congress has not, does not, and likely will not address all aspects of regulation regarding interstate commerce.[46] Neither the Constitution nor the Commerce Clause itself "says [anything] about the protection of interstate commerce in the absence of any action by Congress."[47] The Commerce Clause, however, does not only provide an affirmative grant of power to Congress.[48] Implicit within the Commerce Clause, the Supreme Court of the United States has held, is the limitation of states to interfere with interstate commerce.[49] Particularly, this "negative sweep" of the Commerce Clause, referred to as the Dormant Commerce Clause, places an "implicit restriction on the ability of states to regulate interstate commerce."[50] It is a judicially interpreted extension of the Commerce Clause that prohibits certain state regulation when Congress has not spoken.[51] Despite the dearth of Congressional input, the Dormant Commerce Clause also "puts it into the power of the Court to place limits upon state authority."[52] This "judicially enforced barrier[] to congressional regulation touch[es] even on essential attributes of 'state sovereignty' such as state taxing powers."[53]

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[44] *Id.*
[45] Rogers, *supra* note 35, at 105; see also Wickard v. Filburn, 317 U.S. 111(1942).
[46] Peter D. Enrich, *Saving the States from Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 Harv. L. Rev. 377, 406 (1996).
[47] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 30, (10th ed. 2013); See Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978) ("the bounds of these restraints appear nowhere in the words of the Commerce Clause but have emerged gradually in the decisions of this Court giving effect to its basic purpose."
[48] Tatarowicz, *supra* note 18, at 854.
[49] Gibbons v. Ogden, 9 Wheat. 1, 231-232, 239 (1824).
[50] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 117, (10th ed. 2013).
[51] Enrich, *supra* note 46, at 406.
[52] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 117, (10th ed. 2013) (citing Felix Frankfurter, The Commerce Clause Under Marshall, Taney and Waite 18-19 (Quadrangle Paperback ed. 1964).)
[53] Rogers, *supra* note 35, at 105.

The courts have established, although considered by some to be tortuous,[54] a two tiered analytical framework in analyzing potential state law violations of the Commerce Clause when Congress has not directly spoken on the issue.[55] Discriminatory laws motivated by "simple economic protectionism" are subject to a "virtually *per se* rule of invalidity."[56] This test applies when a state law "impose[s] commercial barriers or discriminate[s] against an article of commerce by reason of its origin or destination out of State."[57] The discriminating characteristic of such a state law can be found "on its face" or unveiled behind the Law's purpose or effect.[58] Such laws contravene the "principle that our economic unit is the Nation,"[59] because they "excite [state] jealousies and retaliatory measures" that the Constitution was designed to prevent.[60] Under the virtually *per se* rule of invalidity, a state law can only be considered valid if it can be shown "that the state has no other means to advance a legitimate local purpose."[61]

If, on the other hand, a state law advances a legitimate government interest—such as to "safeguard the health and safety of its people"—while imposing "incidental burdens on interstate commerce," the Pike Balancing test applies.[62] Under the Pike Balancing test, such a state law "will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[63] The analysis becomes a question of degree and the validity of the

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[54] Tatarowicz, *supra* note 18, at 936 ("The search for a bright-line test for impermissible state discrimination against interstate commerce is likely doomed to fail, as the tortured history of the Court's Commerce Clause jurisprudence suggests.").
[55] C & A Carbone, Inc. v. Town of Clarkstown, N.Y., 511 U.S. 383, 390 (1994).
[56] Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978).
[57] *Carbone*, 511 U.S. at 390.
[58] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 575 (1997).
[59] *Philadelphia*, 437 U.S. at 623.
[60] *Carbone*, 511 U.S. at 390.
[61] *Philadelphia*, 437 U.S. at 624; Maine v. Taylor, 477 U.S. 131, 138 (1986).
[62] Philadelphia v. New Jersey, 437 U.S. 617, 623-24 (1978).
[63] Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970).

state law will "depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."[64]

Analysis of state tax policies under the Dormant Commerce Clause implements these same standards.

The Complete Auto Transit Case and its Progeny.

Modern jurisprudence pertaining to the Dormant Commerce Clause oversight of state taxing sovereignty was established in the Supreme Court case, *Complete Auto Transit, Inc. v. Brady*.[65] In *Complete Auto*, the Supreme Court of the United States upheld, against Commerce Clause challenge, a Mississippi tax that applied to "the privilege of . . . doing business" within Mississippi.[66] In affirming the Supreme Court of Mississippi's decision to uphold the Mississippi tax, the Court chose to focus on the practical effect of a tax measure on interstate commerce instead of "attaching constitutional significance to [] semantic difference[s]" based on wordplay and draftsmanship.[67] Thus, one central theme behind the holding in *Complete Auto* was that analysis of state tax policy under the Commerce Clause "should focus on the 'practical effect' of the challenged tax measure, and not merely on its formal phrasing or technical structure."[68]

Interestingly, however, the primary significance of *Complete Auto* was not found in its holding. In dicta, the Supreme Court established a four-part test that would later be used to determine when a particular state tax violates the Commerce Clause.[69] This test, later referred to as the Complete Auto test, will sustain a tax against a Commerce Clause challenge so long as the

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[64] *Id*.
[65] 430 U.S. 274 (1977).
[66] *Id*.
[67] *Id*. at 285.
[68] Enrich, *supra* note 46, at 425.
[69] *Complete Auto*, 430 U.S. at 288-89 ("Accordingly, we now reject the rule of Spector Motor Service, Inc. v. O'Connor, that a state tax on the 'privilege of doing business' is per se unconstitutional when it is applied to interstate commerce, and that case is overruled.")

"tax (1) is applied to an activity with a substantial nexus with the taxing state, (2) is fairly apportioned, (3) does not discriminate against interstate commerce, and (4) is fairly related to the services provided by the state."[70] After the Supreme Court's landmark decision in 1977, the Complete Auto test has "emerged as the starting point for modern Commerce Clause analysis of state taxes."[71]

The Anti-Discrimination Prong of the Complete Auto Test.

The Complete Auto test "applies to all forms of state tax, user fee or other law that directly or indirectly, partially or in total, impacts protected [interstate] commerce."[72] Arguably, the most applicable challenge to State BLTI policies stem from the third prong of the Complete Auto test, which looks to whether the tax discriminates against interstate commerce.[73] This anti-discrimination prong of the Complete Auto test has been identified as "perhaps the most crucial element of the Commerce Clause as applied to state taxation."[74] Thus, it is likely the most appropriate avenue for opponents of tax incentive programs, such as the Excelsior Jobs Program, to issue challenges because the effects of these tax incentive programs favor local economies.[75]

Essentially, under the anti-discrimination prong of the Complete Auto test, state tax policies, such as BLTIs, must provide "equal treatment for in-state and out-of-state taxpayers similarly situated" when interstate commerce is implicated.[76] Although the premise of the anti-discrimination prong seems relatively straightforward, the parameters behind its enforcement has

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[70] WALTER HELLERSTEIN ET AL., STATE AND LOCAL TAXATION, 117, (10th ed. 2013) (citing 430 U.S., at 279).
[71] *Id*. at 131.
[72] Tatarowicz, *supra* note 18, at 857.
[73] Kaye, *supra* note 31, at 128.
[74] Tatarowicz, *supra* note 18, at 863 ("In contrast to the antidiscrimination requirement, which is virtually not qualified, the remaining restrictions on state taxation (substantial nexus, fair apportionment, and fair relation to services provided by the state) grant the state greater leeway in designing taxing provisions. Moreover, the substantial nexus, fair apportionment, and fairly related requirements are to some extent independently incorporated by the Due Process clause.")
[75] Kaye, *supra* note 31, at 128.
[76] Maryland v. Louisiana, 451 U.S. 725, 728 (1981).

not been so clear-cut. Throughout the years, however, relevant case law has elaborated on the anti-discrimination prong and has set forth two concrete standards that will be used to assess the constitutionality of BLTIs under the anti-discrimination prong of the Commerce Clause. Under these standards, a taxing measure will violate the Complete Auto test, and accordingly the Commerce Clause, if it obstructs free trade or cultivates economic protectionism.

Standard 1: Free Trade Standard.

For purposes of this Note, the first standard enunciated under the anti-discrimination prong will be referred to as the Free Trade standard.[77] The Free Trade standard emphasizes the importance in Commerce Clause jurisprudence of establishing and maintaining a "national free market."[78] As eloquently stated by Justice Jackson, "every farmer and every craftsman shall be encouraged to produce by the certainty that he will have free access to every market in the Nation [and] every consumer may look to the free competition from every producing area of the Nation to protect him from exploitation."[79] In nurturing this "certainty," the Free Trade standard guarantees the "'right' to engage in interstate trade free from restrictive state regulation."[80]

In Boston Stock Exchange v. State Tax Commission,[81] the Supreme Court of the United States articulated that the Free Trade standard was a potential means by which state taxes could violate the Commerce Clause. There, New York amended its securities transfer tax, which reduced the tax burden on transfers by nonresidents and on transfers of large blocks of shares, but only if the transfers were made on a New York exchange.[82] Several stock exchanges located outside of New York challenged the amended New York transfer tax as unconstitutional under the anti-

[77] *See* Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318 (1977).
[78] Wyoming v. Oklahoma, 502 U.S. 437, 469-70 (1992).
[79] H.P. Hood & Sons, Inc. v. Du Mond, 336 U.S. 525, 539 (1949).
[80] *Wyoming*, 502 U.S. at 470.
[81] 429 U.S. 318 (1977).
[82] *Boston Stock Exchange*, 429 U.S. at 318.

discrimination prong of the Commerce Clause.[83] The Supreme Court held that the amended New York transfer tax was unconstitutional as it impermissibly discriminated against interstate commerce.[84]

Ultimately, the Court reasoned that discriminatory treatment from the amended transfer tax violated the Commerce Clause because it had the effect of obstructing free trade.[85] The Court propounded on the fact that the "fundamental purpose of the [Commerce] Clause is to assure that there be free trade among the several State[s]."[86] Free trade was obstructed by the New York tax because the tax diverted the "flow of securities . . . from the most economically efficient channels" into New York.[87] The Court cautioned that "[t]his diversion of interstate commerce and diminution of free competition in securities sales are wholly inconsistent with the free trade purpose of the Commerce Clause."[88] Thus, pursuant to the Court's holding in *Boston Stock Exchange*, the anti-discrimination prong of the Complete Auto test will be violated when a state tax policy diverts economic activity from their most economically efficient channels, thereby obstructing free trade.[89]

Standard 2: Economic Protectionism from Discriminatory Effects

For purposes of this Note, the other anti-discrimination prong standard enunciated by case law will be referred to as the Economic Protectionism standard. The Supreme Court of the United States has found state tax policies to violate the anti-discrimination prong of the Complete Auto test when such policies proliferate protectionist or isolationist ideals between and against sister

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[83] *Id*.
[84] *Id*.
[85] *Id*. at 330 (noting that "[t]he extra tax burden on out-of-state sales created by s 270-a is not what the New York Court of Appeals holds it out to be; it neither compensates for a like burden on in-state sales, nor neutralizes an economic advantage previously enjoyed by the appellant Exchanges because of s 270.")
[86] *Id*. at 335.
[87] Bos. Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977).
[88] *Id*.
[89] *Id*.

states.[90] Such policies, which are designed to mandate a "preferred right of access, [to in-state residents] over out-of-state consumers, to natural resources located within [state] borders,"[91] cause the "multiplication of preferential trade areas destructive of the free commerce anticipated by the Constitution."[92]

In Maryland v. Louisiana,[93] the Supreme Court elaborated on the Economic Protectionism standard often used in Commerce Clause cases. There, a Louisiana "first-use" tax was challenged under the anti-discrimination prong of the Complete Auto test because the Louisiana first-use tax scheme offered tax exemptions to Louisiana consumers "but [] uniformly applie[d]" to out-of-state consumers, effectively burdening interstate commerce.[94] The Court agreed that the Louisiana first-use tax is unconstitutionally discriminatory against interstate commerce because it fostered economic protectionism by "providing a direct commercial advantage to local business."[95] Essentially, the Louisianan taxing scheme violated the Commerce Clause because it favored local business and local activities over out-of-state activities.[96]

In Bacchus Imports, Ltd. v. Dias,[97] the Supreme Court of the United States further elaborated on the Economic Protectionism standard. There, the Court analyzed a Hawaii excise tax that was challenged, in part, as unconstitutionally discriminatory under the Commerce Clause because it offered tax exemptions to locally produced alcoholic beverages without offering such incentives to out-of-state beverages.[98] The taxing scheme was defended on the grounds that the

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[90] New England Power Co. v. New Hampshire, 455 U.S. 331, 338 (1982).
[91] *Id*.
[92] Maryland v. Louisiana, 451 U.S. 725, 728 (1981).
[93] 451 U.S. 725 (1981).
[94] *Maryland*, 451 U.S. at 725.
[95] *Id*. at 728.
[96] *Id*. at 728.
[97] 468 U.S. 263 (1984).
[98] *Bacchus*, 468 U.S. at 265.

exemptions did not constitute a substantial competitive threat to out-of-state alcoholic beverages,[99] and that they were meant to promote the struggling liquor enterprises within Hawaii.[100]

The Court held that the Hawaii excise liquor tax was unconstitutionally discriminatory under the Commerce Clause because "it had both the purpose and effect of discriminating in favor of local products," therefore fostering economic protectionism.[101] The Court identified the Hawaii excise tax as a protectionist tax because it was meant to bolster local economy by providing a direct commercial advantage through lower tax burdens.[102] This was sufficient for the Court to incorporate the *per se* rule of invalidity and consequently invalidate the tax.[103]

Pivotal to their holding, the Supreme Court analyzed the nuance behind protectionist taxes. The Court first defined economic protectionism as legislation "imposed by a State operating to the disadvantage of the products of other States when introduced into the first mentioned State."[104] Such legislation, the Court articulated, is "a regulation in restraint of commerce among the States, and as such is a usurpation of the power conferred by the Constitution upon the Congress of the United States."[105] The Court then held that state taxing legislation will "constitute[] 'economic protectionism' . . . on the basis of either discriminatory purpose, . . . or discriminatory effect."[106] Discriminatory effect was said to be found "as long as there is some competition between the locally produced exempt products and non-exempt products from outside the State."[107] The Court

[99] *Id*. at 268.
[100] *Id*. at 272.
[101] *Id*. at 273.
[102] *Id*. at 270.
[103] Bacchus Imports, Ltd. v. Dias, 468 U.S. 263, 270 (1984).
[104] *Id*. at 271 (citing Walling v. Michigan, 116 U.S. 446, 455 (1886).).
[105] *Id*.
[106] *Id*. at 270.
[107] *Id*. at 271.

reiterated their stance that they "need not know how unequal the Tax is before concluding that it unconstitutionally discriminates."[108]

Thus, a state tax policy will be found to violate the Economic Protectionism standard, and accordingly the Commerce Clause, when it "attempts to convey advantages on local merchants," or "give local consumers an advantage over consumers in other States."[109] As indicated in *Maryland* and *Bacchus*, a commercial advantage obtained through preferential tax treatment is also deemed violative of the Commerce Clause, regardless of the means by which it is manifested or of the intent of the tax or of the magnitude of the effect.[110] The Economic Protectionism standard refrains from assessing such factors because economic protectionism is seen as the "very evil that the dormant Commerce Clause was designed to prevent."[111] Thus, in its most extreme application, the Economic Protectionism standard will find a state tax measure violative of the Commerce Clause if it has the indirect effect of favoring local businesses regardless of the certainty or magnitude of such effects.

III. <u>ANALYSIS.</u>

Although the standards enunciated by case law regarding the anti-discrimination prong have been applied to various tax policies, the constitutionality of BLTIs under the anti-discrimination prong of the Complete Auto test remains largely unanswered.[112] There are conflicting decisions regarding whether tax incentive programs survive constitutional analysis.[113] This Section of the Note will initially analyze BLTI policies under the standards enunciated under

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[108] *Id*. at 269 (holding, therefore, that the "small competitive threat" from the Hawaii excise tax was sufficient to show protectionist effects.)
[109] Camps Newfound/Owatonna, Inc. v. Town of Harrison, 520 U.S. 564, 576-78 (1997).
[110] Maryland v. Louisiana, 451 U.S. 725 (1981); Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984).
[111] Philadelphia v. New Jersey, 437 U.S. 617, 623 (1978).
[112] Kaye, *supra* note 31, at 128.
[113] Tatarowicz, *supra* note 18, at 870.

the case law regarding the anti-discrimination prong. This Section will then analyze whether such standards sufficiently encapsulate the entire concern behind the anti-discrimination prong. The bulk of this Section will argue that although the standards are indeed insufficient in determining whether the anti-discrimination clause has been violated, BLTIs are nonetheless unconstitutional given other commonly used considerations. Lastly, this section will discuss why BLTIs have not already been deemed unconstitutional.

***BLTIs under the Anti-Discrimination Prong*.**

BLTI tax policies likely violate the Free Trade standard enunciated in *Boston Stock Exchange*, meaning they likely have an effect of impermissibly obstructing free trade.[114] Under the Free Trade standard, a tax measure will be found unconstitutional when it directs economic activity from the most economically efficient channels.[115] Arguably, BLTIs were created for this exact purpose. BLTI policies were designed to attract and retain business activity through the implementation of tax credits and the like, aimed at reducing the tax burden of participating businesses.[116] In a scenario where all relevant economic and business-oriented considerations between two states are made equal, the location decision by the business-in-question would not trend towards one state or the other. In fact, each state would have an equal chance at acquiring the business, and its subsequent economic impact. If one state were to employ a BLTI, however, the decision to locate made by the business will favor the State with the BLTI. This does not necessarily mean that the economic activity is being directed away from the most economically efficient channels, as both States had the potential to attract the State.

[114] *See* Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977).
[115] *Id.*
[116] Enrich, *supra* note 46, at 382 ("Recent years, however, have seen an extraordinary expansion in the use of tax incentives, not to protect in-state businesses, but to influence business decisions about where to locate.")

However, in instances where the BLTI benefit to the business outweighs the economic efficiency of locating within another state, the Free Trade standard will conclusively be violated.[117] Take for instance a scenario where in which one State (State A) has a small competitive advantage—through its resources, workforce, etc.—that renders it the most economically efficient state to run a business. For illustrative purposes, assume the efficiency benefit can be quantified at 100 dollars.[118] Thus, all things equal, the optimal location for the business to operate is in State A and the business should choose this State to headquarter in. If, however, a competing State (State B) implements a BLTI that reduces the tax obligation by 120 dollars, then the business will likely operate within State B and experience an additional twenty-dollar reduction in overall costs.[119] In this situation, the business decision has been directed away from the most economically efficient channels through tax regulation imposed by State B. Although the figures were arbitrarily chosen, the principle stands the same: BLTIs were made to divert location decisions from the most economically sensible states.[120] Such a scenario violates the Free Trade standard, and it is exactly because of that fact that BLTIs were inherently made to nurture such an outcome that they cannot ever satisfy the Free Trade standard.

Furthermore, BLTI policies likely violate the Economic Protectionism standard enunciated in *Bacchus Imports*.[121] Under the Economic Protectionism standard, a taxing measure will violate the anti-discrimination prong if it "operat[es] to the disadvantage of the products of other States when introduced into the first mentioned State."[122] Unlike the Free Trade standard, however, this

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[117] *See Boston*, 429 U.S. at 331 ("Thus, . . . the choice of exchange by all nonresidents and by residents engaging in large transactions is not made solely on the basis of nontax criteria . . . [Where] the obvious effect of the tax is to extend a financial advantage to sales on the New York exchanges at the expense of the regional exchanges."

[118] Note that this figure is primarily incorporated for illustrative purposes. Actual analytical figures likely are much higher and are determined in greater detail by businesses looking to determine the optimal business location.

[119] Note here, too, that the BLTI figure is only used for illustrative purposes.

[120] Enrich, *supra* note 46, at 433.

[121] Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984).

[122] *Id.* at 271.

standard does not assess the comparative economic efficiency between states. Rather it determines whether a regulatory measure discriminatorily benefits "in-state economic interests by burdening out-of-state competitors."[123] The protectionist quality of the taxing measure can be shown through either discriminatory purpose or effect.[124]

With regards to BLTIs, they likely exhibit both a discriminatory purpose and effect.[125] Overall, BLTIs are created to stimulate the economic activity of the enacting State by attracting business activity through tax reduction.[126] Although this may be a noble goal, it does not escape the fact that states are in an unavoidable competition amongst themselves for attracting such businesses.[127] Therefore, to suggest that the entire purpose behind BLTI implementation is to stimulate economic activity would be an incomplete assertion. Rather, a more accurate depiction of the purpose behind BLTIs is to provide implementing States with a competitive edge over other States in their acquisition of businesses. Thus, there is an inherently discriminatory purpose behind BLTI policy implementation.

BLTIs also bring about discriminatory effects upon interstate commerce in two ways. First, BLTIs have an effect similar to those found under legislation imposing "home-processing" requirements.[128] Home-processing requirements are forms of legislation that require in-state businesses to utilize in-state processors, refiners, etc.[129] Through such legislation, in-state processors and the like now have exclusive access to such in-state businesses, effectively depriving

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[123] New Energy Co. of Indiana v. Limbach, 486 U.S. 269, 273 (1988).
[124] *See Bacchus*, 468 U.S. at 270.
[125] Enrich, *supra* note 46, at 433 ("The[] intended effect [of BLTIS] is to influence business decisions about where to site economic activity and to diminish the significance of nontax considerations in such decisions.")
[126] *Id*. at 432.
[127] *Id*. at 396 (1996) (stating that the States find themselves in a classic prisoner's dilemma, where each State is forced to compete with one another).
[128] *See* Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951) (defining home processing requirements at legislation that "erect[s]an economic barrier protecting a major local industry against competition from without the State").
[129] *Id*.

out-of-state processors from such demand.[130] They have been deemed largely unconstitutional because they patently discriminate against out-of-state processors.[131] In effect, however, BLTIs are not much different than home-processing requirements. Although BLTIs do not operate in the field of compulsions, they have the practical effect of assisting in-state businesses at the expense of out-of-state businesses. Unless a business is completely vertically integrated, it must, at some point, interact with other peripheral businesses to create its finished product. Such peripheral businesses located in-state are given, at the very least, a geographical advantage over similar out-of-state businesses. This advantage—i.e., discriminatory effect—stems directly from the implementation of the state BLTI policy.

BLTI policies also have the discriminatory effect of shielding in-state businesses from larger tax liabilities that out-of-state business are susceptible to. This effect occurs after the business, enticed by the BLTI, has located within the State that implements the BLTI. After locating within the State, the business effectively becomes considered an in-state entity. As an in-state entity, this business is now shielded from larger tax burdens that its out-of-state competitors face because it receives BLTI tax credits. This lower tax burden reduces the expenses incurred by the business, which provides it with a direct commercial advantage made solely through regulatory policy.[132]

Thus, under the standards set forth by case law in analyzing whether a particular tax measure unconstitutionally discriminates against interstate commerce, BLTIs are likely to be found unconstitutional.

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[130] C & A Carbone, Inc. v. Town of Clarkstown, N.Y., 511 U.S. 383, 391 (1994) ("With respect to this stream of commerce, the flow control ordinance discriminates, for it allows only the favored operator to process waste that is within the limits of the town.").
[131] *E.g.*, *Dean Milk*, 340 U.S. at 349 (striking down a city ordinance that required all milk sold in the city to be pasteurized within five miles of the city lines).
[132] *Id.*

BLTIs v. Differential Sales Taxes.

Interestingly, under the anti-discrimination standards set forth above, certain sales taxes would also be found unconstitutional as well. Sales taxes are taxes imposed by states and localities that apply to the final sale of goods or services.[133] Differential sales taxes are sales taxes that incorporate a different sales tax rate than other states. Sales tax rates within the Unites States range from 0.00% in States such as Alaska, Delaware, etc. to 11.5% in Puerto Rico.[134]

When considering the discriminatory effect of differential sales taxes,[135] particularly those that apply a lower sales tax rate, such taxing measures violate the two standards enunciated under the anti-discrimination prong. For one, differential sales taxes potentially obstruct free trade in the same way as BLTIs; they are regulatory measures that divert economic activity from the most economically efficient channels when the lower sales tax outweighs reductions of costs through efficiency.[136] Further, differential sales taxes violate the Economic Protectionism standard because they provide in-state entities with a direct commercial advantage over out-of-state entities.[137] In-state entities enjoy lower tax expenses that they can utilize to lower prices while maintaining profit levels. Therefore, under both standards, differential sales taxes seem to violate the Commerce Clause under the relevant case law. This is a problematic outcome because the validity of sales taxes—even of differential sales taxes—is virtually unquestioned when the State has a sufficient nexus with the transaction, and they are considered to be well within a State's

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[133] Oklahoma Tax Comm'n v. Jefferson Lines, Inc., 514 U.S. 175, 184 (1995) ("It has long been settled that a sale of tangible goods has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State.")

[134] Sales Tax Inst., STATE SALES TAX RATES, https://www.salestaxinstitute.com/resources/rates.

[135] *See* Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (specifying that discriminatory effect is sufficient to render a taxing measure unconstitutional).

[136] *See* Boston Stock Exch. v. State Tax Comm'n, 429 U.S. 318, 336 (1977).

[137] Dean Milk Co. v. City of Madison, 340 U.S. 349, 354 (1951).

sovereignty to impose.[138] On the likely premise that differential sales taxes are constitutional, there must be some other consideration that may potentially validate BLTIs as well.

Virtually Per Se Rule of Invalidity.

One potential way to validate a differential sales tax is through its examination under the virtually *per se* rule of invalidity. The virtually *per se* rule of invalidity is a potential, yet extremely unlikely, means by which a discriminatory law can still be deemed constitutional under the Commerce Clause.[139] In order for a discriminatory law to pass constitutional muster under the virtually *per se* rule of invalidity, the law must promote a legitimate government interest and there must be no non-discriminatory alternatives available to reach that interest.[140] This standard is an exceedingly difficult standard to satisfy.[141] In many cases, Courts refrain in even partaking in the often-futile analysis altogether.[142]

BLTIs likely do not surmount the virtually *per se* rule of invalidity because they do not promote a legitimate government interest. It cannot be said that States have a legitimate government interest in gaining a competitive advantage over other States in attracting business. Such an interest would counter our constitutional principles of free and unified trade.[143] Assuming arguendo that States can sufficiently argue that BLTI implementation furthers the State's legitimate government interest of stimulating the economy, BLTIs still do not pass constitutional muster. This is the case because there exists other non-discriminatory alternatives also have the

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[138] S. Dakota v. Wayfair, Inc., 138 S. Ct. 2080, 2092 (2018) (agreeing that "'It has long been settled' that the sale of goods or services "has a sufficient nexus to the State in which the sale is consummated to be treated as a local transaction taxable by that State.'").
[139] C & A Carbone, Inc. v. Town of Clarkstown, N.Y., 511 U.S. 383, 390 (1994).
[140] *Id.*
[141] *Id.* at 392 (explaining that the virtually *per se* rule of invalidity are subject to rigorous scrutiny and often found invalid).
[142] Tatarowicz, *supra* note 18, at 862 (stating that only "in the narrowest of circumstances" do such measures survive constitutional muster).
[143] *Carbone*, 511 U.S. at 390.

effect of stimulating economic activity. States can implement regulation that can strengthen workforce capabilities, further develop their infrastructure, etc. These methods would have a significant effect on stimulating economic activity within the State without treating in-state and out-of-state entities differently. Thus, BLTIs cannot surmount the virtually *per se* rule of invalidity.

Differential sales taxes, however, are subject to a different fate than BLTIs under the virtually *per se* rule of invalidity. Although the concept of sales tax imposition easily surmounts this standard, the fact that States implement such taxes at varying levels presents difficult questions. When analyzing sales taxes under the virtually *per se* rule of invalidity, states have a legitimate government interest in generating revenue from the sale of goods or services. There is also no other means by which to generate the revenue than to impose a tax. On the other hand, with regards to differential sales taxes, though a legitimate government interest may be found, there is no reason why the tax cannot incorporate the tax rate that avoids the discriminatory effect incidental to differential sales taxes. To simplify, the non-discriminatory alternative when attempting to generate sales tax revenue would be to impose the same sales tax rate as everyone else. However, because there is no ordinary sales tax rate—as different states impose different rates—imposing the "same" sales tax rate is impossible. Thus, there are no non-discriminatory alternatives available in imposing a sales tax at any rate, and the virtually *per se* rule of invalidity is surmounted.

Pike Balancing Test: Whether the Burden Outweighs the Benefits

Although differential sales taxes likely survive analysis under the anti-discrimination prong of the Dormant Commerce Clause under the virtually *per se* rule of invalidity, it is highly unlikely that such taxing measures would be subject to such treatment. This is the case because differential

sales tax only present incidental effects on interstate commerce.[144] Yes, differential sales taxes (particularly, those below the average sales tax rate) have the effect of discriminating against interstate commerce, but the aim of these taxing measures cannot seriously be deemed to garner local competitive advantage. On the other hand, BLTI tax policies do not have an incidental affect on interstate commerce. BLTIs are deliberately designed to impact and affect interstate commerce directly. Thus, although BLTIs will likely be analyzed under the virtually *per se* rule of invalidity, differential sales taxes would be scrutinized under the more lenient Pike Balancing test.

The Pike Balancing test applies when "legislative objectives are credibly advanced [from the State legislation] and there is no patent discrimination against interstate trade."[145] This occurs when "the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental."[146] Under the Pike Balancing test, state legislation "will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits."[147] The analysis of any particular legislation becomes, therefore, a "question . . . of degree."[148] Under such an analysis, differential sales taxes easily survive constitutional muster.[149]

On the other hand, even though analysis of BLTI policies under the Pike Balancing test would be unlikely,[150] BLTIs would still fail under this standard anyway. With regards to BLTIs,

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[144] *See* Pike v. Bruce Church, Inc., 397 U.S. 137, 142 (1970) (discussing the appropriate constitutional analysis for state statutes that only have an incidental effect on interstate commerce).
[145] Philadelphia v. New Jersey, 437 U.S. 617, 624 (1978).
[146] *Pike*, 397 U.S. at 142.
[147] *Id.*
[148] *Id.*
[149] Differential sales taxes—as sales taxes—aim to generate taxing revenue from the sales within the State; a legitimate government purpose. Note that this is the same legitimate government interest used when Differential sales taxes are analyzed under the virtually *per se* rule of invalidity. Furthermore, although analysis into the quantitative impact of differential sales tax is not within the purview of this note, it at least can be said that the benefits of generating sales tax revenue is not inherently outweighed by burdens on interstate commerce.
[150] Since BLTIs do not incidentally affect interstate commerce but are instead aimed to create such affects.

the burden on interstate commerce would result from the inefficiency in business activity allocation. The benefit to the implementing State would result from the economic stimulation from the business entity. In order to properly analyze whether the burden on interstate commerce is outweighed by the putative local benefits of BLTI policy, a brief analysis on the economic impact of BLTIs is vital.

Economic Impact of BLTIs.

By implementing BLTI policies, States have the ability to compete against one another to entice businesses through regulatory tax measures—through policy that has nothing to do with the business-attracting resources within the particular State. This form of competition leads to peculiar economic consequences.

First, States find themselves in a prisoner's dilemma where they directly reduce taxable income in a race-to-the-bottom fashion.[151] States compete against one another for the limited investment dollars of businesses within the United States.[152] When states compete by implementing BLTIs, they effectively reduce their tax revenue by offering tax credits and the like to businesses. The most competitive BLTI is the one which reduces the most taxes for businesses. This directly reduces tax revenue for the State. In order to level the playing field, other States must offer the same—lower—tax rate. The only means by which State competitors can garner more attraction is through reducing the tax burden even further. Such a competitive scheme effectively diminishes tax revenue simply in order to maintain competitive footing. States would also refrain from increasing the tax obligation afterwards since their competitive position would

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[151] Enrich, *supra* note 46, at 468 ("In analyzing interstate bidding wars from a game theory perspective, Taylor focuses on the supposed direct economic costs that a state may incur if it fails to match the incentives offered by others. These economic costs may be illusory, however, if location incentives are largely ineffective, as the research suggests. If these economic costs were the only relevant costs, then a state could escape the prisoners' dilemma by simply declining to compete. The political costs of such a strategy, however, would likely be substantial, and these political costs keep the states caught in the dilemma. In short, the states are political prisoners

[152] *Id.*

effectively vanish. The only means by which the tax rate could potentially return to its initial rate would require a consensus of all the states. Given this unlikely consensus,[153] the competitors (i.e., the States) are unlikely to ever attain the previous, higher tax rate. In the long run, all of the competitors are worse off.

Second, BLTIs do not upgrade business-oriented or business-attracting infrastructure. For example, BLTIs create no meaningful impact on a State's natural resource deposits (or rather the State's efficiency in acquiring such resources) or the educational levels of denizens within that particular State. By offering the BLTI, the State's hope rests upon the shoulders of the business entity to stimulate and catalyze the economy instead. To secure this hope, States reduce taxable revenue.

But herein lies the issue; businesses will only choose to enter into a state if the benefit from the reduced tax burden outweighs the combined inefficiency in conducting business in the less-opportune location and the mandated costs of improving such infrastructure. Otherwise, the business would choose to locate in the more efficient location in the first place.

***BLTIs under the Pike Balancing Test*.**

When considering the economic impact of BLTI policies, BLTIs inherently fail the Pike Balancing test. This is the case because businesses, at least those operating properly, only choose to accept the BLTI offer when the inefficiency of operating within the State and the cost of meeting BLTI requirements is outweighed by the potential tax reductions received under the BLTI program. When considering the innocuous economic impact that BLTI policies have on State

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[153] *Id*. at 472 (stating that such a consensus requires trust on all parties).

economies,[154] the balance under the Pike Balancing Test tilts only against their constitutionality. Thus, BLTIs likely fail constitutional inquiry under the Pike Balancing test.

***Why BLTIs have not been defeated already*.**

Despite the apparent unconstitutionality of BLTIs, the Supreme Court of the United States has not spoken on the constitutionality of BLTI policies.[155] After the Sixth Circuit Court of Appeals found that such tax incentive programs violated the Dormant Commerce Clause because they impermissibly discriminated against interstate commerce in Cuno v. DaimlerChrysler, Inc.,[156] the issue of constitutionality of tax incentive programs was finally going to have its day in court.[157] However, in 2006, the Supreme Court dismissed the claim on the procedural issue of standing.[158] Thus, the prevalence of BLTI State policies throughout the United States, despite their likely unconstitutionality, results from the inability to bring the issue in front of the Supreme Court.[159]

IV. CONCLUSION

Overall, BLTIs are likely unconstitutional because they violate the anti-discrimination prong of the Dormant Commerce Clause. Regardless of the constitutional inquisition implemented (the virtually *per se* rule of invalidity or the Pike Balancing test) the inherent nature of BLTIs to garner a competitive advantage in the interstate marketplace renders them impermissibly discriminatory. This renders BLTI policies patently unconstitutional no matter the circumstance.

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[154] Kaye, *supra* note 31, at 128 (referring to the economic impact of BLTIs).
[155] *Id*.
[156] Cuno v. DaimlerChrysler, Inc., 386 F.3d 738 (6th Cir. 2004), vacated in part sub nom. DaimlerChrysler Corp. v. Cuno, 547 U.S. 332 (2006).
[157] Kaye, *supra* note 31, at 128.
[158] DaimlerChrysler Corp. v. Cuno, 547 U.S. 332 (2006).
[159] Although interesting, the issue of standing is not within the purview of this Note.