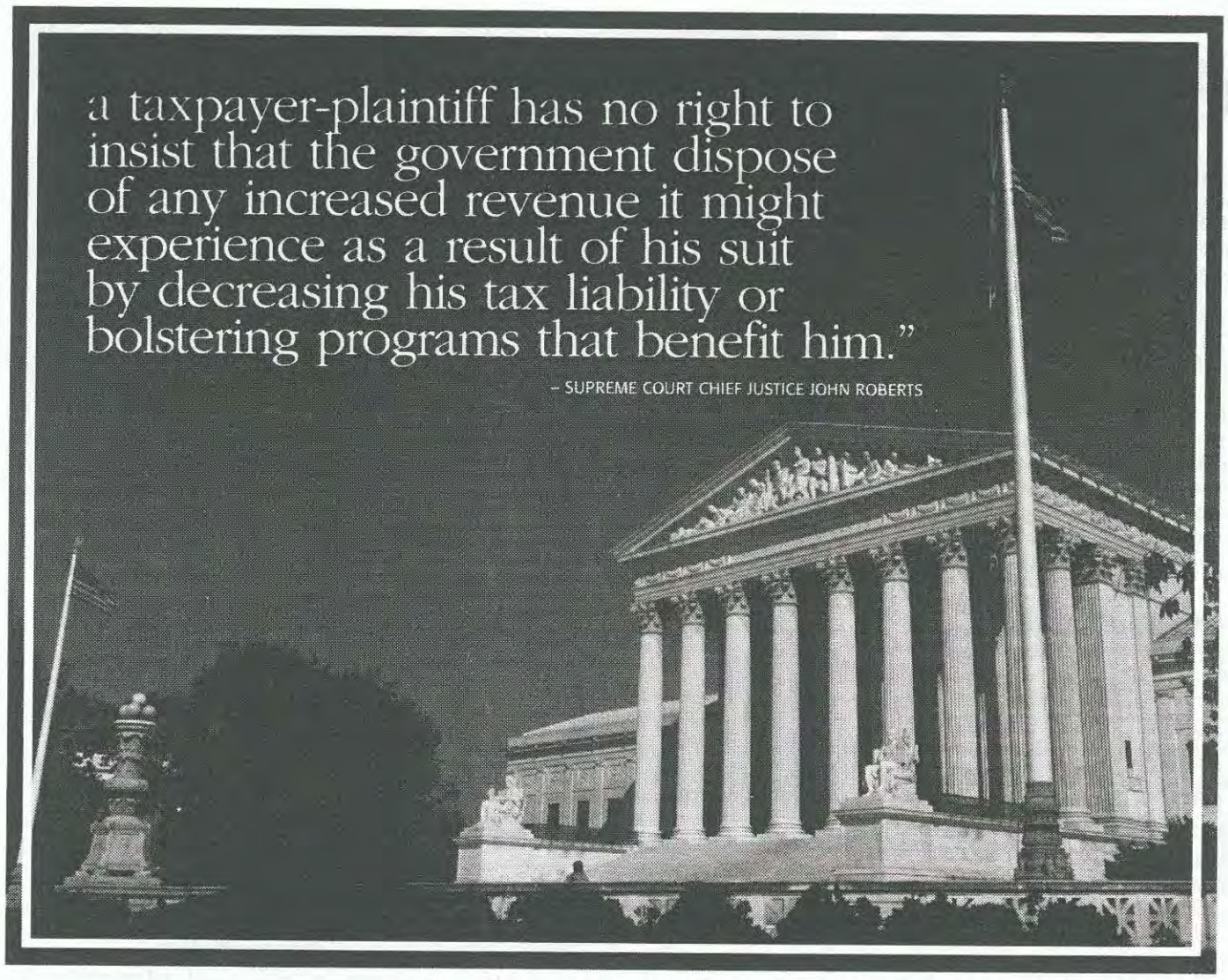
Supreme Court: tax incentives up to individual states

By Tom Martin
BUSINESS LEXINGTON

Citing an interpretation of the constitution that has survived time and change, the U.S. Supreme Court has handed Kentucky and other Ohio Valley states a major victory in their efforts to attract industries and the jobs and tax revenues they produce.

In a unanimous decision sorting out who can — and cannot — sue in such cases, while also fortifying the barrier between the appropriate roles of legislatures and the judiciary, the court overturned an Ohio case that struck down economic development tax breaks in Ohio and threatened similar programs in Kentucky, Tennessee and Michigan.

Such a program provided $305 million over two decades in tax incentives to attract Toyota to build its $800 million assembly plant in Georgetown. The dividends to the area economy include 7,000 jobs, an annual payroll of approximately $516 million and tax revenues estimated at $1.5 billion over the past two decades



Incentives

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for a return on investment of 37 percent.

In the opening paragraph of the Supreme Court opinion in the case of Cuno v. DaimlerChrysler, Chief Justice John Roberts wrote:

"Jeeps were first mass-produced in 1941 for the U. S. Army by the Willys-Overland Motor Company in Toledo, Ohio. Nearly 60 years later, the city of Toledo and State of Ohio sought to encourage the current manufacturer of Jeeps — DaimlerChrysler — to expand its Jeep operation in Toledo, by offering local and state tax benefits for new investment. Taxpayers in Toledo sued, alleging that their local and state tax burdens were increased by the tax breaks for DaimlerChrysler, tax breaks that they asserted violated the Commerce Clause. The Court of Appeals agreed that a state tax credit offered under Ohio law violated the Commerce Clause, and state and local officials and DaimlerChrysler sought review in this Court. We are obligated before reaching this Commerce Clause question to determine whether the taxpayers who objected to the credit have standing to press their complaint in federal court. We conclude that they do not, and we therefore can proceed no further."

"This is essentially approving state legislatures' passing tax incentive legislation for economic development purposes," said Jeffrey Teeters, a partner with Frost Brown Todd's complex business litigation group who represented area chambers of commerce in their friend-of-the-court filing in this case, "While it's not saying the incentives are good or bad, it is saying a taxpayer plaintiff cannot go to court to challenge what a state legislature decides to do with its incentive programs."

The case

In April 2000, then independent presidential candidate Ralph Nader supported the filing of a lawsuit against DaimlerChrysler in U.S. District Court for the Northern District of Ohio. The suit was filed on behalf of three small businesses and a dozen taxpayers, including its namesake, Charlotte Cuno. It argued that tax incentives offered by Ohio for the construction of a Jeep plant in Toledo violated the U.S. Constitution's interstate commerce clause by giving DaimlerChrysler tax breaks that discriminated against out-of-state companies. On August 1, 2001, the federal trial court upheld the constitutionality of the Ohio investment tax credit. That ruling was then appealed to the 6th U.S. Circuit Court of Appeals in Cincinnati, which has jurisdiction over Michigan, Ohio, Kentucky and Tennessee. The Court of Appeals overturned the lower court ruling in September of 2004.

What the court said

Writing on behalf of the high court, Chief Justice John Roberts said "a taxpayer-plaintiff has no right to insist that the government dispose of any increased revenue it might experience as a result of his suit by decreasing his tax liability or bolstering programs that benefit him. To the contrary, the decision of how to allocate any such savings is the very epitome of a policy judgment committed to the broad and legitimate discretion of lawmakers, which the courts cannot presume either to control or to predict."

Drawing a distinct line between the constitutionally appropriate roles of judiciary and legislature, the high court opinion goes on to state, "because state budgets frequently contain an array of tax and spending provisions, any number of which may be challenged on a variety of bases, affording state tax-payers standing to press such challenges simply because their tax burden gives them an interest in the state treasury would interpose the federal courts as virtually continuing monitors of the wisdom and soundness of state fiscal administration, contrary to the more modest role envisioned for federal courts in Article III of the constitution."

Reading between the lines, Teeters believes the court has taken its cue from 18th century Federalism. "They're saying, 'we're going to let the states do what the states are permitted to do. The state governments have the authority to administer their fiscal policies the way they choose and the federal courts and the U.S. Constitution are not going to interject into that."

While unlikely that in the winter of 1788 he had in mind the manufacture of Japanese automobiles in Georgetown or Jeeps in Toledo, Alexander Hamilton — writing in Federalist No. 33 — stated: "the individual states... retain independent and uncontrollable authority to raise revenue to any extent of which they may stand in need, by every kind of taxation, except in duties on imports and exports."

Fast-forwarding to the Central Kentucky of 2006, Commerce Lexington President and CEO Bob Quick said the current economic incentives debate is about the return actually realized from investing public dollars to attract companies such as Toyota. "Studies have shown clearly that the return Toyota has provided as a private sector entity for each dollar received from the public by far paid value back to the community and the region," he said.

As the Cuno v. DaimlerChrysler case made its way up the judicial ladder to the Supreme Court, Congressman Ben Chandler proposed remedial legislation that would remove any ambiguities concerning the right of states to offer tax breaks.

"I am pleased with the unanimous decision by the Supreme Court to vacate the ruling of the 6th Circuit Court of Appeals," Chandler said in a statement. "It is premature to say how the House of Representatives will react to the decision; it could obviate the need for Congress to act to preserve economic development incentives. This decision certainly reaffirms the wisdom of our legislation."

With its ruling in Cuno v. DaimlerChrysler, the Supreme Court has thrown out the 6th Circuit decision and sent the case back to federal court in Ohio with instructions that it be dismissed there.

Tax incentives and the big fish they lure

Since 1997, Kentucky has generated over $10.8 billion in capital investment from tax credits and wage assessment programs, according to the state's Cabinet for Economic Development, and those investments are directly related to the creation of more than 74,000 jobs in manufacturing and non-government services. The manufacturing jobs generate an estimated annual payroll of $1.6 billion with the service sector accounting for an estimated annual payroll of $851 million.

UPS

The Kentucky Economic Development Finance Authority recently approved one of the most generous single tax incentive packages in the state's history – $31.6 million – to aid UPS in its plans for a $1 billion expansion of its main air hub in Louisville.

UPS is qualified to receive up to an additional $20 million through the Kentucky Enterprise Initiative (KEIA) which "allows KEDFA-approved companies to seek refunds on sales and use taxes on the cost of construction materials, building fixtures and equipment used for research and development." State officials anticipate UPS will seek KEDFA approval for these refunds in phases over the next three fiscal years.

According to an Associated Press report, the deal was cinched when state legislators promised to continue funding a tuition support program for UPS workers. The Fletcher administration projects a direct economic impact for Kentucky of $344.8 million from the creation of 1,284 full-time and 3,787 part-time jobs. There would be an indirect economic impact of $400 million from other companies moving to the area. Under the incentives package, UPS is permitted to keep four percent of the state income taxes it withholds from employees' paychecks and one percent of local payroll taxes, up to $31.6 million. The benefits, which apply only to the new jobs created in Kentucky, cease either in 10 years or when the total received by UPS reaches $31.6 million, depending on which occurs first.

Honda?

Honda Motors plans to build a $400 million assembly line in the region, and Indiana and Ohio are openly pursuing the factory and its 1,500 jobs. But if Kentucky tax incentives also are on the table, state officials are holding their cards very close to their vests. "We don't discuss projects that we may or may not be in negotiations with," said J.R. Wilhite, Commissioner, Department for Existing Business Development.

Jeffrey Smith, a spokesman for Honda USA, said in New York, "It is our practice not to discuss our site selection information or criteria until details are final and until we've made a formal announcement. I can tell you that we are in the final stages of securing a plant site in the Midwest."

Despite fierce competition in the automotive industry, Toyota-Kentucky president Gary Convis said his company would have no issues with the siting of a rival Honda plant in Kentucky. "I don't know why they wouldn't look at Kentucky very seriously." Actually, he added, "it would enhance the state of Kentucky and that would enhance the lives of the people who work for our company and those who will work for it in the future, so I would see it as a positive."