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Section of Real Property, Probate and Trust Law**

**Hot Topics Relating to Saving Taxes and Getting Tax Relief
and Governmental Incentives**

This is a brief summary of the *Cuno v. DaimlerChrysler, Inc.*, 386 F.3d 738 (6th Cir. 2004) case and the *Kelo v. City of New London*, 843 A.2d 500 (Conn. 2004) case, together with a discussion of articles about these cases.

I. *Cuno v. DaimlerChrysler, Inc.*

A. Case Summary

In *Cuno*, DaimlerChrysler entered into an agreement with the City of Toledo to construct a new vehicle assembly plant near an existing facility in exchange for an investment tax credit of 13.5% against the state corporate franchise tax for certain qualified investments and a ten-year, 100% personal property tax exemption. The total benefit to DaimlerChrysler would have been approximately \$280 million. The plaintiffs in *Cuno* claimed that the investment tax credit violated the Commerce Clause of the US Constitution because it discriminated against interstate commerce. The Sixth Circuit agreed.

DaimlerChrysler defended by arguing that the tax credit did not penalize out-of-state economic activity. Rather, any corporation paying Ohio's corporate franchise tax would reduce its existing tax liability by locating new equipment in the state, but a similar corporation that chose to add new equipment to an out-of-state facility would simply keep paying the same amount it had previously been paying with respect to Ohio's corporate franchise tax. The tax credit in question did not function like a tariff and did not rely on the taxpayer's in-state and out-of-state activities to determine its applicable tax rate, so they were not discriminatory in the defendant's view. Furthermore, the tax credit functioned more like subsidies, which typically have not been held to violate the Commerce Clause.

The Sixth Circuit, however, was not persuaded. Based on the plaintiff's arguments and on the Court's own interpretation of prior Supreme Court cases regarding dormant Commerce Clause issues, the Court found that the defendant's arguments relied on a distinction between laws that benefit in-state activity and laws that burden out-of-state activity --- a distinction that is not supported by Supreme Court precedent in *Bacchus Imports, Ltd. v. Dias*, 468 US 263, 273 (1984) (holding that the effect of a tax benefit and a tax burden are the same and that constitutionality should not depend on whether one focuses on the benefited or burdened party). Furthermore, the Court found the plaintiffs arguments persuasive and supported by other Supreme Court precedent.

Specifically, the plaintiffs argued that the investment tax credit encouraged the development of local business through use of Ohio's taxing powers, encouraging in-state investment and development at the expense of investment and development in other states. Furthermore, the tax credit could not properly be analogized to an inoffensive subsidy, according to the Sixth Circuit, because the state's regulation of interstate commerce exercised through its power to tax is not in question in cases of direct subsidies.

B. Discussion in Print

Cuno has generated some public discussion and some have predicted that it will be brought before the US Supreme Court. As noted in *The Business Journal*, the *Cuno* decision could stop the work of economic developers who have recently become quite active again and have been using tax credit incentives to promote economic development in targeted regions. See Matt Harrington, *State's Dell Deal Similar to Ohio Case*, THE BUSINESS JOURNAL OF THE GREATER TRIAD AREA, Jan. 10, 2005, available at <http://www.bizjournals.com/triad/stories/2005/01/10/story5.html>; see also *Federal Court of Appeals Ruling May Hurt Tax Competition, State Tax Reform*, FISCAL FACTS (Tax Foundation, Washington, D.C.), Sept. 20, 2004, at 2-3.

Some have focused on the negative aspects of this decision, including the fact that other tax credits in Ohio, Kentucky, and Michigan, in addition to the investment tax credit, are in jeopardy after *Cuno* as well. It has also been noted that the Sixth Circuit mentioned but never revisited the fact that even a discriminatory tax would be permissible if there were no other reasonable, less drastic means of attaining the desired result. See *U.S. 6th Circuit Declares Manufacturing Credit Invalid*, MANUFACTURING & LOGISTICS CLIENT BULLETIN (Bricker & Eckler LLP, Columbus, OH), Sept. 2004, at 1-2. One can speculate from this silence that the court decided that there was another reasonable and less intrusive method of providing the benefit.

One such method could be the implementation of a subsidy program having the same effects as the investment tax credit. As reflected in the Sixth Circuit's opinion, subsidies, though having the same effect as a tax credit that violates the Commerce Clause, are not generally found to violate the Commerce Clause because they are not seen as an exercise of a state's power to regulate interstate commerce. Thus, Ohio may be able to create a subsidy having the same effect as the tax credit without running afoul of the Constitution or the Sixth Circuit's ruling in *Cuno*. See *Federal Court of Appeals Ruling May Hurt Tax Competition, State Tax Reform*, FISCAL FACTS (Tax Foundation, Washington, D.C.), Sept. 20, 2004, at 2-3.

On October 1, 2004, Senators Voinovich and Devine of Ohio introduced a bill in the U.S. Senate that would supercede the Sixth Circuit's decision in *Cuno*. Supporters of the bill include the National League of Cities, the US Conference of Mayors, and Ohio Governor Taft. See *Federal Legislation (S. 2881) Introduced in Response to Cuno v. DaimlerChrysler, Inc.*, LEGAL ALERT (Sutherland Asbill & Brennan LLP, Atlanta, GA), Oct. 7, 2004, at 1-2.

II. *Kelo v. City of New London*

A. Case Summary

In *Kelo*, private property owners challenged the City of New London's exercise of eminent domain to take property from the current private owners in order to convey it to Pfizer, who would develop a global research facility thereon, which was in line with an economic development plan projected to create more than 1,000 jobs, increase property tax revenues by between 100% and 200%, and revitalize the economically distressed city. The questions before the Supreme Court of Connecticut were (1) whether economic development can be properly considered a "public use" under the Fifth Amendment to the US Constitution, (2) if so, whether giving the property to private entities would truly serve such public purpose, and (3) if so, whether eminent domain was "reasonably necessary" under the Fifth Amendment to achieve such public use. The Court answered in the affirmative to all three questions.

Citing prior US Supreme Court cases, the Connecticut Supreme Court stated that a legislative body's determination that the purpose of a particular project is a public purpose is conclusive and subject to very narrow judiciary review; a court should not substitute its judgment for the legislature's as to what constitutes a public use unless the use in question lacks a reasonable foundation. And once a legislative body has found a public purpose, the government is entitled exercise eminent domain to meet that purpose. "[W]here the exercise of the eminent domain power is rationally related to a conceivable public purpose, [the US Supreme Court] has never held a compensated taking to be proscribed by the Public Use Clause." *Kelo*, 843 A.2d at 527 (quoting the US Supreme Court in *Hawaii Housing Authority v. Midkiff*, 467 US 229, 241 (1984)). Thus, relying on US Supreme Court case law, as well as precedent from various other states in which economic development has been held a public use, the Connecticut Supreme Court held that New London's condemnation of property for the advancement of its economic development plan was constitutional under the Fifth Amendment.

The Court then turned to the question of whether the subsequent delivery of the property to a private entity would serve the aforementioned public purpose and found that it would. The Court concluded that the exercise of eminent domain would not be unconstitutional so long as the benefit to the public was the primary intent of such condemnation, while the benefit to the private party was only a secondary effect. In the case at hand, the Court affirmed the lower court's holding that the Pfizer's benefit was only a secondary effect, while the benefit to the public would be the primary effect of New London's seizure of the property in question pursuant to its redevelopment plan.

Then, the Court upheld the lower court's holding that the exercise of eminent domain was "reasonably necessary" in order to achieve the public purpose set forth in the redevelopment plan. Given the legislative body's authority to determine whether such a taking is reasonably necessary and given the findings in the case below, the Court held that it could not find error in the lower court's holding that the difficulties of successfully

developing commercial properties while a few residential hold-outs remained in surrounding parcels made it reasonably necessary to seize the properties.

B. Discussion in Print

Because *Kelo* will be argued before the United States Supreme Court on February 22nd, it has received a large amount of press coverage. Most of this coverage, including articles in the *New York Times*, *USA Today*, the *National Law Journal* and *People* magazine, has focused on the plight of the individual property owners whose property New London wishes to condemn. In fact, in a panel debate on eminent domain, even the panelists who voiced their support of government action to improve blighted areas, when pressed about *Kelo* stated, “What was the Connecticut Supreme Court thinking?” *Debating Eminent Domain: A Panel of Experts from Government, Academia, and Public-Policy Advocacy Discuss the Rise of Takings in America*, NAT’L L. J., Dec. 6, 2004, at 12 (quoting David Dana).

Connecticut House Minority Leader Robert Ward has presented a bill (H.B. 5062) that would limit municipalities’ eminent domain powers. If the bill passes, cities in Connecticut will be prohibited from seizing residential buildings that are occupied by their owners and that have four or fewer units, if the property will ultimately be transferred to a private owner or owners. See Dan Levine, *Dems Confront Eminent Domain Politics*, CONN. L. TRIB., Jan. 24, 2005, at 9. Like the decision in *Cuno*, this bill would place economic developers and planners in a difficult situation and could stall several redevelopment projects.

Among the groups that have united against the Connecticut Supreme Court’s decision in *Kelo*, are some unusual bedfellows, including the NAACP, the Institute for Justice, the AARP, the Farm Bureau, and the Becket Fund for Religious Liberty. See 25 “*Friends of the Court*” *File Briefs Urging U.S. Supreme Court To End Eminent Domain Abuse*, CASES (Institute for Justice, Washington, D.C.), Dec. 9, 2004, available at http://www.ji.org/private_property/connecticut/12_9_04pr.html.

The opponents have various reasons for opposing the *Kelo* decision. Some argue that the politically and economically powerful are immune from eminent domain “abuses,” pointing to the Italian Dramatic Club, a powerful social club in Susette Kelo’s New London neighborhood which will be allowed to remain when Pfizer expands. See *Institute for Justice Files Lawsuit Challenging Eminent Domain Abuse in New London, Connecticut*, CASES (Institute for Justice, Washington, D.C.), Dec. 20, 2000, available at http://www.ji.org/private_property/connecticut/12_20_00pr.html. Most, however, focus on the “fairness” of having one’s home seized for the purpose of conveying it to another private owner. They contend that government’s use of eminent domain has gone too far.

On the other hand, one of the most persuasive arguments in favor of the *Kelo* decision is precisely the converse of the foregoing argument – that it is dangerous to place too many limits on the government’s power of eminent domain. Though

acknowledging that Susette Kelo is a sympathetic plaintiff with a sympathetic claim, Professor Penalver of Fordham Law School has succinctly stated this position:

Eminent domain is an important power that allows the state to protect large parcels of property without engaging in an expensive series of consensual market transactions. It protects the state from hold-outs seeking to capture a lion's share of the benefits the state hopes to achieve for the community as a whole. . . . An overly aggressive interpretation of the public use requirement [precluding the taking of private property from one owner to give to another] could actually have the effect of preventing the government from protecting the "little guy" in a variety of other contexts.

Eduardo Penalver, *Public Use and Private Profit*, N.Y. L. J., Oct. 29, 2004, at 2.

Daniel Mandelker, a professor at Washington University Law School, takes a balanced view of *Kelo*. He believes that the Connecticut Supreme Court acted appropriately in that case, but that abuses can occur if there is no clear redevelopment plan in place when other local governments exercise their power of eminent domain in the future. Furthermore, he notes that the *Kelo* case “will test whether condemnation through eminent domain can be used where economic redevelopment will be beneficial but the project area is not in a blighted condition.” Press Release, Washington University, *Highest Court to Clarify Government’s Role in Urban Redevelopment, Says Land Use Law Expert* (Nov. 11, 2004), available at <http://news-info.wustl.edu/tips/page/normal/4212.html>.