

The Gentle Art of Corporate Seduction: Tax Incentives in the United States and the European Union

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I. INTRODUCTION

“Wal-Mart Received \$200 Million in Subsidies Since 2004, Report Says.”¹ This headline illustrates a compelling problem in the U.S. federal system—tax competition among the states. A 2004 study detailed how Wal-Mart received over \$1 billion in economic development subsidies from approximately 240 state and local governments for its retail stores as well as its distribution centers.² Wal-Mart, one of the world’s largest corporations, “presents itself as an entrepreneurial success story, yet it routinely gets big tax breaks, free land, cash grants, and other forms of taxpayer assistance.”³ The follow-up report found that Wal-Mart continues to benefit from economic development subsidies, negotiating “[thirty-nine] deals worth more than

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1. John Buhl, *Wal-Mart Received \$200 Million in Subsidies Since 2004, Report Says*, 44 ST. TAX NOTES 788, Doc. No. 2007-13417 (2007) (LEXIS).

2. Philip Mattera et al., *Shopping for Subsidies: How Wal-Mart Uses Taxpayer Money*, 32 ST. TAX NOTES 1001, 1002, Doc. No. 2004-11480 (2004) (LEXIS).

3. Buhl, *supra* note 1 (citing Press Release, Philip Mattera, Research Director, Good Jobs First (June 5, 2007)).

\$200 million in . . . the past three years.”⁴ While both the United States and the European Union face the same problem of state tax competition, this Article explains why this scenario would be extremely unusual in the European Union and examines whether any lessons can be learned from its experience.

The United States and the European Union are arguably the most powerful and successful examples of federalism. Founded in part because of the need for economic unity,⁵ both continue to struggle with the individual sovereignty of their subnational governmental units (the individual American States and the European Union Member States).⁶ One part of this sovereignty is the power to provide subsidies to promote certain public policies. Specifically, the states and Member States enjoy the power to provide these subsidies through various tax incentives such as investment tax credits.

However, this power is not unlimited. In an effort to establish a common market in both the United States and the European Union, the tax policy of one state cannot be discriminatory against other states in a way that interferes with commerce within the common market.⁷ Although both systems adhere to this general principle, the United States

4. Good Jobs First, *Wal-Mart Continues to Benefit from Economic Development Subsidies; More Than \$200 Million Documented Over Past Three Years*, <http://www.goodjobsfirst.org/news/article.cfm?id=142> (last visited Aug. 26, 2008). See DAVID CAY JOHNSTON, *FREE LUNCH: HOW THE WEALTHIEST AMERICANS ENRICH THEMSELVES AT GOVERNMENT EXPENSE (AND STICK YOU WITH THE BILL)* 99–104 (2007) for an exposition of Wal-Mart’s policy of shopping for subsidies.

5. The United States was founded in 1787, in hopes of a solution to “the mutual jealousies and aggressions of the States” that had led to economic retaliation. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 522 (1935) (citations omitted). See generally THE FEDERALIST NO. 42 (James Madison); 2 THE RECORDS OF THE FEDERAL CONVENTION OF 1787, 308 (Max Farrand ed., 1911); 3 *id.* at 478, 547, 548. The European Economic Community was founded in 1958 with the establishment of a common market in the hopes of so intertwining their economies that future war would be avoided. See Treaty Establishing the European Economic Community, art. 2, Mar. 25, 1957, 298 U.N.T.S. 11 [hereinafter EEC Treaty]. “From the outset, the EU was partly meant to make war unthinkable inside Europe.” *Charlemagne: The Burden of History*, ECONOMIST, May 19, 2007, at 59.

6. The Treaty of Maastricht established the European Union. Treaty on European Union, art. 1, Feb. 7, 1992, 1992 O.J. (C 191) 1 [hereinafter TEU]. The Treaty of Amsterdam, effective May 1, 1999, amended the EEC Treaty and the TEU. Treaty of Amsterdam, Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Oct. 2, 1997, 1997 O.J. (C 340) 1. The most recent revisions of the Treaty entered into force on February 1, 2003. Treaty of Nice Amending the Treaty on European Union, the Treaties Establishing the European Communities and Certain Related Acts, Feb. 26, 2001, 2001 O.J. (C 80) 1 [hereinafter Treaty of Nice]. On December 13, 2007, the Treaty of Lisbon was signed by the twenty-seven Member States. Treaty of Lisbon Amending the Treaty on European Union and the Treaty Establishing the European Community, 2007 O.J. (C 306) 1. However, the Treaty also needs to be ratified by all twenty-seven Member States before it becomes effective. Tony Barber, *EU Weighs Future as Leaders Sign New Treaty*, FIN. TIMES (U.K.), Dec. 14, 2007, at 2.

7. See *infra* text accompanying notes 11–13, 42–47.

and the European Union have considerably different approaches in tempering the ability of the states and Member States to provide subsidies through tax policy.

Part II of this Article discusses differing theories of tax competition while Part III outlines the use of tax incentives in the United States and the European Union. Part IV then describes the procedures in place in each of the respective “federal” systems to allow challenges to tax incentives that might obstruct the efficient functioning of the common market and examines the implications of the choices made. Part V recommends a proposal based on lessons learned from the EU experience.

Pursuant to the Commerce Clause of the U.S. Constitution, Congress has the authority to regulate state tax competition.⁸ However, Congress has usually declined to exercise this authority.⁹ Generally, the federal government has adopted a laissez-faire attitude and has declined “to establish principles for state tax competition.”¹⁰ Although the Commerce Clause is phrased as an affirmative grant of power to Congress, the Commerce Clause has long been interpreted by the Supreme Court as also denying the states the ability to tax or regulate in any manner that would unduly burden interstate commerce.¹¹ Thus, this dormant Commerce Clause doctrine limits a state’s ability to interfere with interstate commerce¹² and implicitly prohibits state discrimination of interstate commerce.¹³ Modern Commerce Clause doctrine forbids

8. See U.S. CONST. art. I, § 8, cl. 3 [hereinafter Commerce Clause] (“The Congress shall have Power To . . . regulate Commerce . . . among the Several States.”).

9. See Kathryn L. Moore, *State and Local Taxation: When Will Congress Intervene?*, 23 J. LEGIS. 171, 182–204 (1997) (reviewing the legislative history of various bills prohibiting state taxation); see also Charles E. McLure Jr. & Walter Hellerstein, *Congressional Intervention in State Taxation: A Normative Analysis of Three Proposals*, 31 ST. TAX NOTES 721, 723–735, Doc. No. 2004-3173 (2004) (LEXIS) (providing an overview of congressional intervention in state tax matters and proposals regarding Internet access taxes, sales tax streamlining, and business activity taxes).

10. Thomas F. Field, *Tax Competition in Europe and America*, 27 ST. TAX NOTES 1211, 1213 (2003).

11. LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 6-2, at 1030 (3d ed. 2000).

It is now established beyond dispute that “the Commerce Clause was not merely an authorization to Congress to enact laws for the protection and encouragement of commerce among the States, but by its own force created an area of trade free from interference by the States. . . . [T]he Commerce Clause even without implementing legislation by Congress is a limitation upon the power of the States.”

Boston Stock Exch. v. State Tax Comm’n, 429 U.S. 318, 328 (1977) (citing *Freeman v. Hewit*, 329 U.S. 249, 252 (1946)).

12. See generally TRIBE, *supra* note 11, § 6-2, at 1030.

13. See Mark Tushnet, *Rethinking the Dormant Commerce Clause*, 1979 WIS. L. REV. 125, 130–31 (“Beyond the proscription of purposeful discrimination, the commerce clause has been held to authorize judicial invalidation of state laws that unduly burden interstate commerce.”).

nearly all discrimination on the basis of economic factors from sister-states and is designed to preclude states from engaging in economic protectionism.¹⁴ Thus, tax subsidies that encourage investment within a state must comply with the dormant Commerce Clause.¹⁵

On the other hand, in the United States, states are generally free to directly subsidize in-state activities¹⁶ under the “market-participant” exception. “The ‘market-participant’ exception permits states acting as ‘market participants’ as opposed to ‘regulators’—essentially when the state is engaged in ordinary buying or selling with taxpayer money—to make geographic distinctions the [dormant Commerce Clause Doctrine] would otherwise prohibit.”¹⁷ The Supreme Court has indicated that even direct monetary subsidies to in-state companies usually do not violate the Commerce Clause.¹⁸

The 1988 Supreme Court case of *New Energy Co. of Indiana v. Limbach* explicitly reiterates this dichotomy:¹⁹

The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State’s regulation of interstate commerce*. Direct subsidization of domestic industry does not

14. Douglas Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law*, 92 COLUM. L. REV. 249, 269 (1992).

15. See generally ERWIN CHERMERINSKY, CONSTITUTIONAL LAW: PRINCIPLES AND POLICIES 401 (2d ed. 2002) (“Even if Congress has not acted or no preemption is found, the state or local law can be challenged on the ground that it excessively burdens commerce among the states.”).

16. See, e.g., *Camps Newfound/Owatonna v. Town of Harrison*, 520 U.S. 564, 591 (1997) (“Direct subsidization of domestic industry does not ordinarily run afoul of [the Commerce Clause].” (citing *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278 (1988))). For an example of a prohibited subsidy see *W. Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 204–05 (1994) (holding a Massachusetts tax on all milk dealers unconstitutional because its impact was identical to that of a discriminatory tax as the tax revenues were used to subsidize in-state dairy farmers).

17. Brannon Denning, *Is the Dormant Commerce Clause Expendable? A Response to Edward Zelinsky*, 77 MISS. L.J. 623, 626 n.17 (2007); see also David S. Bogen, *The Market-Participant Doctrine and the Clear Statement Rule*, 29 SEATTLE U. L. REV. 543 (2006) (“According to the market participant doctrine, however, the state does not violate the dormant Commerce Clause by favoring its own citizens and companies when it buys or sells goods or services.”). See generally Dan T. Coenen, *Untangling the Market Participant Exception to the Dormant Commerce Clause*, 88 MICH. L. REV. 395 (1989) (explaining the development of the rule, alternative approaches to the rule, and application of the rule).

18. See *W. Lynn Creamery*, 512 U.S. at 199 n.15 (“We have never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that ‘[d]irect subsidization of domestic industry does not ordinarily run afoul’ of the negative Commerce Clause. In addition, it is undisputed that States may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads, sound public education, or low taxes.” (citations omitted)).

19. 486 U.S. 269 (1988).

ordinarily run afoul of that prohibition; discriminatory taxation . . . does.²⁰

This dichotomy between the treatment of direct subsidies and tax subsidies under the dormant Commerce Clause has been severely criticized.²¹

Furthermore, the Supreme Court has provided murky guidance for determining when violations of the clause have occurred and the case law on specific tax schemes has not established a clear pattern of precedent.²² Under the test spelled out in dicta in *Complete Auto Transit, Inc. v. Brady*, a tax on interstate commerce must meet four requirements to survive a constitutional challenge under the Commerce Clause.²³ The third prong of this test, the ban on discrimination against interstate commerce, is the predominant basis upon which the Supreme Court has struck down state taxes in recent years.²⁴ A tax law is discriminatory if it “tax[es] a transaction or incident more heavily when it crosses state lines than when it occurs entirely within the [s]tate.”²⁵

State tax incentives reward a corporation’s in-state activities and raise an important dormant Commerce Clause question that has yet to be answered by the Supreme Court.²⁶ In fact, Professor Enrich noted in

20. *Id.* at 278.

21. See, e.g., Edward A. Zelinsky, *Restoring Politics to the Commerce Clause: The Case for Abandoning The Dormant Commerce Clause Prohibition on Discriminatory Taxation*, 29 OHIO N.U.L. REV. 29 (2002). Professor Zelinsky has concluded “that the time has come to scrap the dormant Commerce Clause prohibition on discriminatory taxation. Since the judicially-created prohibition has served its historic purpose, to create a single common market of the United States, it can now safely be laid to rest.” *Id.* at 29. The Supreme Court’s distinction between discriminatory taxation, which is prohibited under their decisions, and equivalent direct government subsidies, which are generally permitted, is fundamentally incoherent because taxes and subsidies are often similar in design and effect. *Id.* at 30–31.

22. David F. Shores, *State Taxation of Interstate Commerce—Quiet Revolution or Much Ado About Nothing?*, 38 TAX L. REV. 127, 128–29 (1982). “This case-by-case approach has left ‘much room for controversy and confusion and little in the way of precise guides to the States in the exercise of their indispensable power of taxation.’” *Boston Stock Exch. v. State Tax Comm’n*, 429 U.S. 318, 329 (1977) (quoting *Nw. States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959)).

23. 430 U.S. 274, 279 (1977); see also CHEMERINSKY, *supra* note 15, at 435; RICHARD D. POMP & OLIVER OLDMAN, *STATE AND LOCAL TAXATION* 1-15 (4th ed. 2001). The four requirements are: (1) the activity taxed has a “substantial nexus with the taxing [s]tate”; (2) the tax is fairly apportioned to reflect the degree of activity that occurs within the state; (3) the tax “does not discriminate against interstate commerce”; and (4) the tax “is fairly related to benefits provided by the [s]tate.” *Complete Auto Transit, Inc.*, 430 U.S. at 279.

24. *TRIBE*, *supra* note 11, § 6-16, at 1107.

25. *Chem. Waste Mgmt., Inc. v. Hunt*, 504 U.S. 334, 342 (1992) (citing *Armco Inc. v. Hardesty*, 467 U.S. 638, 642 (1984)).

26. 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*

1996, “[t]he Supreme Court’s calendar has included a steady diet of state tax cases raising Commerce Clause issues, but to date, the Court has not applied its Commerce Clause doctrine to a state [investment tax credit], to a jobs credit, or any of the other characteristic location incentives.”²⁷ While the Court consistently finds discriminatory tax schemes unconstitutional, the Court is reluctant to strike down positive tax incentives that favor local industry.²⁸ Indeed, until the *Cuno* case discussed below,²⁹ the Supreme Court had not seen “a challenge grounded in the claim that a state tax provision’s primary purpose or effect is to attract business to locate or expand in the state.”³⁰

Professors Hellerstein and Coenen note: “a tax which by its terms or operation imposes greater burdens on out-of-state goods, activities, or enterprises than on competing in-state goods, activities, or enterprises will be struck down as discriminatory under the Commerce Clause.”³¹ In *Boston Stock Exchange*, the Supreme Court stated: “No State, consistent with the Commerce Clause, may ‘impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.’”³² Although this seems like an applicable standard that could produce consistent results, it has left much of the interpretation to the courts. This is demonstrated by the Court’s general willingness to allow location tax incentives, which clearly favor one state’s businesses over another.³³ This topic of tax competition between the American States has received much attention lately.³⁴

On March 1, 2006, the Supreme Court heard oral arguments in *DaimlerChrysler Corp. v. Cuno*,³⁵ the appeal of a Sixth Circuit case.³⁶ In *Cuno*, the Sixth Circuit ruled on two Ohio tax incentives stemming from

Taxpayer, 60 TAX LAW. 835, 837 (2007).

27. Peter D. Enrich, *Saving the States From Themselves: Commerce Clause Constraints on State Tax Incentives for Business*, 110 HARV. L. REV. 377, 407 (1996) [hereinafter Enrich, *Saving the States*].

28. *Id.* at 407–08.

29. See *infra* notes 35–41 and accompanying text.

30. Enrich, *Saving the States*, *supra* note 27, at 381.

31. Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 793 (1996).

32. 429 U.S. 318, 329 (1977) (quoting *Nw. Cement Co. v. Minnesota*, 358 U.S. 450, 458 (1959)).

33. See Enrich, *Saving the States*, *supra* note 27, at 407, and accompanying text.

34. See, e.g., James R. Rogers, *The Law and Policy of State Tax Competition: Much Ado About Nothing?*, 4 GEO. J. L. & PUB. POL’Y 101 (2006).

35. Transcript of Oral Argument at 1, *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006) (Nos. 04-1704, 04-1724). See JOHNSTON, *supra* note 4, at 85–94 for a discussion of the behind the scenes events that preceded the litigation.

36. *Cuno v. DaimlerChrysler Corp.*, 386 F.3d 738 (6th Cir. 2004), *cert. granted*, 545 U.S. 1165 (2005), *vacated in part and remanded*, 547 U.S. 332 (2006).

an agreement between the City of Toledo and DaimlerChrysler to build a plant in Ohio.³⁷ The Sixth Circuit held that the investment tax credit violated the Commerce Clause because it “discriminates against interstate economic activity by coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state.”³⁸ However, the court found the personal property tax exemptions constitutional because they did not favor in-state activity.³⁹ Although the Supreme Court ultimately limited its holding in *Cuno* to the issue of standing,⁴⁰ the discussion surrounding the case provides an excellent opportunity to compare and contrast the economic development policy in the United States with the state aid law in the European Union.⁴¹

Like the United States, the European Union bars tax discrimination.⁴² Article 12 of the Treaty Establishing the European Community (“EC Treaty”) explicitly states that “any discrimination on grounds of nationality shall be prohibited.”⁴³ Generally speaking, Member States are not permitted to pass national legislation that distinguishes between domestic and foreign persons, goods, services, or capital.⁴⁴ These restrictions are part of the four fundamental freedoms espoused by the EC Treaty.⁴⁵ According to the jurisprudence of the European Court of Justice, the “Four Freedoms” are directly applicable,⁴⁶ permitting economic operators to challenge the validity of national law, including a tax law.⁴⁷ The European Court of Justice has taken an expansive

37. *Cuno*, 386 F.3d. at 741–48.

38. *Id.* at 743, 746.

39. *Id.* at 747.

40. *Cuno*, 547 U.S. at 338.

41. E.g., Deborah H. Schenk, *The Cuno Case: A Comparison of U.S. Subsidies and European State Aid*, 1 EUR. ST. AID Q. 3 (2006); Diane P. Wood, *Cuno v. DaimlerChrysler, Inc.: State ‘Aids’ from an American Perspective*, 1 EUR. ST. AID Q. 3 (2007); Reuven S. Avi-Yonah, *Passport to Toledo: Cuno, the World Trade Organization and the European Court of Justice*, TAX NOTES, Dec. 26, 2005, at 1661.

42. Tracy A. Kaye, *Tax Discrimination: A Comparative Analysis of U.S. and EU Approaches*, in COMPARATIVE FISCAL FEDERALISM 191, 212–13 (Reuven S. Avi-Yonah et al. eds., 2007) [hereinafter Kaye, *Discrimination*].

43. Consolidated Version of the Treaty Establishing the European Community, art. 12, 2002 O.J. (C 325) 43 [hereinafter EC Treaty] (incorporating changes made by Treaty of Nice art. 87). See generally Kaye, *Discrimination*, *supra* note 42.

44. A number of provisions within the EC Treaty prohibit measures that discriminate or restrict these fundamental freedoms. Wolfgang Schön, *State Aid in the Area of Taxation*, in EC STATE AIDS 241, 244 (Leigh Hancker et al. eds., 3d ed. 2006) [hereinafter Schön, *State Aid*].

45. EC Treaty, *supra* note 43, art. 14.

46. Case 26/62, *NV Algemene Transport - en Expeditie Onderneming van Gend & Loos v. Nederlandse Administratie der Belastingen*, 1963 E.C.R. 1, ¶ 12.

47. SERVAAS VAN THIEL, *EU CASE LAW ON INCOME TAX* at 4–9 (2001); see BEN J.M. TERRA & PETER J. WATTEL, *EUROPEAN TAX LAW* 32–34 (5th ed. 2008).

approach to evaluating the validity of tax regimes, and the resulting case law “illustrate[s] how the tax treatment of losses in cross-border situations, exit taxation, taxes on transfer of assets, withholding taxes on cross-border income, anti-abuse rules as well as inheritance taxes can all constitute tax obstacles to the internal market. And these are just a few examples.”⁴⁸

Unlike the U.S. Constitution, the EC Treaty also explicitly prohibits state aid because the founders believed that state aid distorts competition within the common market.⁴⁹ “State aid control comes from the need to maintain a level playing field for all undertakings active in the Single European Market, no matter in which Member State they are established.”⁵⁰ In general, state aid is financial support given by a government to a certain business sector, enterprise, or geographic region through either direct or indirect transfer of resources.⁵¹

Specifically, Article 87(1) states that “any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.”⁵² Therefore, state aid selectively favors *certain* undertakings for the production of *certain* goods, while general aid assists all sectors or industries. The first measure is prohibited; the second is not.⁵³

The Treaty also provides exceptions to the general prohibition on state aid. Paragraphs (2) and (3) of Article 87 list aid that is deemed “compatible” with the common market and aid that the Commission may declare “compatible.”⁵⁴ For example, under Article 87(3), state aid can

48. László Kovács, Eur. Comm’r for Taxation & Customs, Internal Market Without Direct Tax Obstacles: the Commission’s Proposals to Help Cross Border Activities in the European Union (Nov. 23, 2006), available at http://ec.europa.eu/commission_barroso/kovacs/speeches/dhik_20061123.pdf; see Kaye, *Discrimination*, *supra* note 42, at 235–37.

49. EC Treaty, *supra* note 43, art. 87.

50. Phedon Nicolaidis, *The Economics of Granting and Controlling State Aid*, in EC STATE AIDS 17, 19 (Leigh Hancher et al. eds., 3d ed. 2006) (citing European Commission, *State Aid Action Plan: Less and Better Targeted State Aid*, COM (2005) 107 final (June 7, 2005)).

51. CARLO PINTO, TAX COMPETITION AND EU LAW 100 (2003).

52. EC Treaty, *supra* note 43, art. 87(1); see also Wolfgang Schön, *Taxation and State Aid Law in the European Union*, 36 COMMON MKT. L. REV. 911, 919 (1999) [hereinafter Schön, *Taxation*] (discussing the application of Article 87(1) in tax matters).

53. See Fred C. de Hosson, *Tax Facilities for State-Induced Costs under the EC State Aid Rules*, 35 INTERTAX 719, 720 (2007) (“[A] ‘tax expenditure’ . . . can only be construed as state aid if it leads to *certain* undertakings or the production of *certain* goods having an advantage.”); see also Martha O’Brien, *Company Taxation, State Aid and Fundamental Freedoms: Is the Next Step Enhanced Co-operation?*, 30 EUR. L. REV. 209, 224–27 (2005) (describing why the boundaries between selective and general provisions are yet to be defined).

54. EC Treaty, *supra* note 43, art. 87(2)–(3); see also GEORGE A. BERMAN ET AL., CASES AND

be held to be compatible if it is “aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious unemployment.”⁵⁵ Finally, Article 88 outlines notification, waiting, and adjudication procedures for all proposed measures of state aid with the potential to affect competition between the Member States.⁵⁶ This has led to a number of decisions from the Commission as it pursues state aid investigations with respect to special national tax measures for multinationals.⁵⁷ Many of these cases arise out of complaints made by the competitors of those firms that have been granted state aid.⁵⁸ In fact, the Member State case law over the last decade reflects a steady increase in the number of competitors seeking to enforce state aid rules against Member States and beneficiaries in the national courts.⁵⁹

Although tax incentives were not the initial focus of the state aid restrictions, the European Court of Justice (ECJ) made it clear in dictum in *Italy v. Commission* that Article 87 applies to aid in any form.⁶⁰ Thus,

MATERIALS ON EUROPEAN UNION LAW 1014–15 (2d ed. 2002).

55. EC Treaty, *supra* note 43, art. 87(3)(a).

56. *Id.* art. 88; BERMANN ET AL., *supra* note 54, at 1015. For example:

If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State or through State resources is not compatible with the common market . . . it shall decide that the State concerned shall abolish or alter such aid within a period of time to be determined by the Commission. If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 and 227, refer the matter to the Court of Justice direct.

EC Treaty, *supra* note 43, art. 88(2).

57. See European Commission, *Report on the Implementation of the Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation*, COM (2004) 434 final (Feb. 9, 2004) [hereinafter *2004 Commission Report*], available at http://ec.europa.eu/comm/competition/state_aid/others/business/rapportaidesfiscales_en.pdf (“[C]larifying and reinforcing the application of the state aid rules in order to reduce distortions of competition as they affect the single market and economic and monetary union.”). See generally Pierpaolo Rossi-Maccanico, *State Aid Review of Member States’ Measures Relating to Direct Business Taxation*, 2 EUR. ST. AID Q. 229 (2004) [hereinafter Rossi-Maccanico, *State Aid Review*].

58. BERMANN ET AL., *supra* note 54, at 1019 (“Firms frequently challenge a grant of state aid to their rivals, and typically they are accorded standing to do so.”); see *id.* at 141 (noting that competitors, as well as the prospective recipients of the state aid, have been held to have standing to sue to challenge Commission decisions addressed to the Member States in either the Court of First Instance or the Court of Justice).

59. Thomas Jestaedt et al., *Study on the Enforcement of State Aid Law at National Level* 43–44 (Mar. 2006) available at http://ec.europa.eu/comm/competition/state_aid/studies_reports/study_part_1.pdf.

60. The aim of Article 92 [now Article 87] is to prevent trade between Member States from being affected by benefits granted by the public authorities which . . . distort competition by favouring certain undertakings or the production of certain goods. Accordingly, Article 92 does not distinguish between the measures of state intervention concerned by reference to their causes or aims but defines them in relation to their effects. Consequently, the alleged fiscal nature or social aim of the

unlike in the United States, there is no incoherence in EU law with respect to the treatment of tax measures versus direct subsidies. The analysis and the outcome will be the same regardless of the aid instrument that is chosen. Tax measures are state aid if the state grants the recipients a fiscal advantage that affects competition and trade between the Member States.⁶¹ The tax measure must also be specific or selective and not a part of the general overall tax system.⁶² The ECJ has clarified that tax measures are specific if they differentiate between enterprises that are in legally and factually comparable situations.⁶³

In 1998, the European Commission and European Council began extensively utilizing these state aid restrictions to regulate the tax policies of the individual Member States.⁶⁴ Mario Monti (previous Commissioner for Internal Market and Taxation) was appointed Commissioner for Competition,⁶⁵ and brought his experience in the area of taxation and the internal market to bear on the use of the state aid laws as a way to promote the internal market.⁶⁶ In 2001, he commenced formal investigation procedures under Article 88 with respect to eleven national tax provisions.⁶⁷ Thus, the European Union is now explicit in restricting state aid that is provided through certain tax incentives or tax reductions.⁶⁸ If the tax exemptions affect industries or regions, then

measure in issue cannot suffice to shield it from the application of Article 92.

Case C-173/73, *Italian Republic v. Comm'n*, 1974 E.C.R. I-709, ¶ 13.

61. Pierpaolo Rossi-Maccanico, *A Review of State Aid in Multinational Tax Regimes*, 46 TAX NOTES INT'L 941, 943 (2007) [hereinafter Rossi-Maccanico, *Review of State Aid*].

62. *Id.* "Selectivity may derive from a legislative, regulatory, or administrative provision, or from a discretionary practice on the part of the tax authorities." *Id.*

63. *Id.* at 957 (citing Case C-143/99, *Adria-Wien Pipeline GmbH and Wietersdorfer & Peggauer Zementwerke GmbH v. Finanzlandesdirektion für Kärnten*, 2001 E.C.R. I-8365).

64. Schön, *State Aid*, *supra* note 44, at 242 (citing the *Commission Notice on the Application of the State Aid Rules to Measures Relating to Direct Business Taxation*, 1998 O.J. (C 384) 3 that describes its approach to tax incentives [hereinafter *Commission Notice on State Aid*]).

65. Chuck Gnaedinger, *New EU Commissioners Named; Monti's Replacement Announced*, 19 TAX NOTES INT'L 359 (1999); see Profile of Mario Monti, European Commission, http://ec.europa.eu/archives/commission_1999_2004/monti/cv_en.html (last visited Aug. 26, 2008).

66. Schön, *State Aid*, *supra* note 44, at 242; see Maria Reh binder, *Recent Developments in Commission State Aid Policy and Practice*, in THE LAW OF STATE AID IN THE EUROPEAN UNION 117, 118 (Andrea Biondi et al. eds., Oxford University Press 2003) (noting that Commissioner Monti indicated that strict state aid policy would be a political priority); Mario Monti, *Editorial: The Single Market and Beyond: Challenges for Tax Policy in the European Union*, 6 EC TAX REV. 2, 2-3 (1997).

67. TERRA & WATTEL, *supra* note 47, at 202, 207 (discussing investigations and injunctions occurring during Monti's tenure).

68. Overview: What Is State Aid?, http://ec.europa.eu/comm/competition/state_aid/overview/what_is_state_aid.html (last visited Aug. 26, 2008). See generally 2004 Commission Report, *supra* note 57.

Article 87 and the law of state aid apply.⁶⁹ This means that Member States are required to notify any new aid to the Commission.⁷⁰

Regardless of all of these prohibitions, Member States continue to provide legal (and illegal) state aid through the form of tax incentives in the belief that tax relief can stimulate a Member State's economy and help it become a contributing member of the common market.⁷¹ In fact, approximately forty-five percent of state aid is allocated by means of tax measures granted by Member States and approved by the Commission.⁷²

The European Commission's focus is on identifying those tax measures that constitute prohibited state aid.⁷³ This is problematic, however, because Member States' tax authorities' actions are often hidden "due to their non-publicity and to the confidentiality assured to the taxpayers involved in negotiations with them or in an enforcement procedure of recovery of tax claims."⁷⁴ Of course, the first step is to distinguish between general tax measures and "selective" tax incentives in the form of reduced tax rates, tax holidays, investment credits, accelerated depreciation, etc.⁷⁵ This process is analogous to the determination made in the United States as to whether a tax measure constitutes a "tax expenditure."⁷⁶ Further, Professor Schön notes that the key to determining if a tax measure is prohibited is whether the tax incentive is "normal," "disadvantageous," or "advantageous" to the taxpayer.⁷⁷ Only the latter is considered state aid under Article 87.⁷⁸

69. STEPHEN WEATHERILL & PAUL BEAUMONT, *EC LAW: THE ESSENTIAL GUIDE TO THE LEGAL WORKINGS OF THE EUROPEAN COMMUNITY* 405 (2d ed. 1995).

70. The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedures provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.

EC Treaty, *supra* note 43, art. 88(3).

71. *E.g.*, Schön, *Taxation*, *supra* note 52, at 920–22.

72. European Commission, Studies and Reports, *Chart: Share of Each Aid Instrument in Total Aid to Manufacturing and Services, 2004–2006*, available at http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.html (last visited Aug. 26, 2008); State Aid Scoreboard, at 38, COM (2007) 791 final (Dec. 13, 2007).

73. Ninth Survey on State Aid in the European Union, at 19, COM (2001) 403 final (July 18, 2001).

74. PINTO, *supra* note 51, at 126–27.

75. Schön, *Taxation*, *supra* note 52, at 916–17, 920.

76. For a description of the tax expenditure concept, see generally STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* (1973).

77. Schön, *Taxation*, *supra* note 52, at 922–23.

78. *See id.* at 920.

Both the Commission and the ECJ focus almost exclusively on the “effects” of a tax in order to determine whether it is prohibited state aid.⁷⁹ Additionally, the Commission will allow tax incentives that are generally applicable but prohibit those that it considers to be exceptions.⁸⁰ When determining whether a tax incentive constitutes prohibited state aid, the EC Treaty allows a Member State to adjust its general tax system, so long as it does not unfairly distort competition within the common market.⁸¹ It is also fully within the discretion of a Member State to employ disadvantageous taxes (tax disincentives).⁸² Part II of this Article sets forth the current approaches to distinguishing between appropriate and inappropriate tax incentives.

II. TAX COMPETITION

A. *European Union*

The Single European Act incorporated the objective of an internal market into the founding Treaty.⁸³ The “internal market” is defined as “an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured.”⁸⁴ The original view of the Commission was that any disparity between the tax systems of the Member States had to be alleviated in order to optimize productivity within the European Community as differing tax systems could be one of those internal frontiers.⁸⁵ Tax harmonization would improve neutrality and guarantee that companies located in nations because of efficiency of resources, not simply because of advantageous tax schemes.⁸⁶ In 1990, the EC Commissioner for Taxation, Mrs. Scrivener, stated that the

79. *Id.* at 922–23.

80. *Commission Notice on State Aid*, *supra* note 64, at 384/5.

81. Schön, *Taxation*, *supra* note 52, at 924.

82. *E.g.*, *id.* at 922 (citing examples of increased taxes on tobacco or mineral oil).

83. Single European Act, art. 13, 1987 O.J. (L 169) 1.

84. EC Treaty, *supra* note 43, art. 14.

85. TAX COMPETITION IN EUROPE 4 (Wolfgang Schön ed., 2003). For example, the Neumark Committee Report recommended a uniform split rate system of corporate taxation for the European Community. EEC FISCAL AND FIN. COMM., TAX HARMONIZATION IN THE COMMON MARKET (Neumark Report) (July 8, 1962), *reprinted in* TAX HARMONIZATION IN THE COMMON MARKET 40 (Commerce Clearing House, Inc. ed. & trans., 1963). The van den Tempel Committee Report recommended a uniform classical system of corporate taxation. A.J. VAN DEN TEMPEL, CORPORATION TAX AND INDIVIDUAL INCOME TAX IN THE EUROPEAN COMMUNITIES (EEC Comm’n, Approximation of Legislation Series No. 15, 1970) at 41; *see Commission White Paper on Completing the Internal Market*, at 38, COM (85) 310 final (June 14, 1985) (urging the completion of ongoing work regarding the removal of tax obstacles).

86. TAX COMPETITION IN EUROPE, *supra* note 85, at 4.

European Commission had abandoned its goal of full harmonization of direct taxation for a more practical approach—convergence of the respective corporate tax systems.⁸⁷

Various studies such as the 1992 Ruding Report on corporate taxation were undertaken.⁸⁸ Commissioner Scrivener established a committee of independent experts chaired by Mr. Ruding, a former Dutch Finance Minister, to identify future proposals on company taxation after 1992.⁸⁹ The Ruding Committee considered the following questions: (1) whether the differences in corporate taxation among the Member States create distortions with respect to investment decisions and competition in the single market; (2) whether the distortions should be eliminated through Community measures or whether market forces and competition between national tax systems should be allowed to run their course; and (3) what specific Community measures are required to remove or mitigate these distortions.⁹⁰ The Ruding Report concluded that the tax differences did distort the internal market and generated significant differences in the cost of capital.⁹¹ The Report contained many recommendations for legislative proposals to eliminate or reduce these distortions,⁹² but the Commission declared most of the recommendations to be too ambitious.⁹³

87. Commission Communication, *Guidelines on Company Taxation*, at 10, SEC (1990) 601 final (Apr. 20, 1990) [hereinafter *Guidelines on Company Taxation*]. For example, the 1975 Draft Directive proposing a partial integration system was withdrawn in 1990. See generally Proposal for a Council Directive Concerning the Harmonization of Systems of Company Taxation and of Withholding Taxes on Dividends, 1975 O.J. (C 253) 2 (withdrawn Apr. 18, 1990).

88. The EC Commissioner for Taxation, Mrs. Scrivener, issued a communication in 1990 setting forth guidelines on company taxation and the measures thought necessary to establish the internal market. *Guidelines on Company Taxation*, supra note 87, at 1.

89. *Id.* at 11–12. See European Commission, *Report of the Committee of Independent Experts on Company Taxation* 11 (1992) [hereinafter *Ruding Report*].

90. *Ruding Report*, supra note 89, at 11.

91. *Id.* at 196.

92. Although the Committee found that there had been some convergence of the Member States' tax regimes, it decided that further action was needed at the Community level. See generally *id.* at 143–97. The priorities outlined in the *Ruding Report* were: (1) removing the discriminatory and distortionary features of each country's tax system that impede cross-border business investment and shareholding; (2) setting a minimum statutory corporate tax rate and common rules for the tax base in order to limit excessive tax competition between the Member States; and (3) encouraging maximum transparency of any tax incentives granted by a Member State. *Id.* at 13. Due to the Commission's close scrutiny of the use of direct subsidies, the Ruding Committee expressed concern that Member States may instead resort to tax incentives. *Id.* at 42. The Committee stressed the need to ensure that hidden tax incentives, particularly those affecting the tax base, did not distort competition within the Community. *Id.*

93. See Tracy A. Kaye, *European Tax Harmonization and the Implications for U.S. Tax Policy*, 19 B.C. INT'L & COMP. L. REV. 109, 146–47 (1996) (discussing the Commission's divergent responses to the suggestions for the elimination of double-taxation and for tax harmonization (citing Commission of the European Communities, *Commission Communication to the Council and to the*

The Commission conducted another comprehensive study on corporate taxation in the European Union that was released in October 2001.⁹⁴ This Study found differences of more than thirty percentage points in the effective tax burden with respect to various cross-border investments within the European Union.⁹⁵ Thus, companies have an incentive to make their investments in the country with the lowest tax burden for their situation, which is not necessarily the most economically efficient location.⁹⁶ The Study made several recommendations for the coordination of tax policy, one of which was the development of a common consolidated tax base.⁹⁷

The goal of the Common Consolidated Corporate Tax Base project (CCCTB) is to improve the efficiency of the internal market and create a business-friendly tax environment by minimizing compliance costs in cross-border activity.⁹⁸ The benefits of a CCCTB-regime include: reduced tax compliance cost for businesses; lower tax administration cost for governments; the ability to offset cross-border profits and losses; the reduction of double taxation of foreign source income; increased tax transparency; and the elimination of transfer pricing disputes among participating countries.⁹⁹

The CCCTB creates a single tax base for all European group economic activity in an effort to eliminate tax differences among Member States.¹⁰⁰ For example, a U.K. multi-national corporation with a company in France and Germany would not distinguish among its individual companies, but would calculate group profits collectively.¹⁰¹

European Parliament Subsequent to the Conclusions of the Ruding Committee Indicating Guidelines on Company Taxation Linked to the Further Development of the Internal Market, SEC (92) 1118 final (June 24, 1992)). The Commission endorsed only the extension of the scope of the Parent-Subsidiary Directive, the Mergers Directive, and other less sensitive tax proposals. *Id.* at 147–48.

94. European Commission, *Company Taxation in the Internal Market*, COM (2001) 582 final (Oct. 23, 2001) [hereinafter *Company Taxation*].

95. Executive Summary, *Company Taxation*, *supra* note 94, at 5.

96. PINTO, *supra* note 51, at 47.

97. *Company Taxation*, *supra* note 94, at 375–77.

98. László Kovács, European Comm'r for Taxation & Customs, Keynote Address in the UK Houses of Parliament: The European Commission's Project for a Common Consolidated Corporate Tax Base (CCCTB) (Sept. 28, 2006) (transcript available at http://ec.europa.eu/commission_barroso/kovacs/speeches/Speech_London_280906.pdf). See generally Michel Aujean, *The CCCTB Project and the Future of European Taxation*, in 53 COMMON CONSOLIDATED CORPORATE TAX BASE (Michael Lang et al. eds., 2008).

99. Audio CD-ROM: Foreign Lawyers Forum, held by ABA Section of Taxation 2008 Midyear Meeting (Jan. 18, 2008) (on file with author).

100. *Id.*; see Thomas Neale, *CCCTB: How Far Have We Got and What Are the Next Steps?*, in 53 COMMON CONSOLIDATED CORPORATE TAX BASE, *supra* note 98, at 39 (“Any initiative will be related to the tax base, and not the tax rate.”).

101. See Claus Staringer, *Requirements for Forming a Group*, in 53 COMMON CONSOLIDATED CORPORATE TAX BASE, *supra* note 98, at 115, 125.

This calculation would then be apportioned in accordance with another set of rules, and each Member State would tax its allocated base.¹⁰² Thus, rather than having companies limit themselves to national operations in order to minimize costs of compliance with EU law, the CCCTB would facilitate cross-border operations and simplify EU taxation.¹⁰³ Furthermore, an interesting side effect of the CCCTB is that it would also limit any tax incentives that are designed as base reductions, as all twenty-seven Member States must agree to the base.

Although not all Member States agree with the implementation of the project, all twenty-seven participate in the working group responsible for evaluating the practical aspects of a common corporate tax base.¹⁰⁴ The goal of the European Commission is to present a “comprehensive Community legislative measure” at the end of 2008,¹⁰⁵ followed by a directive in 2010.¹⁰⁶

Although tax harmonization is still considered desirable by the Commission, modern economic evaluation stresses the benefits that can be derived from healthy tax competition.¹⁰⁷ The basic economic principle is that tax competition permits taxpayers to exert some

102. Foreign Lawyers Forum, *supra* note 99. Currently however, the CCCTB has not determined the allocation of the corporate tax. This process is expected to be highly politicized. *Id.*

103. European Commission, Directorate-General, Taxation and Customs Union, *Progress to Date and Future Plans for the CCCTB*, Brussels, Belgium, 19–20 (Nov. 20, 2006) [hereinafter *Progress to Date*]; see Wolfgang Schön, *Group Taxation and the CCCTB*, 48 TAX NOTES INT’L 1071–72 (2007) (“[T]he uniform taxable base for groups impressively masters those frictions, which exist at present in the weak points of international group taxation. There are also advantages that are based precisely on a Europe-wide uniformity, for example, a huge reduction of compliance costs, which are triggered by differences in content between the national profit measurement systems.”).

104. European Commission, Directorate-General, Taxation and Customs Union, *Summary Record of the Meeting of the Common Consolidated Corporate Tax Base Working Group*, Brussels, Belgium (Aug. 31, 2006) at 1, available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/CCCTBWP037summary_en.pdf.

105. *Progress to Date*, *supra* note 103, at 19. The Commission prepared a working paper that sets out a possible outline of the principles of a CCCTB to bring the various structural elements of the base together into a coherent set of rules. See European Commission, *CCCTB: Possible Elements of a Technical Outline*, at 1 (July 26, 2007), available at http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/CCCTBWP057_en.pdf.

106. Foreign Lawyers Forum, *supra* note 99. However, in Commissioner Kovács’ speech to the IFA he stated: “I would rather present a perfectly elaborated and well justified product at the appropriate time than present an incomplete one just to meet an artificial deadline.” László Kovács, Eur. Comm’r for Taxation & Customs, Keynote speech at the Sixty-Second Congress of the International Fiscal Association 3 (Aug. 31, 2008), available at http://ec.europa.eu/commission_barroso/kovacs/speeches/2008/0831IFA.pdf.

107. See TAX COMPETITION IN EUROPE, *supra* note 85, at 4 (explaining that publications by the Commission still maintain tax harmonization as ideal); see also James R. Hines, *Harmful Tax Competition and its Harmful Remedies*, 50 BRIT. TAX REV. 209 (2006) (book review) (discussing criticisms of tax harmonization).

influence over governments' tax policies.¹⁰⁸ This theory was enunciated in 1956 by renowned economist Charles Tiebout.¹⁰⁹ Tiebout set forth the concept of taxpayer influence known as "voting with the feet," a premise that highlighted the positive effects of tax competition by concluding that taxpayers would move freely to find the most efficient balance of tax burden and government services.¹¹⁰

Without competition, tax regimes are immune to market pressure, creating the possibility of oppressive tax schemes. By contrast, when competition exists, taxpayers can move to another Member State if the tax regime in their current Member State is overly unfavorable. This creates a "downward pressure" on the tax burden.¹¹¹ Furthermore, tax competition encourages governments to seek the most efficient balance between the tax burden on taxpayers and the government services offered for those taxes.¹¹²

In a 1996 memorandum, Mario Monti (as Commissioner for the Internal Market), stressed that unfair tax competition leads to an increased tax burden on labor resulting in higher unemployment in the European Union.¹¹³ The Monti Memorandum called for a more coordinated approach toward harmful tax competition as "the apparent defence of national fiscal sovereignty has gradually brought about a real loss of fiscal sovereignty by each Member State in favour of the markets, through tax erosion, especially on the more mobile tax bases."¹¹⁴

Subsequently, a 1996 Commission Report dealing with tax competition showed a higher relative weight of taxes on less-mobile personal income as compared to taxes on corporate income and consumption.¹¹⁵ The Report stated that this was partly due to harmful tax competition that had forced Member States to reduce taxes on capital and

108. Field, *supra* note 10, at 1211.

109. Charles Tiebout, *A Pure Theory of Local Expenditures*, 64 J. POL. ECON. 416, 418 (1956).

110. *Id.* Tiebout theorized that the best way to ensure efficiency in taxation was to freely permit variance of tax regimes among communities, thereby allowing taxpayers to find their preferred position and ultimately forcing tax rates to the appropriate, balanced levels. *Id.* at 420.

111. TAX COMPETITION IN EUROPE, *supra* note 85, at 6; Field, *supra* note 10, at 1211.

112. PINTO, *supra* note 51, at 10–11.

113. European Commission, *Taxation in the European Union Discussion Paper for the Informal Meeting of ECOFIN Ministers*, at 4, SEC (1996) 487 final (Mar. 20, 1996) (citing *Commission White Paper on Growth, Competitiveness and Employment*, COM (1993) 700 (Dec. 5, 1993) [hereinafter *White Paper on Growth*]).

114. PINTO, *supra* note 51, at 36 (citing *White Paper on Growth*, *supra* note 113).

115. European Commission, *Taxation in the European Union: Report on the Development of Tax Systems*, COM (1996) 546 final (Oct. 22, 1996) reprinted in 25 INTERTAX 23, 26 (1997).

increase taxes on labor.¹¹⁶ In 1997, the Commission proposed adoption of a common policy to tackle harmful tax competition.¹¹⁷

The Code of Conduct for Business Taxation was established by the Economy and Finance Council (ECOFIN)¹¹⁸ based on this recommendation from the European Commission with regard to the elimination of harmful tax competition.¹¹⁹ The Code is not binding on the Member States, but those adopting it agree to reduce any existing tax measures that constitute harmful competition and to refrain from instituting any similar measures in the future.¹²⁰ Although not a legally binding document, the Code carries great political force.¹²¹

What does the Code consider harmful?¹²² It sets forth the following considerations for evaluation:

116. *Id.*

117. Schön, *State Aid*, *supra* note 44, at 242 (citing European Commission, *Towards Tax Coordination in the European Union; A Package to Tackle Harmful Tax Competition*, COM (1997) 495 final (Oct. 15, 1997)).

118. Conclusions of the ECOFIN Council Meeting on 1 December 1997 Concerning Taxation Policy, 1998 O.J. (C 2) 1, 1.

The Council of Ministers is comprised of representatives of the Member States, usually the ministers responsible for the subject matter under discussion [T]he Member States' Finance Ministers meet with respect to tax and other economic matters and are known as the Economy and Finance Council (ECOFIN) In tax matters, the Council is the principal lawmaking body of the Community, but it can only act on a proposal from the Commission.

Kaye, *Discrimination*, *supra* note 42, at 201 (citations omitted).

119. Resolution of the Council and the Representatives of the Governments of the Member States, Meeting Within the Council of 1 December 1997 on a Code of Conduct for Business Taxation, 1998 O.J. (C 2) 2, 2 [hereinafter Code of Conduct].

120. *Id.* at 4. Generally speaking, the Code of Conduct requires the following: (1) Member States must refrain from creating new "harmful" tax measures (known as standstill); (2) all existing tax policies must be examined for compliance—those policies that would be categorized as "harmful" by the Code must be amended to conform (known as rollback); (3) the signatories to the Code must inform other signatories of "harmful" policies—there must be transparency; and (4) the signatories to the Code and the Council participate in ongoing evaluation of policies by a tax policy group known as the Primarolo group. *Id.* Mrs. Primarolo is the Chair of the Code of Conduct Group. See Council of the European Union, Code of Conduct Group, *Code of Conduct (Business Taxation) Report to the ECOFIN Council*, ¶ 9, 9655/06 FISC 73 (June 7, 2006) [hereinafter *June 2006 Report to ECOFIN*] ("Mrs. Primarolo was re-appointed by common accord as the Chair of the Code of Conduct Group.")

121. For example, Ireland repealed its preferential 10% tax rate for certain manufacturing activity and replaced the targeted incentive with an overall corporate tax rate of 12.5% in 2003. Michael Mikiciuk, *Foreign Direct Investment Success in Ireland: Can Poland Duplicate Ireland's Economic Success Based on Foreign Direct Investment Policies?*, 14 U. MIAMI INT'L & COMP. L. REV. 65, 106 (2006).

122. Article A defines harmful tax measures as "ones that affect or may affect in a significant way the location of business activity in the [c]ommunity, without prejudice to member states prerogatives in the area of direct taxation." Rossi-Maccanico, *Review of State Aid*, *supra* note 61, at 942 n.4 (citing the Code of Conduct, *supra* note 119, at 3).

- Are advantages accorded, either directly or indirectly, only to nonresidents?
- Are these advantages isolated from the domestic market so that the national tax base is not affected?
- Are advantages granted to a nonresident company without any real economic activity or presence in the regulating Member State?
- Do the rules for profit determination depart from accepted international principles?
- Does the tax regime lack transparency, either in law or in the administration of the law?¹²³

Article J of the Code of Conduct urged the Commission to strictly apply the state aid rules to those measures that were deemed to be harmful.¹²⁴ Classifying a measure as harmful under the Code does not qualify that measure as state aid because the two criteria differ.¹²⁵ Therefore, state aid policy cannot replace Member States' efforts to abolish harmful tax measures.¹²⁶ A tax-policy group known as the Primarolo Group presented various reports that assessed 271 tax measures and found 66 of them to be harmful within the meaning of the Code of Conduct.¹²⁷ Subsequent reports assessed both the offending states' curtailment efforts as well as new Member States' compliance with the Code of Conduct.¹²⁸ In 1999, the Commission pursued eleven state aid investigations with respect to some of these "harmful" tax schemes.¹²⁹

For example, Greece had allowed certain foreign companies to establish offices or branches in Greece to conduct their companies'

123. Code of Conduct, *supra* note 119, at 3.

124. Rossi-Maccanico, *Review of State Aid*, *supra* note 61, at 942; *see* Code of Conduct, *supra* note 119, at 5 ("[The Council] commits itself to strict application of the aid rules.").

125. 2004 Commission Report, *supra* note 57, at 17.

126. *Id.* at 17–18.

127. Council of the European Union, Code of Conduct Group, *Code of Conduct (Business Taxation)—Report to the ECOFIN Council*, at 2, 9427/05 FISC 55 (June 7, 2005) (on file with author); *see* Robert Goulder, *Primarolo Group's Report Identifies 66 Harmful Tax Regimes*, 20 TAX NOTES INT'L 1283 (2000); *see also* Rossi-Maccanico, *Review of State Aid*, *supra* note 61, at 942.

128. *June 2006 Report to ECOFIN*, *supra* note 120, at 2 (noting that thirty measures were found to be harmful in acceding states and that twenty-seven rollbacks of such measures envisaged or already undertaken were adequate to bring the Member States into compliance) (on file with author); *see* Council of the European Union, Code of Conduct Group, *Code of Conduct (Business Taxation)—Report to the ECOFIN Council*, at 2, 9047/07 FISC 62 (June 5, 2007) (noting that Bulgaria and Romania, which acceded to the EU in 2007, had eight harmful measures).

129. *See* Rossi-Maccanico, *Review of State Aid*, *supra* note 61 at 945.

business outside of Greece.¹³⁰ If certain conditions were met, Greece imposed no direct taxes on these offices or branches.¹³¹ This arrangement had been declared harmful by the Primarolo Group.¹³² The Commission found that this aid was specific as it was limited to certain companies conducting investment activities offshore and incompatible with the common market as it affected competition and trade between the Member States.¹³³ Thus, the Commission required Greece to repeal this tax arrangement.¹³⁴

Concurrently, the Organisation for Economic Co-operation and Development (OECD) was working on its own report, entitled *Harmful Tax Competition: An Emerging Global Issue*, which set forth its criteria for evaluating preferential tax regimes and identifying tax havens.¹³⁵ These criteria focus on improving transparency and communication among nations and have led to the establishment of a Model Agreement on Exchange of Information in Tax Matters.¹³⁶ In September 2006, the OECD Committee on Fiscal Affairs released its latest progress report evaluating the preferential tax regimes in member countries.¹³⁷

Thus, both the European Union and the OECD believe it is important to distinguish between fair and harmful tax competition. In general, fair tax competition is competition that has a downward effect by lowering tax rates and finding a balance between the tax burden and public services offered. For example, a 2001 study concluded that tax competition between the Member States resulted in an across-the-board

130. *Id.* at 946.

131. *Id.* (citing the Commission Decision of 11 July 2001—Proposal of Appropriate Measures under Article 88(1) of the EC Treaty on the Aid Scheme of Taxation of Foreign Commercial and Industrial Firms Covered by Act No. 89/67, notice published in 2002 O.J. (C 108) 2, 2 [hereinafter Commission Decision of 11 July 2001]).

132. Council of the European Union, Code of Conduct Group, Code of Conduct (Business Taxation), SN 4901/99, at 74 (Nov. 29, 1999).

133. Rossi-Maccanico, *Review of State Aid*, *supra* note 61, at 946 (citing the Commission Decision of 11 July 2001).

134. *Id.*

135. Organisation for Economic Co-operation and Development, *Harmful Tax Competition: An Emerging Global Issue*, at 19–35 (1998) [hereinafter *OECD Report*], see Organisation for Economic Co-operation and Development, *Harmful Tax Practices: About*, http://www.oecd.org/about/0,2337,en_2649_33745_1_1_1_37427,00.html (last visited Aug. 25, 2008) (“[T]he OECD set out criteria for analyzing preferential regimes and identifying tax havens.”).

136. This is a non-binding agreement that sets forth two model agreements for increasing transparency among nations. Organisation for Economic Co-operation and Development, *Agreement on Exchange of Information on Tax Matters*, ¶ 4, <http://www.oecd.org/dataoecd/15/43/2082215.pdf> (last visited Aug. 25, 2008).

137. CENTRE FOR TAX POLICY AND ADMINISTRATION, THE OECD’S PROJECT ON HARMFUL TAX PRACTICES: 2006 UPDATE ON PROGRESS IN MEMBER COUNTRIES, <http://www.oecd.org/dataoecd/1/17/37446434.pdf>.

reduction in corporate tax rates coupled with an expansion in the tax base itself.¹³⁸ The study also concluded that this trend increased transparency and minimized distortion among tax systems in a way that bolstered the positive effects of tax competition.¹³⁹

Harmful competition, by contrast, is not based on an evaluation of the most efficient relationship between taxation and benefits but focuses only on drawing investment and business to the regulating Member State and away from the other Member States.¹⁴⁰ This kind of behavior is also known as a “race to the bottom” because these types of tax incentives promote inefficiency in domestic systems.¹⁴¹ Rather than focusing on finding the best balance of taxes and public services for taxpayers, Member States attempt to undercut each others’ tax regimes.¹⁴²

For example, tax measures that provide significantly lower levels of taxation, or zero taxation, in order to attract business to a Member State are considered potentially harmful. In 2003, Jersey, Guernsey, and the Isle of Man—all U.K. offshore jurisdictions—came under heavy criticism for tax policies that placed a twenty percent tax rate on resident companies but no tax on nonresident companies.¹⁴³ As a result of criticism from other Member States, the islands converted to a tax-free system for all companies operating within their territory, treating both resident and nonresident companies equally.¹⁴⁴

In categorizing competition between Member States, Pinto suggests evaluating both objective and subjective considerations:

1. Is the tax incentive a general measure or a special targeted measure (e.g. limited to certain categories of income or certain business activities or certain taxpayers)?
2. Does the Member State intend to spur its economic growth generally or attract investment at the expense of other Member States (demonstrated by a tax provision that lacks transparency and is applied on a discretionary basis)?¹⁴⁵

138. PINTO, *supra* note 51, at 40 (citing Sven-Olof Lodin, *The Competitiveness of EU Tax Systems*, 41 EUR. TAX’N 166 (May 2001)).

139. *Id.*

140. TAX COMPETITION IN EUROPE, *supra* note 85, at 7.

141. *E.g.*, PINTO, *supra* note 51, at 11.

142. *See id.* at 11–12.

143. Barry Riley, *Islands Gear Up For ‘Zero-Ten’ Challenge*, FIN. TIMES, Oct. 30, 2006, at 4.

144. *Id.*

145. PINTO, *supra* note 51, at 10–12. *But see* Hines, *supra* note 107.

Professor Avi-Yonah also concludes that “not all tax competition is equally harmful.”¹⁴⁶ In the context of global tax competition, he proposes a similar distinction between harmful and beneficial tax competition; that is, a distinction between limited tax reductions and generally applicable tax reductions.¹⁴⁷

B. *United States*

The opinions with respect to the desirability or undesirability of state tax competition fluctuate between two extremes. The discussion below summarizes the typical arguments that are made in favor of and in opposition to state tax competition.

1. Arguments in Favor of State Tax Competition

Proponents of tax competition argue that it reduces the inherently inefficient taxation of capital.¹⁴⁸ Although admitting that a reduction of tax revenues results from such tax competition, Rogers stresses that this does not indicate “whether the loss of state tax revenues is good or bad for the economy at large.”¹⁴⁹ He postulates that money in private hands increases investment and incomes¹⁵⁰ because consumers and resource owners use the tax savings more efficiently than state governments.¹⁵¹

Another proponent of tax competition, on the other hand, argues that discriminatory tax regimes are socially desirable because they protect tax revenues.¹⁵² Professor Keen’s argument is based on a model in which tax competition can be confined, within a country, to a mobile sector while maintaining or increasing high levels of taxation in an immobile sector.¹⁵³ In doing so, a country can protect its ability to collect a great deal of tax revenue from an immobile base while at the same time

146. Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 HARV. L. REV. 1573, 1610 (2000).

147. *Id.* at 1627–29.

148. Rogers, *supra* note 34, at 110.

149. James R. Rogers, *State Tax Competition and Congressional Commerce Power: The Original Prudence of Concurrent Taxing Authority*, 7 REGENT U. L. REV. 103, 107 (1996).

150. *Id.* at 113.

151. *Id.* at 120.

152. Michael Keen, *Preferential Regimes Can Make Tax Competition Less Harmful*, 54 NAT’L TAX J. 757, 758 (2001).

153. *Id.*

competing with foreign countries, through preferential taxation, for the other's mobile base and the marginal revenue increase it represents.¹⁵⁴

Tax competition is also said to promote efficient resource allocation.¹⁵⁵ Gillette argues that incentives facilitate optimal matches between businesses and localities whenever a locality understands its needs better than a firm.¹⁵⁶ In this case, bidding solves the problem of asymmetric distribution because the same firm assumes different values in different jurisdictions and that additional value is reflected in the bid.¹⁵⁷ Rogers insists that tax competition will not result in the misallocation of resources because "state tax policies will not overcome comparative state cost advantages in equilibrium nor induce firms to locate in states with high relative production costs."¹⁵⁸

The tax revenue reductions caused by tax competition forces government to be thrifty.¹⁵⁹ McLure states that "[i]f competition is restrained, . . . it can generally be expected that economic welfare will suffer."¹⁶⁰ He suggests that "[i]n the absence of competition there is less incentive to be responsive to the desires of consumers and less pressure to minimize costs."¹⁶¹ However, as incentive packages given by state and local governments continue to multiply in number, legal scholars have set forth numerous arguments with respect to the harmful effects of these incentives.

2. Arguments Against State Tax Competition

One counterargument asserts that state tax incentives do not accomplish what they are designed to do: influence the location decisions of businesses. Tax incentives are marginal among the many factors businesses use to decide where to locate and are often only influential as a tie-breaker between comparatively similar business locations.¹⁶²

154. *Id.*

155. Rogers, *supra* note 149, at 108, 120.

156. Clayton P. Gillette, *Business Incentives, Interstate Competition, and the Commerce Clause*, 82 MINN. L. REV. 447, 453-63 (1997-1998).

157. *Id.* at 457-58.

158. Rogers, *supra* note 149, at 115. For further discussion of economic models demonstrating that bidding for firms enhances economic efficiency, see Dan A. Black & William H. Hoyt, *Bidding for Firms*, 79 AM. ECON. REV. 1249 (1989) and Ian R. King et al., *Industrial Blackmail: Dynamic Tax Competition and Public Investment*, 26 CAN. J. ECON. 590 (1993).

159. Rogers, *supra* note 34, at 109.

160. Charles E. McLure, *Tax Competition: Is What's Good for the Private Goose Also Good for the Public Gander?*, 39 NAT'L TAX J. 341, 344 (1986).

161. *Id.*

162. *The National Economic Policy Implications of State Tax Incentive Competition: Hearing on*

Professor Enrich states that “tax incentives and other reductions in business tax burdens, even when they create significant differentials in tax levels, simply are not large enough to exert substantial influence on business location decisions or on levels of economic activity.”¹⁶³ Fisher suggests that “only about 1 in 11 business investments can be attributed to . . . incentives.”¹⁶⁴ “Because state [and] local taxes falling on businesses represent only about 1.2% of the total cost of doing business in the U.S.,” state tax incentives that reduce such costs generally do not provide much leverage over the location decision.¹⁶⁵

Hood describes incentive packages as “shakedowns” by companies already planning to relocate in a state.¹⁶⁶ Because the business investment would have happened in the state anyway, state tax competition causes states to lose substantial tax revenue. It also “distorts the distribution of tax burdens among different classes of taxpayers.”¹⁶⁷ Hood notes that “the majority of the creators of job and productivity gains throughout a state’s economy are hurt as their taxes go up to pay for infrastructure improvements, job-training subsidies, and other enticements.”¹⁶⁸

Tax incentive competition is at best a zero-sum game; it merely moves economic activity from one state to another with no net gain on either the national or local level.¹⁶⁹ Any influx of jobs and investment “won” through incentive wars by one locality is offset by a

“Cuno and Competitiveness: Where to Draw the Line” Before the Subcomm. on Int’l Trade of the S. Comm. on Finance, 109th Cong. (2006) (statement of Peter Fisher) [hereinafter Statement of Fisher]. See generally ROGER WILSON, ECONOMIC DEVELOPMENT IN THE STATES: STATE BUSINESS INCENTIVES AND ECONOMIC GROWTH: ARE THEY EFFECTIVE? A REVIEW OF THE LITERATURE 8–17 (The Council of State Governments) (1989) (discussing the nature and process of plant location decisions).

163. Enrich, *Saving the States*, *supra* note 27, at 397.

164. Brief of *Amicus Curiae* Economics and Public Policy Professors et al. in Support of Respondents at 21, *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006) (Nos. 04-1704, 04-1724) (citing ALAN PETERS & PETER FISHER, *STATE ENTERPRISE ZONE PROGRAMS: HAVE THEY WORKED?* 113 (2002)) [hereinafter *Cuno Amicus Curiae Brief*].

165. *Id.* at 17–18 (citing ROBERT G. LYNCH, *RETHINKING GROWTH STRATEGIES: HOW STATE AND LOCAL TAXES AND SERVICES AFFECT ECONOMIC DEVELOPMENT* 4 (2004)). Moreover, targeted tax incentives are “offered to companies that would have undertaken the desired investment in the first place.” David Brunori, *Principles of Tax Policy and Targeted Tax Incentives*, 97 *ST. TAX TODAY* 111 (1997).

166. John Hood, *Ante Freeze: Stop the State Bidding Wars for Big Business*, 68 *POL’Y REV.* 62, 66 (1994).

167. Enrich, *Saving the States*, *supra* note 27, at 405. One source notes that “these expenditures place small existing businesses at a disadvantage since they provide the large recruited companies with excess profits, gained from businesses subsidies, which could not be obtained without some risk in the marketplace.” WILSON, *supra* note 162, at 5–6.

168. Hood, *supra* note 166, at 62.

169. Statement of Fisher, *supra* note 162.

corresponding loss to another. Enrich notes that “competitive efforts of other states are likely to cancel out any positive effects that might be achieved by offering tax breaks.”¹⁷⁰ Tax incentive competition quite possibly can be a negative-sum game that produces a net loss.¹⁷¹

Although models designed to demonstrate the benefits of preferential tax regimes seem straightforward, as Keen admits, “[t]he assumptions being made on the tax bases are evidently extreme.”¹⁷² In fact, the assumptions are extreme enough so as to make the oversimplified model’s practical relevance and applicability tenuous at best.¹⁷³ For example, such a model assumes that revenue maximization is a government’s sole goal,¹⁷⁴ thereby failing to account for other governmental interests, such as employment and improved standard of living.¹⁷⁵ Additionally, it cannot be assumed that immobile bases are perfectly inelastic; at some point the shifting tax burden will become too onerous causing the immobile base to become mobile.¹⁷⁶ A model should not assume that high tax rates do not exacerbate diminishing marginal returns to labor. By reducing the return an individual receives for his or her labor, the opportunity cost of engaging in income-producing activities increases.¹⁷⁷ This, in turn, would cause productivity to stagnate, if not decline, leading to a reduction in the tax revenue collected from the immobile base. Absent the existence of circumstances in practice that mirror the model’s assumptions, the strong conclusion that discriminatory taxation is desirable and beneficial must be discounted and found to be unpersuasive in practice.

Fisher suggests that tax incentives override market considerations in firm-location decisions, resulting in “a pattern of economic activity that requires greater use of real resources and hence reduces national economic efficiency.”¹⁷⁸ Once a state lures a targeted business, it must pay for public service support for the business in the form of infrastructure and transportation costs, while leaving the previous state

170. Enrich, *Saving the States*, *supra* note 27, at 397.

171. Cuno Amicus Curiae Brief, *supra* note 164, at 10.

172. Keen, *supra* note 152, at 758–59.

173. See Joseph Bankman & David Weisbach, *Reply: Consumption Taxation Is Still Superior to Income Taxation*, 60 STAN. L. REV. 789, 790 (2007) (noting that the strong conclusions of simplified models are likely to be weakened by more complex models).

174. *E.g.*, Keen, *supra* note 152, at 759.

175. *E.g.*, *supra* text accompanying note 55.

176. See Keen, *supra* note 152, at 759–60 (noting that when the two bases are equally elastic, revenues are unaffected).

177. Bankman & Weisbach, *supra* note 173, at 792–93 (arguing that future consumption is a motivating benefit of working and higher income taxation reduces the benefit).

178. Statement of Fisher, *supra* note 162.

with redundant public service support infrastructure. Enrich describes the states as follows:

[They] find themselves caught in a classic prisoners' dilemma. If all the states would refrain from deploying location incentives for businesses, then they all could retain more robust tax bases to support other governmental functions. But, if the other states are going to offer a widening array of tax breaks, then none can afford the costs—more political than economic—of abstaining.¹⁷⁹ As a result, incentives proliferate, leaving all the states worse off.

The state that wins the incentive wars also “loses” because as Enrich notes, “[b]usinesses have become increasingly adept at playing the states off against one another to stimulate more attractive offers.”¹⁸⁰ Fisher asserts that the revenue lost through incentive packages makes it harder to finance the state’s education, police, fire, transportation, and utilities programs.¹⁸¹ By fostering a “race to the bottom” in which states must continually increase tax incentives in order to lure businesses, tax competition undermines the ability of state and local government to finance the investments in public education and infrastructure that provide the foundation for future economic growth.¹⁸² This tax competition and these bidding wars are “reducing the level of comity and cooperation among the states.”¹⁸³

There are a myriad of studies concerning the economic effects of state credits and incentives.¹⁸⁴ Those measuring the influence of tax policies on local or state economic growth are probably the most common type of empirical research of potential relevance to state tax incentives.¹⁸⁵ Bartik’s discussion of recent research on the effect of state and local taxes on economic development stated that “it seems quite likely that taxes do have statistically significant negative effects on the growth of a state or metropolitan area,” although “the exact magnitude of this negative effect is less clear.”¹⁸⁶ Whether these tax effects are “large enough that a policy of reducing state and local business taxes, adopted

179. Enrich, *Saving the States*, *supra* note 27, at 396.

180. *Id.* at 395.

181. Statement of Fisher, *supra* note 162.

182. *Id.*

183. Enrich, *Saving the States*, *supra* note 27, at 400–01.

184. See Kirk J. Stark & Daniel J. Wilson, *What Do We Know About the Interstate Economic Effects of State Tax Incentives?*, 4 GEO. J.L. & PUB. POL’Y 133, 163 (2006) for an excellent introduction to the literature.

185. *Id.* at 157–58.

186. Timothy J. Bartik, *The Effects of State and Local Taxes on Economic Development: A Review of Recent Research*, 6 ECON. DEV. Q. 102, 105 (1992).

solely for the purpose of encouraging growth, would have net benefits,” is an entirely separate question.¹⁸⁷

Stark and Wilson state that while studies that examine the influence of tax policies on local or state economic growth are “no doubt valuable for state and local policymakers in setting economic development policies,” they “are of questionable relevance to the constitutionality of state business tax incentives under the dormant Commerce Clause.”¹⁸⁸ They explain:

[I]t is not clear from these studies whether the observed effect is attributable to changes in the level of economic activity within a state (in-state effects) or a relocation of economic activity from one state to another (relocation effects). Presumably only the latter would be objectionable on Commerce Clause grounds. A state subsidy that has exclusively in-state effects cannot be said to encroach on Congress’s exclusive authority to regulate interstate commerce. Second, because these studies focus on the effect of overall tax levels on economic activity, they do not adequately capture the discrete influence of specific tax incentives, such as the investment tax credit or the research and development tax credit. From the standpoint of dormant Commerce Clause analysis, this is an important shortcoming of existing empirical research.¹⁸⁹

They then examine “more narrowly tailored econometric studies that have looked at the precise effect of specific tax incentives.”¹⁹⁰ For example, one study conducted by Wilson focused upon “the effects of one state’s tax incentives on the R&D spending in *other* states.”¹⁹¹ Wilson found that “the in-state and out-of-state effects of state R&D tax incentives roughly offset each other, leaving little overall impact on R&D spending for the nation as a whole.”¹⁹² Thus, it appears that “a state’s adoption of R&D tax credits has adverse practical effects on the level of R&D undertaken within other states.”¹⁹³

Jarrell adds that “[i]nterstate studies on the impact of [economic development incentives] on growth show marginally positive results, but the results are so inconsistent, even when using similar methods and

187. *Id.* at 106.

188. Stark & Wilson, *supra* note 184, at 159.

189. *Id.*

190. *Id.*

191. *Id.* at 163 (citing Daniel J. Wilson, *Beggar Thy Neighbor? The In-State vs. Out-of-State Impact of State R&D Tax Credits* (Federal Reserve Bank of San Francisco, Working Paper No. 2005–08), available at <http://www.frbsf.org/publications/economics/papers/2005/wp05-08bk.pdf>).

192. *Id.*

193. *Id.*

data, that the results are basically useless to policymakers.”¹⁹⁴ A study conducted in Washington state in 1996 that focused on individual tax incentive plans “found little correlation between the amount of tax benefit received and growth in employment which resulted.”¹⁹⁵ Jarrell opines that “[i]f a pattern emerges from these studies at all, it may be that the tax increases seem to have a statistically significant negative impact on economic growth of a region at the extremes—very high taxes or very low taxes.”¹⁹⁶

Although current econometric research does not provide a definitive conclusion concerning the practical economic effects of state tax incentives, I am persuaded to agree with the European Commission and the OECD that harmful tax competition exists.¹⁹⁷ In Part III, I examine the current use of tax incentives in the United States and the European Union.

III. USE OF TAX INCENTIVES

A. *United States*

There is no obligation on the individual states to impose taxes at a minimum rate; nor is there an obligation on the states to impose a certain type of tax such as sales, individual, or corporate taxes.¹⁹⁸ Such sovereignty makes it possible for the individual states to engage in a substantial amount of tax competition as a means of attracting or retaining residents and businesses.¹⁹⁹ “Our states are not united when it comes to taxation. Each merrily goes its own way, angling for an economic advantage, their leaders hoping their actions will translate into votes on election day.”²⁰⁰ In fact, it has been reported that over the years, the states have become “more and more aggressive tax competitors.”²⁰¹

194. Sherry L. Jarrell et al., *Law and Economics of Regulating Local Economic Development Incentives*, 41 WAKE FOREST L. REV. 805, 823 (2006).

195. *Id.* at 826 (citing Wash. State Dep’t of Revenue: Research Div., Economic Vitality, at 10 (Mar. 2, 2002), available at <http://dor.wa.gov/content/aboutus/statisticsandreports/wataxstudy/tax%20study%20economic%vitality.pdf>).

196. *Id.* at 824.

197. At any rate, as my proposal only addresses tax incentives and not direct subsidies, the states can continue to compete on many other levels. I am just removing one weapon from their arsenal, tax incentives. They will agree not to use their state tax code in this endeavor.

198. Field, *supra* note 10, at 1213.

199. *Id.*

200. Martin A. Sullivan, *Economic Analysis: Lessons from Europe on U.S. Corporate Taxes*, 111 TAX NOTES 420, 420 (2006).

201. Field, *supra* note 10, at 1214.

State tax credits and incentives are not a recent phenomenon in the United States.²⁰² Since at least 1791, when New Jersey granted a tax exemption to Alexander Hamilton's new manufacturing company, states have used tax incentives to lure businesses inside their borders.²⁰³ In recent years, however, states have demonstrated extraordinary creativity in developing tax policies designed to influence business decisions.²⁰⁴ As of 2008, forty-eight states offered credits and incentives to persuade businesses to either locate, maintain, or expand their operations within the state.²⁰⁵ Although interstate competition to attract economic development has raised concerns regarding the smooth functioning of the national economy,²⁰⁶ the proliferation of tax credits and incentives has continued relatively unabated.²⁰⁷

For example, in May 2007, ThyssenKrupp AG of Dusseldorf, Germany, chose Alabama for the site of a \$3.7 billion steel mill ending a bidding war for the mill between Alabama and Louisiana.²⁰⁸ The \$461 million in direct subsidies granted included land acquisition, site preparation, worker training, and road improvements.²⁰⁹ An additional \$350 million tax subsidy included relief from sales, property, and utility taxes by the state and local governments.²¹⁰ The company also will not

202. Enrich, *Saving the States*, *supra* note 27, at 382.

203. Mark L. Nachbar, *Credits and Incentives: Alabama Through Hawaii*, 1450-2nd TAX MGMT. (BNA) (2008) (citing Peter W. Bernstein, *States Are Going Down Industrial Policy Lane*, FORTUNE, Mar. 5, 1984, at 112).

204. Peter D. Enrich, *The Rise—And Perhaps the Fall—of Business Tax Incentives*, in THE FUTURE OF STATE TAXATION 73–74 (David Brunori ed., 1998).

205. Nachbar, *supra* note 203. Wyoming, which has neither corporate income nor franchise taxes, does not offer business tax incentives. Alaska offers credits, but for special industries only, like oil and gas exploration. Mark L. Nachbar, *Credits and Incentives*, Nos. 1450-2nd, 1460-2nd, 1470-2nd and 1480-1st, TAX MGMT. (BNA) (2008).

206. See, e.g., David Brunori, *Introduction to THE FUTURE OF STATE TAXATION* 6 (David Brunori ed., 1998) [hereinafter Brunori, *State Taxation*] (stating that “[c]ommentators generally agree that incentives violate the most basic principles of sound tax policy”); David Brunori, *The Politics of State Taxation: Thou Shalt Not Use Tax Incentives*, ST. TAX TODAY 557, 557 (Feb. 18, 2002) [hereinafter Brunori, *Thou Shalt Not Use Tax Incentives*] (stating tax incentives violate “the cardinal rule that tax systems should be designed so that they have a minimal impact on economic activity”).

207. See Brunori, *Thou Shalt Not Use Tax Incentives*, *supra* note 206, at 557 (describing states, corporations, and consultants as actively in pursuit of granting and obtaining tax breaks); see also Brunori, *State Taxation*, *supra* note 206, at 6 (stating that tax incentives have increased “primarily because political leaders lack the will to reject them”).

208. Billy Hamilton, *Saving the States from Themselves*, 45 ST. TAX NOTES 131, DOC. NO. 2007-15385 (2007) (LEXIS).

209. *Id.*

210. *Id.*

have to pay any state corporate income tax “for the next thirty years unless its tax liability exceeds \$185 million in any year.”²¹¹

This proliferation is occurring despite criticism regarding the effectiveness of state tax incentives coming from a myriad of economic studies.²¹² The National Association of State Development Agencies and the Council of State Governments have determined that only a few states have performed cost-benefit analyses of their Economic Development Incentive (EDI) programs.²¹³ “While billions of dollars have been spent on EDI across the country in the last ten to fifteen years, states prefer not to evaluate tax incentive programs.”²¹⁴ “[A]s long as EDI are legal, and as long as states and municipalities compete for a limited number of new and expanding businesses, it is in the local and state politicians’ interests to bid for the businesses if only to stay in the economic development game.”²¹⁵ But while “[s]tate and local governments continue to demonstrate a seemingly limitless enthusiasm for economic development incentives . . . [e]conomists deride [such incentives] as fiscally irresponsible and irrational.”²¹⁶ While it is difficult to determine the amount of corporate state and local economic development incentive spending with precise accuracy, Peters and Fisher estimate spending at \$50 billion per year.²¹⁷

Although nearly all of the states use tax incentives to attract economic development, residents of the states granting such incentives have started challenging these programs.²¹⁸ One of their claims is that

211. *Id.*

212. See Stark & Wilson, *supra* note 184, at 157–63 (providing an analysis of several studies). For a review of the economics literature, see Bartik, *supra* note 186, at 102.

213. Jarrell et al., *supra* note 194, at 822. Most states cannot even account for the exact amount they have spent on EDI during any given period. *Id.*

214. *Id.* at 822–23.

215. *Id.* at 823.

216. Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 140 (2006). “A sampling of studies that have focused on individual tax incentive plans includes one conducted in Washington State in 1996 that found little correlation between the amount of tax benefit received and growth in employment which resulted.” Jarrell et al., *supra* note 194, at 826 (citing Wash. State Dep’t of Revenue: Research Div., *Economic Vitality*, at 10 (Mar. 2, 2002), available at <http://dor.wa.gov/content/aboutus/statisticsandreports/wataxstudy/tax%20study%20economic%vitality.pdf>). “One of the few analyses of a full-service program, the Industrial Development [Agency] (IDA), found that while \$1.3 billion in taxes were foregone due to IDA bonds, the measured benefits were sparse.” *Id.* at 826 (citing Robert G. Lynch et al., *The Effectiveness of Firm-Specific State Tax Incentives in Promoting Economic Development: Evidence from New York State’s Industrial Development Agencies*, 10 ECON. DEV. Q. 57 (1996)).

217. Alan Peters & Peter Fisher, *The Failures of Economic Development Incentives*, 70 J. AM. PLAN. ASS’N 27, 28 (2004).

218. See Jarrell et al., *supra* note 194, at 809 (“Lawsuits around the country have challenged the legality of EDI under state constitutions and other local laws.”).

the resulting tax revenue reductions shift the tax burden to them.²¹⁹ The plaintiffs also attack the constitutionality of these state tax subsidies used to encourage investment within a state, using the dormant Commerce Clause.²²⁰ In Part IV, I analyze whether effective challenges to these targeted tax incentives can be brought in the United States given the current standing doctrine.

B. *European Union*

Although the Member States are required to impose a value added tax at a minimum rate as part of membership in the European Union,²²¹ the Member States retain their sovereignty in the direct tax area with the flexibility to select their own national tax rules with respect to tax base, rates, “and all other elements of their tax system.”²²² Although the EC Treaty has been amended on multiple occasions to provide for the adoption of various harmonization measures by only a qualified majority vote of the Council, a unanimous vote is still required for EU tax legislation.²²³ Such fiscal sovereignty makes it possible for the Member

219. See, e.g., *Blinson v. State*, 651 S.E. 2d 268, 273 (N.C. App. 2007) (“Plaintiffs contend that their status as taxpayers, suffering an increased tax burden as a result of the Dell incentives, is sufficient to provide plaintiffs with standing.”).

220. *Id.* (“[T]he disputed incentives and subsidies . . . discriminated against interstate commerce in violation of the [d]ormant Commerce Clause.”). The dormant Commerce Clause is a doctrine that has been read into the Constitution’s affirmative grant of Congress’s power to regulate commerce. See U.S. CONST. art. I, § 8, cl. 3. See generally *TRIBE*, *supra* note 11, § 6-2 (discussing the dormant Commerce Clause).

221. *TERRA & WATTEL*, *supra* note 47, at 10–11. The Community is financed in part by a percentage of the national bases of the value added tax, capped to a percentage of GNP. *Id.* at 7.

222. *PINTO*, *supra* note 51, at 61; see *LAURENCE W. GORMLEY*, *EU TAXATION LAW 2* (2005) (noting that the power retained by the Member States in the area of direct taxation must be exercised in a manner consistent with the terms of the EC Treaty). Although the EC Treaty only identified the goal of harmonization with relation to indirect taxation, the Treaty also identified as a goal the removal of barriers to free movement of goods, persons, services and capital between Member States. EC Treaty, *supra* note 43, arts. 23–60.

223. The Council shall, acting unanimously on a proposal from the Commission and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Members States as directly affect the establishment or functioning of the common market.

EC Treaty, *supra* note 43, art. 94. Article 94 provides a legal basis for direct taxation harmonization measures. *SERVAAS VAN THIEL*, *FREE MOVEMENT OF PERSONS AND INCOME TAX LAW: THE EUROPEAN COURT IN SEARCH OF PRINCIPLES* 112 (2002); cf. *Albert J. Rädler*, *Tax Provisions of the Treaty of Rome—Lost in Transition*, in *IN MEMORIAM KARI S. TIKKA 1944–2006* 422, 425 (Edward Andersson et al. eds., 2007) (discussing the possibility of changing a tax measure that is distorting competition through an Article 96 directive approved by a qualified majority of the Council if consultation by the Commission with the Member State is unproductive in eliminating the distortion).

States to engage in a significant amount of tax competition as a means of attracting or retaining residents and businesses subject to the limits of the EC Treaty, including the four fundamental freedoms and the state aid restrictions.²²⁴ These limitations are quite significant when compared to the dormant Commerce Clause doctrine of the United States.

State aid generally occurs in one of two common forms: subsidies (grants transferred directly to the beneficiary) and tax measures (achieved through special allowances or deferrals, tax base reductions, or tax rate reductions).²²⁵ Thus, the concept of state aid goes beyond mere subsidy and includes any form of intervention that has a similar effect.²²⁶ The main components of state aid are the following:

1. there must be some advantage or benefit;
2. it is granted by the Member State or through state resources;
3. it gives an advantage to certain enterprises or the production of certain goods (the “selectivity” principle);
4. it “distorts or threatens to distort competition”; and
5. it is capable of affecting trade between Member States.²²⁷

Clearly, the targeted tax incentives currently being used by the American States would constitute state aid.

Certain state aid, however, is permissible. Article 87(2) lists aid that is deemed compatible with the common market.²²⁸ Furthermore, the Commission may declare certain types of aid as compatible with the

224. Christiana Hjl Panayi, *State Aid and Tax: the Third Way?*, 32 *INTERTAX* 283, 284 (2004); see Kaye, *Discrimination*, *supra* note 42, at 227–37 (discussing the applicability of the Four Freedoms).

225. See PINTO, *supra* note 51, at 100 (“The latter consist of a reduction of the tax burden achieved by way of special tax rules that deviate from a country’s general tax system.”). For further information, see Commission Website on Listing of Decisions by Aid Instrument, http://ec.europa.eu/comm/competition/state_aid/legislation/instruments.html (last visited Sept. 18, 2008).

226. Panayi, *supra* note 224, at 285; see, e.g., Case C-200/97, *Ecotrade Srl v. Altiforni e Ferriere di Servola SpA (AFS)*, 1998 E.C.R. I-07907 ¶ 34; Case 30/59, *De Gezamenlijke Steenkolenmijnen in Limburg v. High Authority*, 1961 E.C.R. I, 19.

227. EC Treaty, *supra* note 43, art. 87; Panayi, *supra* note 224, at 285.

228. Such as:

- (a) aid having a social character, granted to individual consumers, provided that such aid is granted without discrimination related to the origin of the products concerned;
- (b) aid to make good the damage caused by natural disasters or exceptional occurrences;
- (c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

EC Treaty, *supra* note 43, art. 87(2)(a)–(c).

common market if it falls into one of the five categories spelled out under the Treaty.²²⁹ The specific procedures governing the granting of state aid in the European Union were set forth in a Council Regulation.²³⁰ In relevant part, Article 89 authorizes the Council to “make any appropriate regulations for the application of Articles 87 and 88.”²³¹ The Council Regulation setting forth the following procedures was passed as an integral step toward the development of a permanent state aid policy for the European Union.²³²

Article 1 of the Council Regulation treats state aid as either existing aid, new aid, or unlawful aid, regardless of the form taken by the aid in question.²³³ The following sections describe the categories of actions that qualify as state aid.

1. Existing Aid

Existing aid includes aid that was in operation in a Member State prior to the creation of the EC Treaty, authorized aid, aid that was previously approved by the Commission or Council, and aid that is authorized by default.²³⁴ The Council Regulation lists two additional categories of existing aid: “aid which is deemed to be existing aid pursuant to Article 15,”²³⁵ and aid that at the time it was put into effect

229. The five categories are as follows:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment; (b) aid to promote the execution of an important project of common European interest or to remedy a serious disturbance in the economy of a Member State; (c) aid to facilitate the development of certain economic activities or of certain economic areas . . . ; (d) aid to promote culture and heritage conservation where such aid does not affect trading conditions and competition in the Community . . . ; (e) such other categories of aid as may be specified by decision of the Council acting by a qualified majority on a proposal from the Commission.

Id. art. 87(3)(a)–(e); *see* BERMANN ET AL., *supra* note 54, at 1014–15.

230. Council Regulation 659/99, 1999 O.J. (L 83) (EC) [hereinafter Procedural Council Regulation]. The Council’s authority to regulate state aid derives from Article 89 of the EC Treaty. EC Treaty, *supra* note 43, art. 88(2).

231. EC Treaty, *supra* note 43, art. 89.

232. Procedural Council Regulation, *supra* note 230, at 1.

233. *Id.* art. 1(a)–(c), (f).

234. *Id.* art. 1(b)(i)–(iv). Aid by default occurs when the Commission has not made a timely decision on the compatibility of aid required by the procedure in Article 88. *See* RAYMOND H.C. LUJA, ASSESSMENT AND RECOVERY OF TAX INCENTIVES IN THE EC AND THE WTO: A VIEW ON STATE AIDS, TRADE SUBSIDIES AND DIRECT TAXATION 87 (2003) (discussing the procedural regulations of existing aid).

235. Procedural Council Regulation, *supra* note 230, art. 1(b)(iv).

did not constitute an aid but due to changes in the common market is now considered an aid.²³⁶

2. New Aid

The term new aid includes aid that is not existing aid or existing aid that has been substantially modified.²³⁷ Any Member State that plans to grant new aid must notify the Commission in “sufficient time” in order to enable the Commission to examine the aid in question and make a decision on the lawfulness of the proposed aid.²³⁸ Even aid that is exempt from the general ban on state aid is required to conform to the notification law.²³⁹

3. Unlawful Aid

The Council Regulation broadly defines unlawful aid as all aid that, when put into effect, violates Article 88(3) of the EC Treaty.²⁴⁰ Thus, unlawful aid usually results from a procedural violation.²⁴¹ This is a different standard than “incompatible” aid, which can become lawful if it is altered as prescribed by the Commission.²⁴² Unlawful aid may also include aid that was issued in violation of the notification requirements.²⁴³

4. Exemptions from State Aid Restrictions

The Commission has the authority to create block exemptions for certain categories of aid that it feels should be compatible with the common market and thus exempt from the notification requirements of

236. *Id.* art. 1(b)(v).

237. *Id.* art. 1(c).

238. *Id.* art. 2 (sharing the steps for complete notification). Two months plus a fifteen day grace period is considered sufficient time by the Commission. *Id.* art. 4; see Paul F. Nemitz, 22. *FIDE Congress, 1–4 November 2006, Cyprus*, in 29 *THE EFFECTIVE APPLICATION OF EU STATE AID PROCEDURES: THE ROLE OF NATIONAL LAW AND PRACTICE*, 8 (2007) (positing that the procedure was established to address the common concern that “one firm’s subsidy may be the unemployment of another’s workforce”).

239. Commission Communication, 1983 O.J. (C 318) 3 (EC).

240. Procedural Council Regulation, *supra* note 230, art. 1(f).

241. Ileana Simplicean-Stroia, *Study of the State Aid Policy in the European Community: The “Illegal” State Aid Problem*, 3 *J. INT’L LEGAL STUD.* 87, 101–02 (1997).

242. *Id.* at 102–03.

243. *Id.* at 103. See Nemitz, *supra* note 238, at 10 (noting that between 2000 and 2005, “717 non-notified aid cases have been registered”).

the EC Treaty.²⁴⁴ Such exemptions are created by the Commission through the adoption of regulations and include the de minimis exemption²⁴⁵ and the regional aid exemption.²⁴⁶ Categorization as an exempt type of aid does not remove the aid from the scrutiny of the Commission, however, and Member States with such aid programs are required to maintain transparency in accordance with rules set forth by the Commission.²⁴⁷

a. De Minimis Exemption

If the aid granted by a state does not exceed a certain fixed amount or continue beyond a certain fixed period of time, then the aid is considered de minimis and is exempt from state aid notification requirements in Article 88.²⁴⁸ Specifically, if the total aid granted to any one enterprise does not exceed EUR 200,000 over the course of three years, then the aid is considered de minimis.²⁴⁹

b. Regional Aid Exemption

Aid that is granted to promote economic development in disadvantaged regions of the European Union qualifies as a categorical exemption known as national regional aid.²⁵⁰ According to Commission guidelines, national regional aid encompasses both aid for investment given to large companies²⁵¹ and, on occasion, operating aid for those companies.²⁵² To qualify as national regional aid, the aid must “redress

244. Council Regulation 994/98, 1998 O.J. (L 142) 1, art. 1 (EC) [hereinafter Exemption Council Regulation].

245. *Id.* art. 1–2.

246. *Id.* art. 1(1)(b).

247. *Id.* art. 3(1). See *id.* art. 3(2)–(4) for required rules. See also Commission Regulation 1998/2006, On the Application of Articles 87 and 88 of the treaty to de minimis Aid, 2006 O.J. (L 379) 8 (EC) [hereinafter De minimis Commission Regulation]. Transparency requirements under the regional aid exemption state that all regional aid schemes within the EU be published and available on the internet. European Commission, Guidelines on National Regional Aid for 2007–2013, 2006 O.J. (C 54) 32 [hereinafter Commission Guidelines].

248. Exemption Council Regulation, *supra* note 244, art. 2(1).

249. De minimis Commission Regulation, *supra* note 247, art. 2(2); see European Commission, *State Aid Scoreboard*, at 30, COM (2007) 347 final (June 28, 2007).

250. Commission Guidelines, *supra* note 247, at 1; Exemption Council Regulation, *supra* note 244, art. 1(1)(b).

251. Aid for initial investment is compatible with the common market if it is granted in approved regions and does not exceed the appropriate ceiling. Commission Regulation (EC) 1628/2006, art. 4, 2006 O.J. (L 302) 34.

252. Commission Guidelines, *supra* note 247, at 13.

regional disparities” and assist development in disadvantaged areas.²⁵³ Furthermore, investment aid to small and medium-sized companies located in disadvantaged regions also constitutes national regional aid.²⁵⁴ In order to ensure consistency in applying this exemption, the Commission must approve regional aid maps presented by Member States that delineate the areas where the Member State believes regional aid is appropriate.²⁵⁵ This condition is now a prerequisite for Member States to be granted regional aid exemptions.²⁵⁶

Since 2002, total state aid granted by the Member States has been declining—from 56.7 billion euros in 2002 to 47.9 billion euros in 2006.²⁵⁷ This is consistent with the Commission’s State Aid Action Plan that emphasizes the principle of “less and better targeted state aid.”²⁵⁸ The central objective of this plan is to encourage Member States to reduce their overall levels of state aid and focus the aid that is granted on projects that fulfill Community objectives.²⁵⁹ In 2006, the Competition Commissioner called the Plan’s implementation her first priority.²⁶⁰ The Commissioner has demonstrated flexibility and practicality by implementing rules and regulations that simplify the Plan’s framework in order to increase efficiency and compliance while maintaining its viability.²⁶¹

253. *Id.* at 13.

254. *Id.* The Commission devoted a great deal of time to the discussion of the parameters of national regional aid in its Commission Guidelines. *See generally id.*

255. *See* EC Treaty, *supra* note 43, art. 87(3). The Commission has approved the regional aid maps of twenty-five Member States for the period 2007 through 2013. State Aid Scoreboard, *supra* note 249, at 32.

256. Press Release, European Commission, State Aid: Commission Approves Regional Aid Map 2007–2013 for Portugal (Feb. 7, 2007) [hereinafter Portugal Approves Regional Map]. The Commission approved Portugal’s regional aid map. *Id.*; Press Release, European Commission, State Aid: Commission Guidelines on National Regional Aid for 2007–2013 in Portugal—Frequently Asked Questions (Feb. 7, 2007). Although 70.1% of Portugal’s population remains eligible for regional aid, the regions are eligible for varying levels of aid and for varying durations. Portugal Approves Regional Map, *supra*.

257. *See* Table: Total State Aid by Member State, in Million Euro, http://ec.europa.eu/comm/competition/state_aid/studies_reports/stat_tables.html (last visited July 9, 2008). These calculations represent total aid less aid to the agriculture, fisheries, and transport sectors.

258. European Commission, *State Aid Action Plan: Less and Better Targeted State Aid: A Roadmap for State Aid Reform 2005–2009*, at COM (2005) 107 final (July 6, 2005), available at http://ec.europa.eu/comm/competition/state_aid/others/action_plan/saap_en.pdf.

259. *E.g., id.* at 5.

260. Neelie Kroes, Comm’r, Competition Comm’n, Remarks at Conference Concurrence 2006 in Paris: Competition Policy—2005 Review, 2006 Outlook, (June 23, 2006), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/06/406&format=HTML&aged=1&language=EN&guiLanguage=en>.

261. *See generally* Neelie Kroes, Comm’r, Competition Comm’n, Introductory Remarks at Press Conference for General Block Exemption Regulation for State Aid, Brussels (July 7, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=SPEECH/08/378&format=>

IV. PROCEDURES FOR CHALLENGING TAX INCENTIVES

A. *United States*

In 2004, in *Cuno v. DaimlerChrysler Corp.*, the Sixth Circuit Court of Appeals invalidated Ohio's investment tax credit (ITC) that was applied against the state franchise tax, finding it discriminatory against interstate commerce.²⁶² The U.S. Supreme Court heard the case and vacated, on the basis of a procedural issue regarding the Sixth Circuit's opinion, in May 2006.²⁶³ The Court did not discuss the merits of the case because it decided that the taxpayers lacked standing to pursue their complaint.²⁶⁴ Therefore, questions regarding the constitutionality of state ITCs and other corporate tax incentives remain unanswered.

City and state taxpayers in *Cuno* originally filed suit in state court, challenging the local property tax abatements and state franchise tax credits that had been granted to an automobile manufacturer.²⁶⁵ Defendants, however, removed the action to U.S. District Court.²⁶⁶ Plaintiffs filed motion to remand, questioning their own "ability to satisfy either the constitutional or prudential limitations on standing in the federal court."²⁶⁷ Upon plaintiffs' motion for remand, defendants argued that plaintiffs' Commerce Clause claims fell within the court's federal question jurisdiction under 28 U.S.C. § 1331 and that the related state claims were within the court's supplemental jurisdiction pursuant to 28 U.S.C. § 1367.²⁶⁸

HTML&aged=0&language=EN&guiLanguage=en; Press Release, Competition Comm'n, State Aid: Competition Commissioner Kroes Meets Polish Treasury Minister Grad to Discuss Polish Shipyards, Brussels (July 9, 2008), available at <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/495&format=HTML&aged=0&language=EN&guiLanguage=en>.

262. 386 F.3d 738, 746 (6th Cir. 2004), cert. granted, 545 U.S. 1165 (2005), vacated in part and remanded, 547 U.S. 332 (2006). In *Cuno*, the Sixth Circuit ruled on two Ohio tax incentives granted to DaimlerChrysler to build a plant in Toledo. *Id.* at 746. The court held that the property tax exemptions did not violate the dormant Commerce Clause because it did not favor in-state activity. *Id.* at 747. However, the Supreme Court in *Camps Newfoundland/Owatonna, Inc. v. Town of Harrison*, found that a property tax exemption that did not apply to nonprofit organizations run for the benefit of nonresidents violated the dormant Commerce Clause. 520 U.S. 564 (1997). The Sixth Circuit distinguished the Ohio property tax scheme by noting that it did not discriminate against nonresidents. *Cuno*, 386 F.3d at 747.

263. *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332, 338 (2006).

264. *Id.* ("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.")

265. *Id.* at 338–39.

266. *Id.* at 339. The removal occurred pursuant to 28 U.S.C. § 1441(1).

267. *Cuno*, 547 U.S. at 339 (citing Plaintiff's Supplemental Motion for Remand to State Court at 13, *Cuno v. DaimlerChrysler Corp.*, 154 F. Supp. 2d 1196 (N.D. Ohio 2001) (No. 3:00cv 7247)).

268. Defendants' Memorandum in Opposition to Plaintiffs' Motion for Remand at 2, *Cuno*, 154

The District Court did not remand, finding instead that the taxpayers had standing “under the ‘municipal taxpayer standing’ rule articulated in *Massachusetts v. Mellon*.”²⁶⁹ The Court of Appeals for the Sixth Circuit addressed the merits of the taxpayers’ case (ignoring the issue of standing) and held that the property tax exemption was constitutional but that the state ITC violated the Commerce Clause.²⁷⁰ Both plaintiffs and defendants sought certiorari to review the Court of Appeals’ decision.²⁷¹ In granting certiorari only with respect to the ITC issue, the Supreme Court asked that the parties address whether plaintiffs had standing to challenge the state’s ITC.²⁷²

The Supreme Court described the requirements to obtain standing under Article III of the U.S. Constitution at the forefront of its opinion in *Cuno*.²⁷³ First, the Court recognized the significance of the case-or-controversy limitation.²⁷⁴ Citing *Raines v. Byrd*, the Court reiterated that “no principle is more fundamental to the judiciary’s proper role in our system of government than the constitutional limitation of federal-court jurisdiction to actual cases or controversies.”²⁷⁵ The *Raines* Court stated that for purposes of establishing standing, the litigant “must allege *personal injury* fairly traceable to the defendant’s allegedly unlawful conduct and likely to be redressed by the requested relief.”²⁷⁶

In determining whether the taxpayers in *Cuno* were personally injured, the Court cited *Massachusetts v. Mellon*, where the Court previously rejected a claim “that improper federal appropriations would ‘increase the burden of future taxation and thereby take [the plaintiff’s] property without due process of law.’”²⁷⁷ The *Mellon* Court explained

F. Supp. 2d 1196 (No. 3:00cv 7247).

269. *Cuno*, 547 U.S. at 339–40 (citing *Massachusetts v. Mellon*, 262 U.S. 447 (1923) (decided with *Frothingham v. Mellon*, 262 U.S. 447 (1923))). “The interest of a taxpayer of a municipality in the application of its moneys is direct and immediate and the remedy by injunction to prevent their misuse is not inappropriate.” *Mellon*, 262 U.S. at 486.

270. *Cuno*, 547 U.S. at 340.

271. *Id.*

272. *Id.*

273. *Id.* at 341–47. The Constitution states:

The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority . . . to Controversies to which the United States shall be a Party; to Controversies between two or more States; between a State and Citizens of another State; between Citizens of different States

U.S. CONST. art. III, § 2, cl. 1.

274. *Cuno*, 547 U.S. at 341.

275. *Id.* at 341–42 (citing *Raines v. Byrd*, 521 U.S. 811, 818 (1997)).

276. *Raines*, 521 U.S. at 818–19 (quoting *Allen v. Wright*, 468 U.S. 737, 751 (1984)).

277. *Cuno*, 547 U.S. at 343 (quoting *Mellon*, 262 U.S. at 486).

that “interest in the moneys of the Treasury . . . is shared with millions of others . . . and the effect upon future taxation, of any payment out of the funds, so remote, fluctuating and uncertain, that no basis is afforded for an appeal to the preventive powers of a court of equity.”²⁷⁸ Thus, where the injury is common to all taxpayers, plaintiff has no standing to challenge the tax in a federal court because the alleged injury is not “concrete and particularized.”²⁷⁹

The *Lujan* Court set forth the following three elements that a plaintiff must satisfy before gaining access to the federal judiciary: (1) the plaintiff must have suffered a concrete and particularized injury in fact, not an injury that is conjectural or hypothetical; (2) there must be a causal connection between the plaintiff’s injury and the alleged illegal conduct; and (3) a favorable court decision must be likely to redress the plaintiff’s alleged injury.²⁸⁰

Finally, the Court cited *Doremus v. Board of Education of Hawthorne* for the proposition that the “rationale for rejecting federal taxpayer standing applies with undiminished force to state taxpayers.”²⁸¹ The Court in *Doremus* explicitly stated that a taxpayer’s claim can meet the case-or-controversy test “only when it is a good-faith pocketbook action.”²⁸² The Court recognized that “the interests of a taxpayer in the moneys of the federal treasury are too indeterminable, remote, uncertain and indirect to furnish a basis for an appeal to the preventive powers of the Court over their manner of expenditure.”²⁸³ The Court thought this proposition “equally true when a state Act is assailed.”²⁸⁴

Based on the reasoning of the aforementioned cases, the *Cuno* Court ultimately concluded that the “state taxpayers have no standing under Article III to challenge state tax or spending decisions simply by virtue of their status as taxpayers.”²⁸⁵ In reaching its holding, the Court also reasoned that *Flast v. Cohen*²⁸⁶ was inapplicable because “[w]hatever rights plaintiffs have under the Commerce Clause, they are

278. *Mellon*, 262 U.S. at 487.

279. *Cuno*, 547 U.S. at 344 (citing *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 560 (1992)).

280. *Lujan*, 504 U.S. at 560–61.

281. *Cuno*, 547 U.S. at 345 (citing *Doremus v. Bd. of Educ. of Hawthorne*, 342 U.S. 429 (1952)).

282. *Doremus*, 342 U.S. at 434.

283. *Id.* at 433–34 (citing *Alabama Power Co. v. Ickes*, 302 U.S. 464, 478–79 (1938); *Mellon*, 262 U.S. at 447, 486).

284. *Id.* at 434.

285. *Cuno*, 547 U.S. at 346.

286. 392 U.S. 83 (1968).

fundamentally unlike” those rights under the Establishment Clause.²⁸⁷ In *Flast*, the Court held that “because ‘the Establishment Clause . . . specifically limits the taxing and spending power conferred by Art. I, § 8,’ ‘a taxpayer will have standing consistent with Article III to invoke federal judicial power when he alleges that congressional action under the taxing and spending clause is in derogation of’ the Establishment Clause.”²⁸⁸ But the Supreme Court denied that this Commerce Clause challenge was analogous to the Establishment Clause challenge in *Flast*.²⁸⁹ Thus, the Supreme Court vacated in part the judgment of the Court of Appeals for the Sixth Circuit, and remanded for dismissal the plaintiffs’ challenge to the Ohio ITC.²⁹⁰

Pursuant to the Court’s decision in *Cuno*, it now appears that a federal court is not the appropriate forum for a state taxpayer to challenge a state tax incentive.²⁹¹ The *Cuno* decision clarifies that being a state taxpayer is not sufficient for standing under Article III of the United States Constitution to challenge a state tax incentive program as a Commerce Clause violation.²⁹² Given *Cuno* and the cases that the Court cites within its opinion, a state taxpayer must establish that he has sustained a direct injury as a result of the challenged tax scheme before such a taxpayer may bring suit in federal court. The injury cannot be one that is common with people generally, nor can it be an injury that is hypothetical. However, the requirements to sue in state court may not be quite as stringent.²⁹³

Competitors of the tax incentive recipient may be better positioned to raise a federal court claim.²⁹⁴ Professor Enrich argues that the states themselves are in the best position to bring a challenge to state tax

287. *Cuno*, 547 U.S. at 347.

288. *Id.* (quoting *Flast*, 392 U.S. at 105–06).

289. *See id.* at 349 (“Plaintiffs thus do not have state taxpayer standing on the ground that their Commerce Clause challenge is just like the Establishment Clause challenge in *Flast*.”).

290. *Id.* at 354.

291. Previously, some commentators had concluded that “judges are often quite friendly to state . . . taxpayers in federal court.” Nancy C. Staudt, *Taxpayers in Court: A Systematic Study of a (Misunderstood) Standing Doctrine*, 52 EMORY L.J. 771, 846–47 (2003). Note that this article pre-dates the *Cuno* holding.

292. Plaintiffs in *Cuno* argued that they had standing as state taxpayers pursuant to the Court’s holding in *Flast*, 392 U.S. 83, 105–06 (1968). *Cuno*, 547 U.S. at 347. Plaintiffs argued that there was a “sufficiently close nexus between the plaintiffs’ taxpayer status and the claims that they assert.” Respondents’ Brief at 11, *Cuno*, 547 U.S. 332 (Nos. 04-1704 & 04-1724). Plaintiffs also argued that they had standing as municipal taxpayers. *Id.* at 15.

293. *See infra* text accompanying notes 300–307.

294. Kristin E. Hickman, *How Did We Get Here Anyway?: Considering the Standing Question in DaimlerChrysler v. Cuno*, 4 GEO. J.L. & PUB. POL’Y 47, 63 (2006). Examples of successful challengers are *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 267 (1984), and *Boston Stock Exchange v. State Tax Commission*, 429 U.S. 318, 329 (1977). Hickman, *supra*, at 63 n.93.

incentives because they are the “most direct losers in the ongoing incentive competition.”²⁹⁵ What may at first appear as healthy inter-state competition can ultimately lead to a “race to the bottom.”²⁹⁶ Secondly, Enrich points out that “states are particularly appropriate parties to bring Commerce Clause issues before the courts” because the Commerce Clause’s “primary focus concerns the structural dangers posed to the federal system by excessive state interference with the dynamics of the national economy.”²⁹⁷ “[T]he states have a peculiarly direct and compelling interest in the enforcement of this structural safeguard of federalism.”²⁹⁸ However, it appears that the states have no interest in challenging tax incentives as more than half the states and several U.S. Territories filed an amicus brief together in support of petitioners’ argument that Ohio’s ITC did not violate the dormant Commerce Clause.²⁹⁹

State court is the alternative venue to pursue these challenges. In *ASARCO Inc. v. Kadish*, the Court distinguished between a state taxpayer’s standing in state court and federal court.³⁰⁰ The Court addressed a state taxpayer’s standing in federal court, stating that the Court has already “likened state taxpayers to federal taxpayers,” and has thus, “refused to confer standing upon a state taxpayer absent a showing of ‘direct injury,’ pecuniary or otherwise.”³⁰¹ But the Court differentiated a state taxpayer’s standing in state court:

[T]he constraints of Article III do not apply to state courts, and accordingly the state courts are not bound by the limitations of a case or controversy or other federal rules of justiciability even when they

295. Enrich, *Saving the States*, *supra* note 27, at 418–19 (stating that the incentive system leaves the states “with diminished and distorted revenue capacities and without appreciable compensating economic gains”).

296. *Id.* at 380.

297. *Id.* at 419.

298. *Id.* Enrich also asserts that the states are the “most attractive and plausible candidates to bring challenges to other states’ location incentives” because “some state officials might find the idea of a legal challenge to a competitor state’s incentive policies highly attractive.” *Id.* at 418–19.

299. Brief of Florida et al. as Amici Curiae in Support of Petitioners, *Wilkins v. Cuno*, 547 U.S. 332 (2006) (No. 04-1724) (decided together with *DaimlerChrysler Corp. v. Cuno* (No. 04-1704)). The complete list of signatories to this amicus brief is as follows: Florida, Alabama, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, Georgia, Guam, Hawaii, Idaho, Illinois, Indiana, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Missouri, Nebraska, Nevada, New York, North Dakota, Northern Mariana Islands, Oklahoma, Oregon, Pennsylvania, Puerto Rico, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Washington, and Wisconsin. *Id.*

300. 490 U.S. 605, 613–24 (1989).

301. *Id.* at 613–14 (citing *Doremus v. Bd. of Educ.*, 342 U.S. 429, 434 (1952)).

address issues of federal law, as when they are called upon to interpret the Constitution³⁰²

Given the *Kadish* decision, it is clear that states are not bound to adhere to the “case-or-controversy” doctrine. Thus, it appears that state court, as opposed to federal court, will more likely address the merits of a state taxpayer’s challenge to a state tax incentive.³⁰³

Of course, the standing rules vary from state to state.³⁰⁴ For example, it appears that the rules for taxpayer standing in Ohio state courts are relatively “lax.”³⁰⁵ The Ohio Court of Appeals held that “a taxpayer challenging the state’s biodiesel purchase has standing to prevent the state from entering into an illegal contract.”³⁰⁶ The court stated that “when an expenditure from the state’s general revenue fund is questioned, a party’s status as a taxpayer, independent of any other particular concern with the expenditure involved, will meet the ‘special interest’ requirement of *Masterson*.”³⁰⁷

It appears that “the inability of [the *Cuno*] plaintiffs to challenge investment tax credits in federal court does not close the book on the constitutionality of investment tax credits. Rather, it requires plaintiffs . . . to proceed through their state court system (which may

302. *Id.* at 617. The *Kadish* Court stated that while state taxpayers “would not have had standing to commence suit in federal court based on the allegations in the complaint, they are not the party attempting to invoke the federal judicial power.” *Id.* at 618. Thus, the Court held that the petitioners (defendants in state court) had standing “to invoke the authority of a federal court.” *Id.*

303. As evidenced by the *Kadish* case, this does not mean that such complaint will never reach the U.S. Supreme Court. *Kadish* suggests that a taxpayer challenge, where a decision is reached on the merits of a significant federal issue in a state’s highest court, could be appealed to the U.S. Supreme Court by the non-taxpayer party. 28 U.S.C. § 1257(a) provides for federal question appeals from “the highest court of a state in which a decision could be had” to the U.S. Supreme Court. The non-taxpayer party could establish Article III standing for such an appeal by virtue of the “direct, specific, and concrete injury” suffered as a result of a loss in state court. *Kadish*, 490 U.S. 623–24. *Kadish* does not provide Article III standing for the taxpayer plaintiffs who originally brought the suit, however, even if they lose in state court. *Id.* at 624. Therefore, *Cuno* and other taxpayer plaintiffs who never had Article III standing will have no further recourse if they lose ultimately in the state court system.

304. See Helen Hershkoff, *State Courts and the “Passive Virtues”: Rethinking the Judicial Function*, 114 HARV. L. REV. 1833 (2001) (“[J]udicial practice in some states differs—and differs radically—from the federal model Many state courts do conform . . . to the Article III model.”).

305. Jennifer Carr & Cara Griffith, *Establishing Standing in the Ohio Incentives Case: An Insurmountable Task?*, 39 ST. TAX NOTES 651, Doc. No. 2006-3301 (LEXIS) (2006).

306. *Id.* (citing *Griffin Indus. Inc. v. Dep’t of Admin. Servs.*, No. 00AP-1139, (Ohio Ct. App. Aug. 2, 2001)).

307. *Id.* (citation omitted). The Court was referencing *Masterson v. Ohio State Racing Commission*, 162 Ohio St. 366, 368 (Ohio 1954), where the Supreme Court of Ohio held that “private citizens may not restrain official acts when they fail to allege and prove damage to themselves different in character from that sustained by the public generally.” *Id.*

have more lenient requirements for standing).”³⁰⁸ Immediately after the Supreme Court’s decision in *Cuno*, Professor Enrich promised “to refile the case in state court.”³⁰⁹ However, Ohio revised its tax structure in 2005 by phasing out the franchise tax and eliminating the ITC.³¹⁰ Therefore, Enrich has abandoned plans to pursue the *Cuno* case in state court.

More litigation over state tax laws that provide tax advantages to in-state business activity is underway in many states. In North Carolina, several groups of taxpayers represented by the North Carolina Institute for Constitutional Law (NCICL) have challenged incentives offered to companies investing in the state. One case involved a plan by North Carolina state and local governments to provide the computer company, Dell Inc., with \$279 million in various tax incentives and subsidies to build a computer manufacturing and distribution facility in the state.³¹¹ Taxpayers relied on the Commerce Clause and various state constitutional arguments to challenge the tax incentive package.³¹² The North Carolina Superior Court dismissed the complaint due to lack of standing.³¹³ The Court of Appeals of North Carolina affirmed the trial court’s conclusion that the taxpayers lacked standing.³¹⁴

308. Kathryn Lee Dietrich, *Saving the States from Unsuitable Plaintiffs: Uncovering the Lack of Standing in Challengers to State Income Tax Credits for Business Development*, 36 CUMB. L. REV. 343, 345 (2005–06). Defendants in state cases attempting removal to take advantage of the *Cuno* precedent will likely fail. Courts after *Cuno* should refuse removal for cases involving taxpayer plaintiffs because the parties have no Article III standing and could not have brought these cases in federal court originally. Because defendants can only remove cases that could have been filed by plaintiffs in federal court from the beginning, *Cuno* should be a barrier to removal. *E.g.*, JACK H. FRIEDENTHAL ET AL., CIVIL PROCEDURE § 2.11 at 59 (4th ed. 2005). Moreover, even if a state challenge is removed to federal court, it should be remanded to state court. Some commentators assert that if a federal court is at all uncertain of its power to hear a case, it must remand. *Id.* at 67. When the plaintiffs in *Cuno* requested remand to state court, the trial court refused, stating that the “municipal taxpayer rule” from the *Mellon* case established standing for the plaintiffs. *Cuno*, 547 U.S. at 339–40. Now that the *Cuno* case has established that no such standing exists for taxpayers challenging state tax incentives, district courts in the future will be more likely to remand such cases as improper removals.

309. John C. Biggins, *Incentives After Cuno—Uncertainties Continue for States and Businesses*, J. MULTISTATE TAX’N & INCENTIVES, Nov. 16, 2006, at 8, 11.

310. OHIO REV. CODE ANN. §§ 5733.01(G), 5733.33(B)(1) (West 2008).

311. Complaint at 1–2, *Blinson v. North Carolina*, 651 S.E.2d 268 (N.C. Ct. App. 2007) (No. 05-CVS-8378) (alleging the existence of a \$242 million incentive package from the state, and a \$37 million package offered by the City of Winston-Salem and Forsyth County governments), available at <http://www.ncicl.org/assets/uploads/brief/2005.06.23-dell-complaint-w-exhibits.pdf>.

312. Kay Miller Hobart, *Judge Dismisses Lawsuit Over Dell Incentives Package*, 40 ST. TAX NOTES 669, Doc. No. 2006-9917 (2006) (LEXIS).

313. *Blinson*, 651 S.E.2d at 273. The judge was “not content to base his decision on standing alone,” and “went on to dismiss the Commerce Clause claims as lacking substantive merit.” Hobart, *supra* note 312.

314. *Blinson*, 651 S.E.2d at 274, *review denied*, 661 S.E.2d 240 (N.C. 2008).

Another group of taxpayers, also represented by the NCICL, is challenging an economic development incentive granted to a wholly owned subsidiary of Google, Inc.³¹⁵ The package, worth approximately \$165 million, includes complete relief of “business personal property taxes and an 80% refund of real property taxes for the next 30 years.”³¹⁶ This case, filed in Wake County Superior Court, alleges violations of numerous provisions of the North Carolina Constitution.³¹⁷

In December 2007, the NCICL initiated two additional lawsuits on behalf of concerned taxpayers.³¹⁸ The first case was filed in Wake County Superior Court in response to the \$60 million incentive package given to Goodyear Tire & Rubber Company and Bridgestone Americas Holding, Inc.³¹⁹ The second case, filed in Durham County Superior Court, challenges a Durham County plan to give \$100,000 in subsidies to the Nitronex Corporation in exchange for moving its business from another county in North Carolina.³²⁰ Neither of the two most recent NCICL incentive challenges rely on the Commerce Clause of the U.S. Constitution. Instead, both complaints allege violations of provisions of the North Carolina Constitution.³²¹ According to the NCICL, both cases are still pending in the North Carolina court system (one at the trial level and the other on appeal) as of August 2008.³²²

Similarly, in Minnesota, taxpayers led by a former Lieutenant Governor brought suit challenging the state’s Job Opportunity Building Zone (JOBZ) program.³²³ The JOBZ program authorizes the local governments to grant “a variety of incentives and credits to businesses that relocate to or expand employment or capital investment in

315. Mary Blocher, *NCICL Files Lawsuit Challenging the Constitutionality of State Economic Subsidies to Google, Inc.*, (July 25, 2007), <http://blog.news-record.com/staff/capblog/ncccl072507.doc>; NC Institute for Constitutional Law, *The Incentive Game: North Carolina Local Economic Development Incentives* 8 (2007) (on file with author).

316. NC Institute for Constitutional Law, *supra* note 315, at 8.

317. Blocher, *supra* note 315.

318. NORTH CAROLINA INSTITUTE FOR CONSTITUTIONAL LAW—Case Status Report, <http://www.ncicl.org/case-status-report/> (last visited Aug. 27, 2008) [hereinafter Case Status Report].

319. Complaint at 1, 9, *Richards v. North Carolina*, No. 07-CVS-020487 (N.C. Super. Ct. Dec. 20, 2007), available at <http://www.ncicl.org/assets/uploads/brief/2007.12.20-rubber-tire-complaint.pdf>.

320. Complaint at 1–2, *Haugh v. County of Durham*, No. 07-CVS-6365 (N.C. Super. Ct. Dec. 21, 2007), available at <http://www.ncicl.org/assets/uploads/brief/2007.12.21-nitronex-complaint.pdf>.

321. *Id.* at 8–10; *Richards* Compl. at 10–13.

322. Case Status Report, *supra* note 318.

323. See *Olson v. Minnesota*, 742 N.W.2d 681 (Minn. Ct. App. 2007). See generally Chris Atkins & Joseph D. Henchman, *The Ohio Incentives Decision and the Quest for a 21st Century Tax System*, 40 ST. TAX NOTES 945, Doc. No. 2006-11356 (LEXIS).

designated zones.”³²⁴ Among their arguments, the taxpayers claimed that the program violated the Commerce Clause of the U.S. Constitution because it is an unfair inducement to expand in the designated zones in Minnesota rather than in some other state.³²⁵ While recognizing that state taxpayer standing is broader than its federal counterpart, the Court of Appeals of Minnesota dismissed the suit because the lack of an injury-in-fact deprived the challengers of standing.³²⁶ A different set of Minnesota taxpayers is bringing a new challenge to the JOBZ program that may withstand a motion to dismiss. Because they “directly compete with businesses receiving benefits under JOBZ,” these taxpayers claim they have an injury in fact.³²⁷ They “are at a competitive disadvantage . . . because JOBZ businesses are able to offer lower prices.”³²⁸

While it has been noted that the standing rules in various state courts are more lenient, there is the possibility that cases filed in state courts will have a fate similar to the dismissed cases in North Carolina and Minnesota, among other states, where the state trial judges ruled that plaintiffs lacked standing to challenge the tax incentives under the Commerce Clause.³²⁹ Thus, it is unclear whether the U.S. Supreme Court will ever send a clear message to the states on whether positive location incentives pass the constitutional test.³³⁰

B. *European Union*

For the purposes of this comparison, the Member State’s national courts serve a similar function to the American state court system. Just like in the United States, the standing rules vary from Member State to

324. Atkins & Henchman, *supra* note 323.

325. *Id.* Taxpayers also claimed that the program violated the Minnesota Constitution in that the legislature “illegally contracted away its power of taxation to local development officials.” *Id.*

326. Olson, 742 N.W.2d at 684–85. Similarly, a former Nebraska State Senator challenged Nebraska’s law that gave “tax credits to companies that invest at least \$3 million and create at least [thirty] new full-time jobs in-state.” Atkins & Henchman, *supra* note 323. The challengers contended that the bill promotes discrimination against small businesses and favors in-state over out-of-state businesses. *Id.* Their challenge rested on both the Commerce Clause of the U.S. Constitution and the Nebraska Constitution’s guarantee of proportionate taxation. *Id.* This case was dismissed. DeCamp v. Nebraska, No. CI041981 (dismissed Mar. 7, 2005).

327. Dale Busacker, *Appeals Court Dismisses Challenge to Economic Development Program*, 47 ST. TAX NOTES 17, Doc. No. 2008-34 (2008) (LEXIS).

328. *Id.*

329. David Brunori, Cuno—*The Right Decision? Unfortunately*, 40 ST. TAX NOTES 723, Doc. No. 2006-9849 (2006) (LEXIS).

330. If a taxpayer challenge reaches a decision on the merits in state court, a U.S. Supreme Court appeal is possible. See discussion *supra* note 303.

Member State.³³¹ Appropriate parties can go to their respective national courts for a determination of whether or not a particular measure constitutes state aid within the meaning of Article 87 of the EC Treaty.³³² The national courts are also entitled to evaluate whether a measure is an existing aid or a new aid.³³³ Finally, interested parties can bring an action in national court for a determination of whether or not an aid measure is in violation of Article 88(3) for failure to notify the Commission.³³⁴ This type of case consists of two parts: first, a determination of whether or not the measure constitutes aid, and second, whether proper notification has occurred.³³⁵

In *SFEI v. La Poste*, the ECJ ruled that a national court may ask the Commission for clarification on how to interpret and apply the concept of aid, even during compatibility proceedings.³³⁶ If the aid is found to be in violation of Article 88(3), the national court then refers that case to the Commission for a decision regarding the compatibility of the measure with the common market.³³⁷ Even if the Commission finds the aid to be compatible, recovery of aid from the recipients can still be mandated by the national courts for the notification violation.³³⁸ National courts are required to provide for all appropriate remedies to protect individual rights that have been violated due to unlawful aid.³³⁹

The Commission has exclusive jurisdiction to decide whether or not state aid is compatible with the common market and the EC Treaty.³⁴⁰

331. RICHARD S. KAY, *STANDING TO RAISE CONSTITUTIONAL ISSUES: A COMPARATIVE ANALYSIS*, reprinted in *STANDING TO RAISE CONSTITUTIONAL ISSUES: COMPARATIVE PERSPECTIVES*, at 1 (Richard S. Kay ed., 2005).

332. CHRISTOPHER BELLAMY ET AL., *EUROPEAN COMMUNITY LAW OF COMPETITION* 1271 (P.M. Roth ed., 5th ed. 2001).

333. *Id.*

334. DESPINA SCHINA, *STATE AIDS UNDER THE EEC TREATY ARTICLES 92 TO 94*, at 139 (1987) (indicating that the Commission relies on complaints from other Member States, third parties, and other sources to learn of violations); see European Commission, *Notice on Cooperation Between National Courts and the Commission in the State Aid Field*, 1995 O.J. (C 312) 8, 9 [hereinafter *EC Notice on Cooperation*] (“National courts are responsible for the protection of rights and the enforcement of duties, usually at the behest of private parties.”).

335. *EC Notice on Cooperation*, *supra* note 334, at 11.

336. Case C-39/94, 1996 E.C.R. I-3547.

337. *EC Notice on Cooperation*, *supra* note 334, at 9.

338. Case C-39/94, *SFEI v. La Poste*, 1996 E.C.R. I-3547, ¶ 43.

339. BELLAMY ET AL., *supra* note 332, at 1272.

340. Case 78/76, *Steinike und Wenlig v. Germany*, 1977 E.C.R. 595. The court held that the purpose of Article 88 was to keep aid under the Commission’s constant scrutiny and that is the Commission’s responsibility to initiate the procedure that might result in a finding of incompatibility. *Id.*

Article 88(3) states:

The Commission shall be informed, in sufficient time to enable it to submit its comments, of any plans to grant or alter aid. If it considers that any such plan is not compatible with the common market having regard to Article 87, it shall without delay initiate the procedure provided for in paragraph 2. The Member State concerned shall not put its proposed measures into effect until this procedure has resulted in a final decision.³⁴¹

After the Commission is notified of a Member State's planned introduction of new state aid, it makes a preliminary examination of the offered plan.³⁴² The Commission can make one of three determinations regarding the proposed aid: (1) that the measure does not constitute aid; (2) that the proposal is state aid and nonetheless is compatible with the common market and the EC Treaty; or (3) that the measure is incompatible with the common market and the EC Treaty.³⁴³ If the Commission has doubts as to the compatibility of the measure, it must commence formal investigation under Article 88(2).³⁴⁴

If, after the Commission is informed of a Member State's plan to offer aid, the Commission considers that the plan is incompatible with the goal of a unified internal market, it immediately begins the procedure provided for in paragraph two.³⁴⁵ The Member State concerned must delay the effective date of its proposed measures until this procedure has resulted in a final decision.³⁴⁶

The Commission is also allowed to initiate the procedure under Article 88(2) of its own accord against aid already in effect.³⁴⁷ If the Commission concludes that aid already in effect, with no alterations, violates the common market, it must propose measures to remedy the situation.³⁴⁸ If the proposal is accepted, it is considered legally binding,

341. EC Treaty, *supra* note 43, art. 88(3).

342. Procedural Council Regulation, *supra* note 230, art. 4(2).

343. *Id.* art. 4(2)–(4); *see also* BELLAMY ET AL., *supra* note 332, at 1271–72.

344. BELLAMY ET AL., *supra* note 332, at 1258.

345. EC Treaty, *supra* note 43, art. 88(2).

346. *Id.* art. 88(3); Procedural Council Regulation, *supra* note 230, art. 3; *see* BELLAMY ET AL., *supra* note 332, at 1253. This requirement is known as the stand still requirement. Procedural Council Regulation, *supra* note 230, art. 3. Because Article 88(1) of the EC Treaty requires the Commission to keep existing aid under constant review, the notification requirement applies only to new aid or significantly altered existing aid. *Id.* art. 2(1).

347. Procedural Council Regulation, *supra* note 230, art. 10(1) (authorizing the Commission to review a law on the basis of information that is available from “whatever source” when a state aid program is unlawful for failure to notify).

348. *Id.* art. 18.

whereas if the proposal is rejected, the Commission is able to proceed with formal investigations.³⁴⁹ If the Commission finds the aid already in effect to be in violation of the Treaty, it must inform the Member State of the violation and allow it to submit comments.³⁵⁰

If the aid was put into place without notification of the Commission, interested parties may bring the issue before a national court who will rule on the alleged illegality of the aid only as it relates to failure to notify.³⁵¹ The national court will then refer the case to the Commission where the compatibility of the proposal will be decided.³⁵² In the event that the aid is considered valid and within the bounds of the common market and EC Treaty, any aid that had been taken back in accordance with a recovery injunction will be repaid to the recipient. If the aid had been recovered because of a national court decision, the aid will not be returned because the obligation to comply with the notification procedure was still violated.³⁵³ If the Commission decides that the unlawful aid is contrary to the common market, the Commission will order the Member State in violation to recover all the aid from the recipient.³⁵⁴

Formal investigation begins with a decision by the Commission announcing the investigation and inviting all interested parties to submit comments.³⁵⁵ If the investigation concerns new aid, the Commission requires that the proposed measure not be put into effect until the procedure is completed.³⁵⁶ In the event of aid already in effect, payment of the aid is permitted to continue.³⁵⁷ The formal investigation procedure may last up to eighteen months and culminates with one of four determinations: (1) the measure does not constitute aid; (2) the measure does constitute aid and is compatible with the common market; (3) the measure does constitute aid and is incompatible with the common market; or (4) the measure does constitute aid and will be deemed compatible with the common market provided that certain conditions imposed by the Commission are met.³⁵⁸

349. *Id.* art. 19.

350. EC Treaty, *supra* note 43, art. 88(3); Procedural Council Regulation, *supra* note 230, art. 17(2).

351. *See EC Notice on Cooperation*, *supra* note 334, at 9 (“National courts are responsible for the protection of rights and the enforcement of duties, usually at the behest of private parties.”).

352. *Id.*

353. BELLAMY ET AL., *supra* note 332, at 1272.

354. Procedural Council Regulation, *supra* note 230, art. 14(1).

355. SCHINA, *supra* note 334, at 148.

356. Procedural Council Regulation, *supra* note 230, art. 3.

357. *See Rossi-Maccanico, Review of State Aid*, *supra* note 61, at 944.

358. LUJA, *supra* note 234, at 92.

For example, after German unification, the promoters of small and medium-sized companies in the new State (Länder) were unable to find sufficient capital.³⁵⁹ Germany responded by expanding the Income Tax Act concessions that created tax benefits for investors in certain companies, and gave the Commission timely notice of the change in its laws.³⁶⁰ The Commission initiated the investigation provided for by Article 88 and, at the end of the formal investigation, concluded that the measure Germany sought to implement did not comport with the creation of a common market.³⁶¹ The law had the effect of reducing costs of financing for the small and medium-sized businesses affected.³⁶²

European Community Courts have the jurisdiction to hear appeals of Commission decisions. Today, both the ECJ and the Court of First Instance (CFI) have jurisdiction to hear actions brought by Member States against the Commission in regards to state aid.³⁶³ The ECJ and the CFI have concurrent jurisdiction to determine the legality of acts of the Council and the Commission pursuant to a grant from Article 230.³⁶⁴

The CFI has jurisdiction to hear “actions brought by the Member States against the Council relating to acts adopted in the field of State aid.”³⁶⁵ Additionally, the CFI has jurisdiction over direct actions brought by individuals “against acts of Community institutions.”³⁶⁶ If, for example, a competitor felt that the Commission made a wrong decision with regard to whether a state program constitutes state aid, the decision of the Commission could be appealed to the CFI. Likewise, a Member State could also appeal to the CFI. In most cases, the ECJ hears actions for annulment, but jurisdiction is specifically granted to the CFI for state-aid-based claims.³⁶⁷

359. Commission Decision 98/476, 1998 O.J. (L 212) 50, 51 (EC).

360. *Id.* at 51. The legislation provided tax deductions for the transfer of certain fixed capital assets and for the sale of shares conducted by capital companies that met certain criteria, such as the location of their central offices in Länder or Berlin and a maximum of 250 employees at the time of sale. *Id.*

361. *Id.* at 56.

362. *Id.* at 55.

363. *EC Notice On Cooperation*, *supra* note 334, at 8.

364. BELLAMY ET AL., *supra* note 332, at 1273.

365. The Court of Justice of the European Communities, *The Court of First Instance, Jurisdiction*, http://curia.europa.eu/en/instit/presentationfr/index_tpi.htm (last visited Aug. 28, 2008). The jurisdictional grant to hear such claims is not exclusive and does not preclude the ECJ from hearing identical claims; in fact, jurisdiction originally lay with the ECJ.

366. *Id.*

367. *See id.* (noting that the Court of Justice has exclusive jurisdiction over actions brought by a Member State against the Council, except for actions regarding state aid).

The ECJ presides over references for preliminary rulings, which are referred from national courts of Member States.³⁶⁸ When national courts have questions on points of interpretation of European Community law, they may refer those inquiries to the ECJ for a determination.³⁶⁹ Decisions of the ECJ with regard to preliminary interpretations are binding.³⁷⁰ Thus, if a national court is evaluating whether a measure constituted state aid and has a question regarding the interpretation of language of the EC Treaty, that question can be referred to the ECJ.³⁷¹

The ECJ ruling in *Germany v. Commission*³⁷² exemplifies the appeal process for state aid actions. In this case, the German government appealed the decision by the Commission with regard to the tax measures it sought to implement.³⁷³ After a formal investigation, the Commission concluded that the measures were incompatible with the common market.³⁷⁴ Germany applied to the ECJ for annulment of the Commission's decision, setting forth arguments that the decision infringed Article 190 (now Article 253 EC).³⁷⁵ The applicant also alleged errors in law by the Commission including failure to take into consideration the de minimis rule and improper exercise of discretion.³⁷⁶ The ECJ evaluated Germany's allegations and concluded that none of the pleas were well-founded; the court subsequently dismissed the claim.³⁷⁷ By dismissing the claim, the ECJ required Germany to abide by the determination of the Commission that monies paid out under Germany's program constituted illegal state aid and must be repaid.³⁷⁸

In the *Kingdom of Belgium and Forum 187 ASBL v. Commission*, the ECJ joined a claim for annulment of a Commission decision brought by Belgium and an independent claim for annulment of the same decision

368. The Court of Justice of the European Communities, <http://curia.europa.eu/en/instit/presentationfr/cje.htm> (last visited Aug. 28, 2008).

369. *Id.*

370. *Id.* It should be noted that although questions of interpretation must be requested by national courts, all parties to the case, including individuals, participate in the ECJ hearing. *Id.*

371. The ECJ does not have jurisdiction to determine whether a measure is actually state aid, however. *See id.*

372. Case C-156/98, *Germany v. Comm'n*, 2000 E.C.R. I-6857.

373. Specifically, the Federal Republic of Germany was applying for an annulment of Commission Decision 98/476/EC of January 21, 1998 with respect to tax concessions granted under paragraph 52(8) of the German Income Tax Act, 1998 O.J. (L 212) 50. *Id.* ¶ 1; *see supra* notes 359–61 and accompanying text.

374. *See Germany v. Comm'n*, 2000 E.C.R. I-6857, ¶¶ 11, 12, 113.

375. *See id.* ¶ 16.

376. *Id.*

377. *Id.* ¶¶ 116–17.

378. Panayi, *supra* note 224, at 302.

brought by a group formed by interested parties.³⁷⁹ In 2003, the Commission concluded that a tax regime providing certain benefits to coordination centers declared beneficiaries by the Belgian government constituted existing aid.³⁸⁰ Based on that conclusion, the Commission declared the tax regime incompatible with the common market and required Belgium to comply with a number of Commission-created requirements designed to amend or abolish the tax regime.³⁸¹

Belgium asked the ECJ to annul parts of the decision that it felt conflicted with prior decisions taken by the Commission on the tax regimes.³⁸² Forum 187, the representative body of a group of coordination centers affected by the Commission's decision,³⁸³ sought the annulment of the entire order by the ECJ in a separate case from the country of Belgium.³⁸⁴ Over the objections of the Commission, the ECJ concluded that Forum 187 had standing to request annulment because it was "responsible for protecting the collective interests of coordination cent[er]s" affected by the contested decision.³⁸⁵

The ECJ concluded that although the Commission rightly decided that the provisions selectively favored certain coordination centers and in fact constituted state aid, the decision nonetheless infringed on the principle of the protection of legitimate expectations created by prior Commission decisions.³⁸⁶ Furthermore, the ECJ held that the Commission's decision infringed on the general principle of equal treatment because coordination centers, each of which had the reasonable expectation of lengthier transition periods for compliance, received disparate treatment under the contested decision.³⁸⁷ On those bases, the ECJ required that the Commission's decision be annulled.³⁸⁸

379. Joined Cases C-182/03 & C-217/03, *Belgium, Forum 187 v. Comm'n*, 2006 E.C.R. I-05479, ¶¶ 1-2.

380. *Id.* ¶ 29.

381. *Id.* ¶ 32.

382. *Id.* ¶ 47.

383. *Id.* ¶ 54.

384. *Id.* ¶ 48.

385. *Id.* ¶ 56.

386. *Id.* ¶ 167.

387. *Id.* ¶¶ 171, 173.

388. *Id.* ¶ 174. Despite this ruling, the ECJ upheld the Commission's decision that the provisions had to be rolled back and simply instructed the Commission to provide a timeframe that comported with the legitimate expectations of the coordination centers. *See id.* ¶¶ 167, 171, 173.

C. Comparative Analysis

Both the European Union and the United States have procedures in place to allow challenges to tax incentives that might obstruct the efficient functioning of the common market. But in the European Union, the Member State bears the burden of proving that the proposed tax incentive does not distort the common market. Any new incentive is subject to a formal investigation by the Commission to determine whether it is compatible with the common market.

The Commission consists of members appointed by the Council for five-year terms.³⁸⁹ These Commissioners are required to act in complete independence of their own governments and the Council, and for the good of the Community.³⁹⁰ The Commission has features of an executive, legislative, and judicial branch in that it formulates Community policy, makes proposals to the Council, and drafts the detailed measures needed for their implementation.³⁹¹ As the “Guardian of the Treaty,” the Commission must also ensure that the Treaties and Community law are respected and applied, and must act on any infringements.³⁹²

The United States does not, however, have a governmental entity that is analogous to the European Commission. The closest analogy would be the Multistate Tax Commission (MTC), which was formed in 1967 by the states “in response to the threat of federal legislation to restrict and regulate state business taxation.”³⁹³ Its purpose is “to study

389. EC Treaty, *supra* note 43, arts. 213, 215. “Pursuant to the Treaty of Nice, the five largest States lost on Nov. 1 their traditional second Commissioner, so that the 2004–09 Commission initially had [twenty-five] members, increasing to [twenty-seven] Commissioners after Bulgaria and Romania joined on Jan. 1, 2007.” BERMANN ET AL., EUROPEAN UNION LAW 5 (Roger J. Goebel ed., 2d ed. Supp. 2007) [hereinafter GOEBEL SUPPLEMENT, EUROPEAN UNION LAW]. “Under Article 214(2) of the EC Treaty, the Parliament must provide a ‘vote of approval’ to the Commission ‘as a body’ before the Council can appoint the Commission.” *Id.* at 6.

390. EC Treaty, *supra* note 43, art. 213; Treaty Establishing a Single Council and a Single Commission of the European Communities, art. 10(2) 1967 O.J. (152); BERMANN ET AL., *supra* note 54, at 44; see T. C. HARTLEY, THE FOUNDATIONS OF EUROPEAN COMMUNITY LAW 11–12 (2d ed. 1988) (describing decision-making within the Commission).

391. See EC Treaty, *supra* note 43, art. 211. In 2005, the Commission proposed drafts “for 411 proposals for legislation and decisions” and issued 288 reports, recommendations and studies. GOEBEL SUPPLEMENT, EUROPEAN UNION LAW, *supra* note 389, at 4. “Exercising its delegated regulatory powers, the Commission adopted 602 regulations, 44 directives and 610 decisions in 2002, and 648 regulations, 61 directives and 560 decisions in 2003.” *Id.* at 4–5.

392. See EC Treaty, *supra* note 43, art. 226; BERMANN ET AL., *supra* note 54, at 46. “In its role of ‘guardian of the Treaties,’ the Commission has on average commenced around 1500 infringement proceedings annually against Member States in 2002–06.” GOEBEL SUPPLEMENT, EUROPEAN UNION LAW, *supra* note 389, at 5.

393. Sullivan, *supra* note 200, at 422; see W. Bartley Hildreth et al., *Interstate Tax Uniformity and the Multistate Tax Commission*, 58 NAT’L TAX J. 575–77 (2005) (describing the origins of the

state tax issues and to recommend uniform tax laws and regulations to the states.³⁹⁴ This entity was not congressionally-sanctioned and does not have binding regulatory authority.³⁹⁵

Appropriate parties have access to a Member State's national court system as well as to the Commission. Although the Commission has exclusive jurisdiction to decide whether or not state aid is compatible with the common market and the EC Treaty,³⁹⁶ the national courts have the authority to determine whether or not a certain proposal constitutes state aid;³⁹⁷ they are also entitled to evaluate whether a measure is an existing aid or a new aid.³⁹⁸ Furthermore, the Commission may bring a Member State to the ECJ.³⁹⁹

In the United States, it appears that the standing doctrine is effectively keeping most parties from challenging the various states' tax incentives. In *Cuno*, the plaintiffs were taxpayers of the jurisdictions losing revenue from the state franchise tax credit and property tax exemptions challenged in this case as violations of the Commerce Clause.⁴⁰⁰ They claimed standing "in their capacities as state and municipal taxpayers."⁴⁰¹ The Supreme Court held that they lacked standing.⁴⁰²

Some commentators believe that the standing rules are less stringent in the state courts.⁴⁰³ However, in North Carolina, when taxpayers brought suit challenging the \$279 million corporate, franchise, income, property, and sales and use tax-incentive package given to Dell Inc. to build in Winston-Salem, the North Carolina Superior Court dismissed the

MTC).

394. Sullivan, *supra* note 200, at 422.

395. However, it was found to be constitutional. Hildreth et al., *supra* note 393, at 577 (citing U.S. Steel Corp. v. Multistate Tax Comm'n, 434 U.S. 452 (1978)).

396. Case 78/76, Steinike und Wenlig v. Germany, 1977 E.C.R. 595 (holding that the purpose of Article 88 was to keep aid under the constant scrutiny of the Commission and that a finding of incompatibility was to be a result of a procedure that is the Commission's responsibility to initiate).

397. BELLAMY ET AL., *supra* note 332, at 1271.

398. *Id.*

399. The EC Treaty provides:

If, after giving notice to the parties concerned to submit their comments, the Commission finds that aid granted by a State . . . is not compatible with the common market having regard to Article 87, . . . it shall decide that the State concerned shall abolish or alter such aid If the State concerned does not comply with this decision within the prescribed time, the Commission or any other interested State may, in derogation from the provisions of Articles 226 and 227, refer the matter to the Court of Justice direct.

EC Treaty, *supra* note 43, art. 88(2).

400. DaimlerChrysler Corp. v. Cuno, 547 U.S. 332, 337 (2006).

401. Respondents' Brief at 7, *Cuno*, 547 U.S. 332 (Nos. 04-1704 and 04-1724).

402. *Cuno*, 547 U.S. at 346.

403. See *supra* note 291.

complaint due to lack of standing.⁴⁰⁴ The same fate has befallen cases filed in Minnesota and Nebraska.⁴⁰⁵

Furthermore, even when standing is not a barrier to consideration of these issues, there is no guarantee that the courts will find a violation of the dormant Commerce Clause as demonstrated by the Sixth Circuit's decision in *DIRECTV, Inc. v. Treesh*.⁴⁰⁶ In this case, "the satellite companies [sought] a permanent injunction against certain provisions recently added to Kentucky's revenue statutes that afford[ed] cable television operators credits and other relief from state taxes assessed against both cable companies and the satellite companies;" the provisions were added through amendments made to Kentucky's tax laws in 2005.⁴⁰⁷ Neither the cable nor the satellite companies were subject to the Kentucky state sales tax prior to these amendments.⁴⁰⁸ Furthermore, the satellite companies are exempt from all local taxes and fees pursuant to federal law, whereas the cable companies were paying franchise fees to the applicable local government for the use of a public right-of-way.⁴⁰⁹

Under the new law that became effective on January 1, 2006, there is a 3% excise tax on the sales price charged for cable or satellite broadcast service and a 2.4% tax on the provider's gross revenues in Kentucky.⁴¹⁰ As part of these changes, local governments are no longer permitted to assess franchise fees on the cable companies and instead receive a proportionate share of the revenues raised from the state excise and gross revenue taxes.⁴¹¹ But if the cable company actually pays such a franchise fee, it is entitled to a credit against these new state taxes.⁴¹²

The satellite companies argued that the provisions of the Kentucky tax law providing the cable companies with "credits against the state excise and gross revenues taxes and relief from franchise fees unconstitutionally discriminate against interstate commerce in violation

404. See *supra* text accompanying notes 311–14.

405. See *supra* notes 323–28 and accompanying text.

406. 487 F.3d 471, 481 (6th Cir. 2007), *cert. denied*, 128 S. Ct. 1876 (2008); see also *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 614–29 (1981) (upholding a state's transparent and politically controversial attempt to shift tax burdens to outsiders by simultaneously reducing various in-state taxes and increasing a coal severance tax that out-of-state consumers principally paid, at least in the short run).

407. *DIRECTV*, 487 F.3d at 473; see Frank Shaforth, *Calling for State Tax Innovation*, 44 ST. TAX NOTES 977, DOC. NO. 2007-14465 (2007) (LEXIS) (analyzing the *DIRECTV* decision).

408. *DIRECTV*, 487 F.3d at 474.

409. *Id.* These franchise fees were "typically five percent of gross revenue within the franchise area." *Id.*

410. *Id.* at 475.

411. *Id.*

412. *Id.*

of the Commerce Clause.”⁴¹³ They alleged that the cable companies are receiving a tax preference because although the cable companies must also pay the new taxes, they receive relief from some of their operating costs—namely the franchise fees previously paid for access to public-rights-of-way.⁴¹⁴ According to the satellite companies, the practical effect of this “tax and subsidy” approach constitutes discrimination against interstate commerce.⁴¹⁵

The Sixth Circuit Court of Appeals affirmed the district court’s grant of the Commissioner of the Kentucky Department of Revenue’s motion to dismiss, as it was unable to find that the Kentucky statute would discriminate against interstate commerce in its practical operation.⁴¹⁶ The court distinguished this case from *West Lynn Creamery v. Healy* by stating that the right to use rights-of-ways without local taxes or fees was not a direct monetary subsidy.⁴¹⁷ Furthermore, the court believed that because cable services and satellite broadcast services are two distinct “goods,” there was not the same “purpose and effect” found in *West Lynn Creamery* “‘to divert market share’ from an out-of-state good to an identical in-state good.”⁴¹⁸ “States must be allowed, and even encouraged, to work ‘to attract business by creating an environment conducive to economic activity.’”⁴¹⁹ Regardless of whether I disagree with the analysis in this case, it is reasonably clear to me that the Commission would have found state aid present in this case.

The most analogous ECJ case is probably *Italian Republic v. Commission*.⁴²⁰ Italy introduced a tax credit for Italian truckers and a compensatory payment for non-Italian truckers from within the Community for the 1993 and 1994 tax years based on a percentage of the actual cost of fuel and lubricants consumed driving over Italian

413. *Id.*

414. *Id.* at 476.

415. *Id.* at 476, 478 (citing *W. Lynn Creamery v. Healy*, 512 U.S. 186, 201 (1994)). “In general, a challenged credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face, or if, on the basis of a ‘sensitive, case-by-case analysis of purposes and effects,’ the provision ‘will in its practical operation work discrimination against interstate commerce . . . ,’ by ‘providing a direct commercial advantage to local business.’” *Id.* (quoting *W. Lynn Creamery*, 512 U.S. at 201 and *Bacchus Imps. Ltd. v. Dias*, 468 U.S. 263, 268 (1984)).

416. *Id.* at 481. The U.S. Supreme Court denied an appeal of the Sixth Circuit decision on April 14, 2008. *DIRECTV, Inc. v. Treesh*, 128 S. Ct. 1876, 1876 (2008).

417. *DIRECTV*, 487 F.3d at 480.

418. *Id.*

419. *Id.* at 481 (citation omitted).

420. Case C-6/97, *Italian Republic v. Comm’n*, 1999 E.C.R. I-2981 (application for the annulment of Commission Decision 97/270/EC of Oct. 22, 1996 on a tax credit scheme introduced by Italy for truckers, 1997 O.J. (L 106) 22).

territory.⁴²¹ The Italian truckers were able to deduct this credit from either their income taxes or their value added tax (VAT).⁴²² Italy failed to implement any detailed rules for granting the compensatory payments to the non-Italian truckers.⁴²³ The ECJ agreed with the Commission's decision that the tax scheme was incompatible with the common market as it did constitute state aid and it did not meet any of the conditions of the permitted exceptions.⁴²⁴

V. LESSONS LEARNED FROM THE EUROPEAN UNION AND A RECOMMENDED PROPOSAL

European Union state aid policy enables Member States to resist protectionist pleas from their companies. The European Union is experiencing a downward trend in the use of tax incentives and virtually no use of the targeted tax incentives utilized so widely by the American States due to the procedures that have been put in place. What are the options for the United States given our longstanding policy of no national subsidy control?⁴²⁵

A. *The Congress*

Although the Commerce Clause confers to Congress the authority to regulate state tax competition, Congress has for the most part declined to exercise such authority.⁴²⁶ However, occasional congressional interventions occur, such as in 1976, when “to prevent states from imposing cumulative and potentially destructive taxes on interstate businesses such as railroads and airlines,” Congress passed the Railroad Revitalization and Regulatory Reform Act of 1976.⁴²⁷ This law

421. *Id.* ¶¶ 2, 4.

422. *Id.* ¶ 3.

423. *See id.* ¶ 30 (“[I]n the absence of any provisions laying down detailed rules for granting the stated compensatory payments, road hauliers who are nationals of other Member States could not in any event usefully avail themselves of the right to claim such payments.”).

424. *Id.* ¶¶ 8, 17.

425. There are two exceptions, however. The first exception is the prohibition of discriminatory subsidies that impose a burden on interstate commerce. *See supra* notes 11–15 and accompanying text. The second exception is the requirements of the GATT/WTO. This topic is beyond the scope of this Article. *See Avi-Yonah, supra* note 41, at 1666 (“GATT Article XVI . . . expressly prohibits the use of any subsidy ‘on the export of any product . . . which subsidy results in the sale of such product for export at a price lower than the comparable price charged for the like product to buyers in the domestic market.’”).

426. *See generally* Enrich, *Saving the States, supra* note 27, at 405–06.

427. Field, *supra* note 10, at 1213.

prohibited states from placing higher tax rates on property owned by railroads than on property owned by other commercial enterprises within the same jurisdiction.⁴²⁸ More recently, in 1998, Congress passed the Internet Tax Freedom Act (ITFA), a law intended to curb state taxes on an “emerging technology” and “achieve neutrality in the taxation of electronic commerce.”⁴²⁹ In 2004, the Internet Tax Nondiscrimination Act (ITNA) expanded the definitions of “Internet access” and “tax on Internet access.”⁴³⁰ The Internet Tax Freedom Act Amendments Act of 2007 extended the moratorium that had been imposed by the ITNA through November 2014.⁴³¹

This is another situation where Congress should intervene. Specifically, I am recommending that Congress pass legislation that would provide an alternative to traditional taxpayer-challenge lawsuits, thus bypassing the obstacle of standing after *Cuno*. One way Congress could accomplish this is through a qui tam statute, allowing concerned citizens to file suits on behalf of the public interest.⁴³² Thus, a qui tam law allows “ordinary citizens to act as private attorneys general.”⁴³³ By providing concerned taxpayers with a qui tam option, Congress could avoid the issue of standing while encouraging enforcement of the Commerce Clause of the United States Constitution.

Governments have used qui tam for centuries to maximize the enforcement of laws.⁴³⁴ For example, England used qui tam throughout the Middle Ages to address the “conflict of interest between local and national officials . . . in order to ensure that the national laws would be enforced.”⁴³⁵ Currently, the most significant example of qui tam in the United States is the False Claims Act,⁴³⁶ which provides citizens with the power to bring a lawsuit against a person or entity involved in fraud perpetrated against the federal government.⁴³⁷ The law gives citizen

428. *Id.* at 1213 n.13 (citing 49 U.S.C. § 11503 (1976)).

429. *Id.* at 1213; see Kaye, *Discrimination*, *supra* note 42, at 208. The Act ended up costing the states “billions in foregone revenues.” *Id.*

430. Kaye, *Discrimination*, *supra* note 42, at 209.

431. Internet Tax Freedom Act Amendments Act of 2007, Pub. L. No. 110-108, 121 Stat. 1024 (2007).

432. *E.g.*, R. Harrison Smith, *A Key Time for Qui Tam: The False Claims Act and Alabama*, 58 ALA. L. REV. 1199, 1201 (2007) (citing Christopher C. Frieden, *Protecting the Government's Interests: Qui Tam Actions Under the False Claims Act and the Government's Right to Veto Settlements of Those Actions*, 47 EMORY L.J. 1041, 1041 (1998)).

433. *Id.* (citing Frieden, *supra* note 432).

434. *Id.* at 1200–01.

435. *Id.* at 1201.

436. 31 U.S.C. §§ 3729–31 (2000).

437. Smith, *supra* note 432, at 1201.

relators⁴³⁸ a financial incentive to expose fraud by allowing them to keep a portion of any funds recovered as a result of the litigation.⁴³⁹ The False Claims Act has proven to be a successful and effective means of combating fraud that would have otherwise drained taxpayer resources.⁴⁴⁰

The False Claims Act could provide a model for a similar *qui tam* statute to empower concerned taxpayers to challenge state tax incentive programs, which are also draining taxpayer resources. As the states are voluntarily colluding with businesses to offer the challenged incentives, they are unlikely to enforce the restrictions of the dormant Commerce Clause themselves. Thus, *qui tam* would be an appropriate tool to use in this situation.

A model statute would give citizens the power to bring a suit, with the guarantee that they would receive a portion of any state tax expenditures that are returned as a result of the litigation by the company that received the unconstitutional targeted state tax incentive. This would provide an incentive for citizens to police state tax incentives and could discourage companies from seeking or accepting them because of the increased risk posed by *qui tam* litigation.⁴⁴¹ By discouraging future abuses of tax incentive programs and enabling taxpayer challenges to

438. Citizens who bring actions pursuant to a *qui tam* statute are referred to as relators. *Id.* (citing 1 JOHN T. BOESE, CIVIL FALSE CLAIMS & *QUI TAM* ACTIONS 1–4 (3d ed. Supp. 2007)).

439. *United States, ex Rel. Springfield Terminal Ry. Co. v. Quinn*, 14 F.3d 645, 649 (D.C. Cir. 1994).

440. Dennis J. Ventry, Jr., *Whistleblowers and Qui Tam for Tax*, 61 TAX LAW. 357, 368 (2008).

441. Ventry has suggested a similar *qui tam* statute to enforce the Internal Revenue Code against tax evaders in his article, *Whistleblowers and Qui Tam for Tax*:

Evidence suggests that adding a *qui tam* provision to the tax whistleblower statute would deter noncompliance and enhance enforcement. First . . . the threat of *qui tam* lawsuits adds real as well as perceived downside risk to the compliance calculus . . . It increases the probability of detection and subsequent prosecution, which researchers have shown corresponds particularly strongly with increased tax compliance. Second, if the government publicizes the threat of *qui tam* lawsuits and the successful prosecution of tax cheats, research also indicates that such publicity could discourage noncompliant behavior and at the same time reinforce compliant behavior. Third, the *qui tam* approach might actually encourage more private persons to come forward with information of wrongdoing than a pure bounty system for two additional reasons: some would-be informants might be comforted knowing that the federal government will help prosecute the lawsuit they initiate, while other informants might be comforted knowing that they will have an opportunity to proceed with the action on their own if the government does not act on what the informant believes to be unique and important information. Fourth, the mixture of bounties and *qui tam* lawsuits seems to be working effectively in the [False Claims Act] context, and the foregoing discussion indicates that the same mixture could work even more effectively in the tax context.

Id. at 383–84.

existing state tax incentive programs, qui tam legislation would be a step in the right direction for the United States.

However, in response to the constitutional challenge raised in *Cuno*, some members of Congress introduced the Economic Development Act of 2005 in the U.S. House and Senate.⁴⁴² It allowed for “any State to provide to any person for economic development purposes tax incentives that otherwise would be the cause or source of discrimination against interstate commerce under the Commerce Clause of the United States Constitution, except as otherwise provided by law.”⁴⁴³ As demonstrated by this congressional response to the potential finding of unconstitutionality of a state tax credit, it appears that Congress is only interested in legislation that reduces taxes. It is unlikely that Congress will be willing to prevent a “race to the bottom” with any federal legislation. As I have written previously, unfortunately, when state taxpayers turn to Congress, the result is that no one pays taxes.⁴⁴⁴ The qui tam solution also requires that the Judiciary participate in the solution to this problem by finding the targeted state tax incentive programs unconstitutional.

B. *The Judiciary*

Given the historic reluctance of Congress to intervene in state taxation, the U.S. Supreme Court has been forced from time to time to examine issues similar to those now confronting the European Union. Thus, the U.S. Supreme Court, like the ECJ, has intervened on occasion with state tax regimes through its jurisprudence. For example, in *Bacchus Imports, Ltd. v. Dias*, the Court struck down a Hawaiian law that granted a tax exemption for certain locally produced liquors.⁴⁴⁵ The Court concluded that because the law had both “the purpose and effect of discriminating in favor of local products,” it violated the Commerce Clause.⁴⁴⁶ The Court rejected Hawaii’s argument that the law was not

442. H.R. 2471, 109th Cong. (2005); S. 1066, 109th Cong. (2005). In the 110th Congress, the Senate has reintroduced the bill. S. 914, 110th Cong. (2007). As of August 19, 2007, S. 914 had seven co-sponsors. See Martin A. Sullivan, *State Tax Incentives: Who Will Clean Up the Mess?*, 40 ST. TAX NOTES 331, Doc. No. 2006-6643 (2006) (LEXIS).

443. ABA TAX SECTION, *SALT Incentives—Will They Last in Light of Cuno?* 9 (2006). “Because the Supreme Court dismissed the constitutional challenge in *Cuno*, it is unlikely this legislation will move forward until similar credits and incentives are endangered at a point in the future.” *Id.*

444. Tracy A. Kaye, *Show Me the Money: Congressional Limitations on State Tax Sovereignty*, 35 HARV. J. ON LEGIS. 149, 166–67 (1998).

445. 468 U.S. 263, 273 (1984).

446. *Id.*

intended to burden out-of-state suppliers of alcohol but instead to benefit local business.⁴⁴⁷ In doing so, the Court concluded that such discriminatory laws constituted nothing more than economic protectionism and thus were violative of a “central tenet of the Commerce Clause.”⁴⁴⁸

Unfortunately, I do not believe that the Judiciary is the solution to this problem either because unlike the ECJ, the U.S. Supreme Court is not obligated to hear every case.⁴⁴⁹ The Supreme Court only grants certiorari in about 150 cases of the approximately 10,000 petitions filed per Term.⁴⁵⁰ The Court’s recent denials of certiorari show a lack of enthusiasm for state tax cases,⁴⁵¹ even though the Court’s review is particularly significant in a constitutional challenge to a state tax system in order to send appropriate messages to the state legislatures.⁴⁵²

Furthermore, the respondents’ brief to the Supreme Court in *Cuno* stated that the Ohio ITC was paradigmatic of a state tax provision that facially discriminated against interstate commerce by giving a direct advantage to in-state activity.⁴⁵³ The respondents stated that petitioners’ novel interpretations of the Commerce Clause did not identify a single case in which the Supreme Court had upheld a measure that provided preferential tax treatment conditioned on in-state economic activity.⁴⁵⁴ Yet, when the Supreme Court of the United States “granted certiorari to consider whether the franchise tax credit violates the Commerce Clause,”⁴⁵⁵ the Court also asked the parties “to address whether plaintiffs have standing to challenge the franchise tax credit in this litigation.”⁴⁵⁶

447. *Id.* at 276.

448. *Id.*

449. The ECJ is obligated under the Treaty to take every case that is referred to it under Article 234 of the EC Treaty.

450. The Justices’ Caseload, <http://www.supremecourt.us/about/justicecaseload.pdf> (last visited Aug. 28, 2008).

451. For recent examples see *Lanco, Inc. v. Director, Division of Taxation*, 908 A.2d 176 (N.J. 2006), *cert. denied*, 127 S. Ct. 2974 (2007) (holding that New Jersey may subject a foreign corporation to the Corporation Business Tax that lacks physical presence in the state but derives income from a licensing agreement with a local retailer) and *Tax Commissioner of West Virginia v. M.B.N.A. America Bank, N.A.*, 640 S.E.2d 226 (W. Va. 2006), *cert. denied*, 127 S. Ct. 2997 (2007) (held that West Virginia may subject a foreign corporation to business franchise and income taxes when the company has a substantial economic presence in the state in contrast with merely a physical one).

452. William J. Quirk & R. Rhett Shaver, *Does Congress Put Federalism at Risk When It Limits the States’ Power to Tax?*, 21 ST. TAX NOTES 649, 650–51 (2001) (citations omitted).

453. Respondents’ Brief at 8, *DaimlerChrysler Corp. v. Cuno*, 547 U.S. 332 (2006) (Nos. 04-1704 and 04-1724).

454. *Id.* at 9.

455. *Cuno*, 547 U.S. at 340.

456. *Id.*

The Supreme Court ultimately concluded that “state taxpayers have no standing under Article III to challenge state tax or spending decisions simply by virtue of their status as taxpayers.”⁴⁵⁷ Chief Justice John G. Roberts Jr., writing for a unanimous court, found that “[b]ecause plaintiffs have no standing to challenge that credit, the lower courts erred by considering their claims against it on the merits.”⁴⁵⁸ The Supreme Court, therefore, vacated the judgment of the Sixth Circuit in part, and remanded the cases “for dismissal of plaintiffs’ challenge to the franchise tax credit.”⁴⁵⁹

In reaching its holding, the Court also reasoned that *Flast v. Cohen*⁴⁶⁰ was inapplicable due to the fact that “[w]hatever rights plaintiffs have under the Commerce Clause, they are fundamentally unlike” those rights under the Establishment Clause.⁴⁶¹ In denying that this Commerce Clause challenge was analogous to the Establishment Clause challenge in *Flast*,⁴⁶² the Supreme Court has already rejected the most creative argument that would have allowed them to hear the *Cuno* case.

Besides the seemingly insurmountable barrier that has been erected to keep challenges of state tax incentives from being heard, it was not clear that the Supreme Court would have found the Ohio tax credit unconstitutional even if they had agreed to consider the merits of the case. In fact, some commentators were predicting a finding of constitutionality by the Supreme Court.⁴⁶³

457. *Id.* at 346.

458. *Id.* at 354.

459. *Id.*; see Jennifer Carr & Cara Griffith, *Will There Ever be an Opinion on the Constitutionality of Tax Incentives?*, 40 ST. TAX NOTES 619, 622, Doc. No. 2006-9524 (2006) (LEXIS) (citing e-mail from Peter Enrich (May 15, 2006)) (lamenting that this conclusion seems fundamentally unfair since defendants forced the plaintiffs into federal court and then successfully claimed plaintiffs had no right to be there); Biggins, *supra* note 309, at 11 (stating that “the U.S. Supreme Court never did reach the merits of the case—i.e., whether states can use tax incentives to attract or retain jobs and investment—leaving the market unrequited in its desire for guidance and predictability”).

460. 392 U.S. 83 (1968). *Flast* requires a taxpayer to establish “a logical link between [taxpayer] status and the type of legislative enactment attacked” and “a nexus between [taxpayer] status and the precise nature of the constitutional infringement alleged” for standing to sue as a taxpayer. *Id.* at 102.

461. *Cuno*, 547 U.S. at 347.

462. *Id.* at 349.

463. See, e.g., Marcia Coyle, *High Court to Hear Challenge to Company Tax Breaks*, NAT’L L. J., Feb. 10, 2006, available at <http://www.law.com/jsp/ihc/PubArticleIHC.jsp?id=1139479513325> (explaining Walter Hellerstein’s prediction that Ohio would prevail in the United States Supreme Court); see also Robert J. Firestone, *State Investment Tax Credits Do Not Violate the Dormant Commerce Clause*, 36 ST. TAX NOTES 189, 198, Doc. No. 2005-5621 (2005) (LEXIS) (“[The Supreme Court] should reverse the Sixth Circuit under its dormant Commerce Clause precedent, which holds that a tax violates the dormant Commerce Clause only when it has the effect of a tariff.”).

C. “Soft Law”

Because of the difficulty of reaching unanimous agreement on EU tax legislation, the use of non-legislative approaches, “soft law,” has become accepted in the European Union.⁴⁶⁴ The European Union’s Code of Conduct for Business Taxation is the first example of “soft law” in the area of corporate taxation.⁴⁶⁵ This effort was successful in that the Code provided a system to tackle the issue of harmful tax competition and the criteria in the Code made evaluation of specific tax regimes possible. The method of peer review performed by the Primarolo Group was an innovation for tax policy.⁴⁶⁶ There is evidence of actual effects on Member States’ tax policies.⁴⁶⁷ “It would be politically difficult now to propose the same type of beggar-thy-neighbour regimes which were so popular up until the mid-1990s.”⁴⁶⁸

As the Multistate Tax Commission has been somewhat successful in its promotion of tax uniformity,⁴⁶⁹ perhaps the promulgation of a State Code of Conduct analogous to the European Union’s Code of Conduct would be an appropriate and worthwhile project for the MTC. The states have shown some willingness to cooperate when their revenue base is at stake as demonstrated by the Streamlined Sales Tax Project (SSTP).⁴⁷⁰

In 1992, the Supreme Court ruled that an out-of-state vendor is not obligated to “collect sales taxes for states in which they (the vendors) do not have nexus.”⁴⁷¹ With the growth of Internet commerce, states became fearful that the Court’s ruling would lead to substantial sales tax revenue loss, leading them to support the SSTP in its drafting of the Streamlined Sales and Use Tax Agreement (“Agreement”).⁴⁷² Although

464. *Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee: Tax Policy in the European Union—Priorities for the Years Ahead*, at 22–23, COM (2001) 260 final (May 23, 2001); see Rädler, *supra* note 223, at 423.

465. Claudio M. Radaelli, *The Code of Conduct Against Harmful Tax Competition: Open Method of Coordination in Disguise?*, 81 PUB. ADMIN. 513, 521 (2003).

466. *Id.* at 526.

467. “[R]ecent changes in The Netherlands’ intermediate royalty and interest companies, advance pricing agreements and advance ruling practices have been linked to the intention of the Dutch government to comply with the criteria listed by the code.” *Id.* at 527.

468. *Id.*

469. Hildreth et al., *supra* note 393, at 583.

470. Karen Setze, *Federal Action Necessary for State Tax Uniformity, Say National Tax Association Speakers*, 36 ST. TAX NOTES 630, Doc. No. 2005-11376 (May 25, 2005) (LEXIS).

471. Steven Maguire, CONGRESSIONAL RESEARCH SERVICE REPORT FOR CONGRESS, *The Streamlined Sales and Use Tax Agreement: A Brief Description*, 2 (2006).

472. *Id.* The SSTP “was created in 2000 by 43 states and the District of Columbia.” *Id.* As of January 1, 2008, seventeen states are in compliance with the Streamlined Sales and Use Tax Agreement through their laws, rules, regulations and policies, with five more states scheduled to be

not a perfect solution,⁴⁷³ it will reduce tax compliance costs and simplify sales and use tax administration among the member states.⁴⁷⁴

The central focus of the SSTP and its Agreement was to simplify the current sales and use tax systems, relying on an optional “agreement among the states to collect and remit sales tax to the taxing state.”⁴⁷⁵ The Agreement “establishes uniform definitions for taxable goods and services and requires that a participating state and local government have only one statewide tax rate for each type of product.”⁴⁷⁶ On October 1, 2005, the Agreement became effective when at least 11 states with more than “20% of the combined population of the 45 states with state sales taxes were deemed in ‘substantial compliance’ with the SSUTA.”⁴⁷⁷ Afterwards, the SSTP dissolved and was replaced with the State and Local Advisory Council.⁴⁷⁸

I propose the formation of a group under the auspices of the MTC to promulgate a State Code of Conduct for Business Taxation analogous to the European Union’s Code of Conduct.⁴⁷⁹ This State Code of Conduct would require abstention from targeted tax incentives. At this point in time, I think it would be impractical to advocate the prohibition of all subsidies given the state autonomy issues. However, a prohibition on

in compliance in the following years. Eric Parker, *Streamlined Governing Board Adds Three More States To Its Ranks*, 46 ST. TAX NOTES 7, Doc. No. 2007-21457 (2007) (LEXIS); see <http://www.streamlinedsalestax.org/govbrdstates.htm> (providing a list of member states).

473. See Brian Galle, *Designing Interstate Institutions: The Example of the Streamlined Sales and Use Tax Agreement (“SSUTA”)*, 40 U.C. DAVIS L. REV. 1381, 1401 (2007) (although the SSTP strives to create uniformity among the tax systems of its members, its goals may be hindered by the same influences that led state legislators to draft diverse sales tax rules because of the separate adoption, enforcement, and interpretation of the Agreement by each member state). Thus, a standard model may transform into a diversified set of rules given the actions of state legislators, agencies, and courts. *Id.* at 1401–11.

474. John A. Swain, *State Sales and Use Tax Jurisdiction: An Economic Nexus Standard for the Twenty-First Century*, 38 GA. L. REV. 343, 371–73 (2003).

475. Eric A. Ess, Comment, *Internet Taxation without Physical Representation?: States Seek Solution to Stop E-Commerce Sales Tax Shortfall*, 50 ST. LOUIS U. L. J. 893, 907 (2006); see <http://www.streamlinedsalestax.org/oprules.html> (last visited Aug. 26, 2008) (stating the project’s mission as the following: “The Streamlined Sales Tax Project will develop measures to design, test and implement a sales and use tax system that radically simplifies sales and use taxes.”).

476. Steven Maguire & Nonna A. Noto, CONGRESSIONAL RESEARCH SERVICE REPORT FOR CONGRESS, *Internet Taxation: Issues and Legislation in the 109th Congress*, June 29, 2006, at 10, available at <http://openncrs.cdt.org/document/RL33261>.

477. *Id.* at n.26.

478. *Id.* (citing Jeffery A. Friedman & Charles Kearns, *Federal Streamlined Sales Tax Legislation Introduced in the Senate*, 39 ST. TAX NOTES 131 (2006)). It has been noted that “large national chains, such as Wal-Mart and J.C. Penney, already pledged their support for the project.” Pamela Swidler, *The Beginning of the End to a Tax-Free Internet: Developing an E-Commerce Clause*, 28 CARDOZO L. REV. 541, 564 (2006).

479. See Sullivan, *supra* note 200, at 421 (making a similar proposal based on the European Union as a model).

targeted tax incentives will still accomplish the goal of transparency and encourage states to compete on the basis of tax rates.

I believe that this proposal will indirectly reduce the size of direct subsidies. Take the example of the subsidy package offered ThyssenKrupp AG by Alabama.⁴⁸⁰ The \$461 million in direct subsidies included land acquisition, site preparation, worker training, and road improvements.⁴⁸¹ Perhaps the voters could swallow that package. But if the German company was also offered an additional cash grant of \$350 million in lieu of the tax subsidy, I believe that there would have been a greater outcry from the Alabamans. Actually, the check would have to be in excess of \$350 million as the deal included a promise that the company will not have to pay any state corporate income tax for the next thirty years unless its tax liability exceeds \$185 million in any year.⁴⁸²

It will be harder for states to generate this large of a direct subsidy package given the procedural constraints that exist on appropriations. Relief from sales, property, income, and utility taxes by the state and local governments usually bypasses the budgetary process in most states. For example, in Connecticut, the amount spent through tax expenditures exceeds the amount spent in any other budgetary category.⁴⁸³ Nevertheless, the state's tax expenditure budget is not integrated into the budgetary process.⁴⁸⁴

“Although tax exemptions and subsidies serve similar ends, they differ in important and relevant respects.”⁴⁸⁵ The Supreme Court is right when it comes to the different perceptions and procedural rules that pertain to direct expenditures versus tax expenditures.⁴⁸⁶ Explicit subsidies are easier to monitor than tax expenditures.⁴⁸⁷ Although approximately half of the states enact tax expenditure budgets,⁴⁸⁸ few states mandate the use of these reports in their annual budget processes.⁴⁸⁹

480. Hamilton, *supra* note 208.

481. *Id.*

482. *Id.*

483. Richard D. Pomp, *Ruminations on Reforming Aspects of Connecticut's Tax Structure*, 41 ST. TAX NOTES 647, Doc. No. 2006-15981 (Aug. 22, 2006) (LEXIS).

484. *Id.*

485. *Camps Newfound/Owatonna, Inc. v. Harrison*, 520 U.S. 564, 589 (1997).

486. See generally Edward A. Zelinsky, *Are Tax "Benefits" Constitutionally Equivalent to Direct Expenditures*, 112 HARV. L. REV. 379 (1998).

487. Mark P. Gergen, *The Selfish State and the Market*, 66 TEX. L. REV. 1097, 1111-12 (1988).

488. Pomp, *supra* note 483.

489. Frank Shafroth, *The Strange State of Tax Expenditures*, 32 ST. TAX NOTES 957, Doc. No. 2004-11991 (June 8, 2004) (LEXIS). New Jersey has enacted a law that requires corporations receiving subsidies to report on jobs created, retained, or lost, average annual pay rates, and the

VI. CONCLUSION

The provision of subsidies is firmly entrenched in the economic culture of our states. Thus, outright prohibition of such subsidies is unrealistic. Also as explained, even the European Union has not completely foregone all such state aid. The goal of my proposal is to make the provision of such subsidies more transparent by taking away the one aid instrument—the state tax system—that is the most difficult for the public to understand and is the most easily hidden from scrutiny. The states should be encouraged to compete on the basis of tax rates, infrastructure, etc.

The SSTP demonstrates that the states have the capability to solve this problem themselves. The step of agreeing to a State Code of Conduct for Business Taxes that would require them to abstain from targeted tax incentives will force states that still bid for companies to use direct subsidies. These subsidies are more readily understood by the average citizen, who will be able to demand restraint from their public officials if they do not perceive sufficient benefits as arising from such spending. In the alternative, a *qui tam* statute modeled after the successful False Claims Act could help avoid the standing problem in federal courts for taxpayer challenges after *Cuno*. Although these proposals might not prevent all corporate seduction, they will serve to increase public scrutiny of tax incentives.

number of employees receiving health benefits. John Buhl, *New Jersey Enacts Tax Subsidy Accountability*, 46 ST. TAX NOTES 526, Doc. No. 2007-25113 (Nov. 12, 2007) (LEXIS). A Good Jobs First research director described the law as a major advance for corporate tax subsidy accountability. *Id.* Rhode Island enacted a similar law requiring disclosure of certain state tax credits in 2008. Press Release, Rhode Island Government, First Annual Tax Credit Disclosure Report (Sept. 11, 2008), available at <http://www.ri.gov/press/view.php?id=7115>. The law “calls for greater disclosure and accountability regarding tax breaks that the state makes available to businesses.” Neil Downing, *Tax Deals Saved Companies \$54.1 Million*, PROVIDENCE JOURNAL, Sept. 11, 2008, at 1.