The Incoherence of Dormant Commerce Clause Nondiscrimination: a Rejoinder to Professor Denning

Edward A. Zelinsky
Benjamin N. Cardozo School of Law, zelinsky@yu.edu

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ESSAY

THE INCOHERENCE OF DORMANT COMMERCE CLAUSE NONDISCRIMINATION: A REJOINDER TO PROFESSOR DENNING

Edward A. Zelinsky*

INTRODUCTION

A sound intuition animates Professor Denning's defense of the doctrinal status quo under the dormant commerce clause: the courts should not lightly abandon well-established constitutional canons. I nevertheless remain unconvinced by Professor Denning's effort to justify the long-standing interpretation of the dormant commerce clause as forbidding taxes which discriminate against interstate commerce. Whatever the historical justification for this constitutional precept, its past utility, or its visceral appeal, dormant commerce clause nondiscrimination is today doctrinally incoherent in tax contexts. The problem is not one of borderlines and close cases. Rather, at its core, the notion of dormant commerce clause tax nondiscrimination currently rests on two untenable distinctions: the distinction between tax incentives and direct expenditures and the distinction between tax provisions which are deemed discriminatory and those which are not. For two reasons, neither of these distinctions is today workable or persuasive.

First, any tax incentive can be transformed into an economically and procedurally equivalent direct spending program. Consider, for example, Hawaii's tax exemption for certain lo-

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* Edward A. Zelinsky is the Morris and Annie Trachman Professor of Law of the Benjamin N. Cardozo School of Law of Yeshiva University. For comments on drafts of this article, Professor Zelinsky thanks Aaron S.J. Zelinsky of the Yale Law School Class of 2010.
cally-produced beverages, a tax exemption invalidated by the United States Supreme Court under the dormant commerce clause as discriminating against interstate commerce.\(^1\) In lieu of such tax subvention, the Hawaii legislature can instead subsidize its local industry by means of direct grants, low interest loans, public infrastructure such as roads and sewers, and governmental services such as job training. The Court has declared that dormant commerce clause nondiscrimination focuses upon the "actual effect" of challenged state tax policies.\(^2\) Unless the Court is prepared to declare that the Commerce Clause forbids equivalent non-tax forms of subvention (including routine state and local activities), Hawaii can achieve with direct spending programs the same subsidizing effect as was previously achieved by the now-forbidden tax exemption.

Second, no convincing line can be drawn between those tax provisions which are to be deemed discriminatory and those which pass dormant commerce clause muster. Besides "actual effect," the Court's other lodestar in dormant commerce clause cases has been "economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors."\(^3\) However, in this context, the notion of "economic protectionism" is overly broad: any tax reduction (or public service) benefits in-state taxpayers to the exclusion of non-residents. If, for example, a state lowers its general tax rates (or improves its public schools), the state thereby favors in-state economic interests and actors over businesses and persons located outside the state. Few, if any, would openly declare that general tax rate reductions discriminate for dormant commerce clause purposes though, like the more targeted tax deductions and credits the Court has stricken, general rate reductions benefit those within the state by lowering their tax burdens. There is no principled distinction between the "economic protectionism" inherent in such general tax reductions (and similar programs) and the protectionism implicit in the narrower tax incentives which the Court has invalidated as

discriminating under the dormant commerce clause. Both tilt the economic playing field by bestowing largesse upon in-state interests, thereby encouraging firms and residents currently in the state to remain and attracting to the state businesses and firms currently outside. There is no persuasive reason to condemn on constitutional grounds some tax reductions as discriminating against interstate commerce while sparing others.

The upshot today is that an arbitrary subset of government policies and programs, i.e., certain, ill-defined tax provisions, are declared unconstitutionally discriminatory under the dormant commerce clause while other taxes and direct spending programs are not, even though these other taxes and programs are procedurally and economically equivalent to the taxes invalidated on constitutional grounds and, in protectionist fashion, favor in-state residents and actors just like the taxes abrogated as discriminatory.4

Professor Denning himself characterizes dormant commerce clause nondiscrimination as an "ill-defined and undertheorized"5 concept. Professor Denning thereby suggests that the dormant commerce clause notion of nondiscrimination will eventually be rendered coherent with additional attention and effort.

I respectfully disagree. Many fine scholars, including Professor Denning himself, have worked energetically and skillfully to rationalize the concept of dormant commerce clause nondiscrimination.6 The failure of these efforts reflects not a lack of effort, but the intractability of the problem: any tax subsidy can be transformed into a procedurally and economically equivalent direct expenditure. There is thus no point in proscribing constitutionally tax subsidies unless the same scrutiny is given to

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4 See Edward A. Zelinsky, Davis v. Department of Revenue: The Incoherence of Dormant Commerce Clause Nondiscrimination, 44 State Tax Notes 947 (2007) [hereinafter Zelinsky, Davis].
6 See Zelinsky, Davis, supra note 4, at 944-45. See also 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, 47-76 (2002) (explaining in more detail) [hereinafter Zelinsky, Restoring Politics to the Commerce Clause].
homologous direct expenditures, including routine state and local outlays. Since most of us recoil from extending so far the dormant commerce clause doctrine of nondiscrimination, we are left with a doctrine which purports to be about "actual effect" but which arbitrarily condemns some policies as discriminating against interstate commerce, i.e., certain tax policies, while condoning others, i.e., economically and procedurally equivalent direct expenditures and tax reductions.

Moreover, the intuitively appealing admonition for states to avoid protectionism ultimately proves hollow since all state activity favors in-state residents and firms to the exclusion of nonresidents. Benefiting their residents is what states do. There is no compelling reason to characterize some policies and programs assisting in-state firms and individuals as "protectionist" discrimination against interstate commerce while deeming other activities which favor in-state persons and interests as nondiscriminatory and thus acceptable for dormant commerce clause purposes.

Abolishing the dormant commerce clause principle of nondiscrimination will not eliminate the complaints of those who believe themselves to be the victims of discriminatory taxation by the states. Rather, such abolition will shift taxpayers' complaints from the courts to Congress (which has ultimate constitutional authority over interstate commerce) and to the state legislatures (which enact the tax laws in question).

PROFESSOR DENNING'S DEFENSE OF DORMANT COMMERCE CLAUSE NONDISCRIMINATION

In response, Professor Denning mounts a four-part defense of the doctrinal status quo. He first faults my critique of dormant commerce clause nondiscrimination for its "false modesty." He further invokes the concept of framing effects to defend for dormant commerce clause purposes the distinction between tax incentives and direct expenditures. Third, Professor Denning argues that I misapply the concept of discrimination by

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7 Denning, supra note 5, at 629.
conflicting taxpayers who are not "similarly situated." Finally, Professor Denning criticizes Congress's performance supervising interstate commerce and state tax laws affecting interstate commerce. Such "congressional supervision," he concludes, occurs only "where the issue is large enough to garner the attention of Congress." When Congress does intervene, it typically does not stop "state abuses" but, rather, "facilitat[es] them." None of these four arguments, I suggest, salvages dormant commerce clause nondiscrimination in tax contexts.

Professor Denning's charge of false modesty has two components. First, Professor Denning argues that the proposal to abolish dormant commerce clause nondiscrimination in tax contexts will "inevitably" lead to the abandonment of the concept of dormant commerce clause nondiscrimination "in non-tax cases as well." Second, Professor Denning contends that abandoning the dormant commerce clause precept of nondiscrimination is tantamount to abandoning the dormant commerce clause itself since, without a notion of nondiscrimination vis-à-vis interstate commerce, the dormant commerce clause "has little reason to exist" and "little judicially-enforceable content."

As to the first of these claims, Professor Denning may well be right that, once dormant commerce clause nondiscrimination is discarded in tax contexts, it will be jettisoned in non-tax settings as well. I confess that this possibility does not fill me with dread. If, upon reflection, dormant commerce clause nondiscrimination proves as incoherent in non-tax cases as it is in tax settings, the presumption favoring long-standing constitutional principles will be overcome in those non-tax cases as well. If so, the litigants who previously challenged particular state spending and regulatory policies as discriminatory will then have the same legislative remedies as those who formerly litigated their contentions that particular state taxes discriminate against interstate commerce. Even as the courthouses close to these discrimination-claiming litigants, Congress and the state legisla-

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8 Id. at 642.
9 Id. at 651.
10 Id. at 649.
11 Id. at 631.
12 Id. at 635.
tures will remain open. In the final analysis, the Commerce Clause is Congress's to enforce.

As to the second of these assertions, I strongly disagree. There will remain much important content to the dormant commerce clause even without a test of nondiscrimination. The dormant commerce clause is today understood as imposing four requirements on state taxes which affect interstate commerce: 1

13 The classic statement of these four requirements is Complete Auto Transit, Inc. v. Brady, 430 U.S. 274, 274 (1977).

14 Such taxes must "not discriminate." 14 Such taxes must be "fairly apportioned." 15 Such taxes must be imposed on persons "with a substantial nexus with the taxing State." 16 Finally, state taxes affecting interstate commerce must be "fairly related to the services provided by the State." 17

15 Id.

16 Id.

17 Id.


apportioning the income of nonresidents on days such nonresidents telecommute from their out-of-state homes.20

These interpretive issues, the standard grist of the constitutional mill, do not belie the significance of the dormant commerce clause norms of apportionment and nexus. On the contrary, these controversies highlight the importance of these norms. Abolishing the dormant commerce clause test of nondiscrimination will leave intact the apportionment and nexus requirements under that clause. The dormant commerce clause will thus remain central to the constitutional jurisprudence of state and local taxation.

Professor Denning’s second major argument for the doctrinal status quo is that taxes and direct expenditures should be treated differently for dormant commerce clause purposes since a significant number of individuals succumb to framing effects and thus fail to appreciate the economic equivalence of tax incentives and direct outlays. To buttress this argument, Professor Denning notes that I have been among those who have documented the existence of tax-related framing effects: many individuals (even well-educated individuals) perceive tax incentives as somehow different from economically and procedurally equivalent tax incentives.21 Professor Denning’s second argument is thus a friendly but pointed effort to hoist me on my own scholarly petard: direct “subsidies are just seen (both as a matter of history and in accord with current practice) as different” from tax incentives.22 Consequently, Professor Denning reasons,

[t]o the extent that certain governmental actions (subsidies, for example) are not perceived by others as imposing a burden on out-of-state commerce or out-of-state commercial actors, it is less likely that those actions will stimulate retaliatory re-


22 Denning, supra note 5, at 638.
responses aimed at the enacting state, its products, or its citizens.\footnote{Id. at 641.}

Hence, the argument concludes, the courts must preempt retaliation between the states by superintending state tax policies under the dormant commerce clause. However, the courts need not police economically comparable direct outlays. These direct outlays are irrationally but consistently perceived by many as different from their tax incentive equivalents and are thus less politically provocative.

Professor Denning does not acknowledge the sweeping nature of this argument which sub silentio recasts the rationale for the dormant commerce clause nondiscrimination principle from substantive concern with the economic impact of state taxes to procedural regard for the states’ internal political processes. The Court has stated that dormant commerce clause nondiscrimination focuses upon the “actual effect” of state tax policies on interstate commerce.\footnote{The exception to this statement is \textit{W. Lynn Creamery, Inc. v. Healy}, 512 U.S. 186 (1994). See Zelinsky, \textit{Restoring Politics to the Commerce Clause}, supra note 6, at 40-42, 64-69.} Professor Denning would shift the focus of the nondiscrimination principle from this substantive concern with the “actual effect” of particular state taxes to the procedural likelihood of states’ “retaliatory responses” to each others’ tax policies.

This is no diffident fine-tuning of existing doctrine, but rather a fundamental reconstruction of the justification for dormant commerce clause nondiscrimination. If, as Professor Denning suggests of my analysis, false modesty is cause for concern, the red flags should be flying at this point in Professor Denning’s argument.
Moreover, what Professor Denning bemoans as retaliation others would praise as interstate competition. If state A attempts to lure an employer from state B with tax credits and exemptions, state B might well respond with its own package of incentives to retain that employer. Many economists and legal scholars view state B's response in this scenario as constituting not an undesirable riposte, but rather as embodying beneficial interstate competition.

In the alternative, suppose that state C reduces its general corporate income tax rate to improve its business climate and that adjoining state D responds by matching that decrease. Again, rather than denounce D for retaliating against C's tax rate reductions, many public finance mavens would view D as legitimately competing in the inter-jurisdictional marketplace.

One need not believe that all forms of interstate tax competition are equally benign to be skeptical of Professor Denning's concept of retaliation and to consequently doubt that the likelihood of retaliation should be the touchstone for dormant commerce clause nondiscrimination.

Finally, if "retaliatory" state tax policies are perceived as a significant problem, Congress, exercising its affirmative authority under the Commerce Clause, can legislate to address this problem. As I will discuss infra, Professor Denning and I disagree as to the comparative advantage of legislative as opposed

25 Some Founders feared that the states would resolve disputes over tax policy by calling out their respective militias. In Federalist No. 7, Hamilton argued that if the Constitution were not adopted, New York's duties on imports could lead to armed conflict with Connecticut and New Jersey. The Federalist No. 7 (Alexander Hamilton). While Hamilton was right in his time to be concerned about this possibility, few of us are today. As I know from personal experience, today Connecticut responds to New York's unfair taxation of Connecticut's residents by litigating and legislating, not by calling out the National Guard. See, e.g., Brief of Richard Blumenthal, AG of Conn. in Support of Petitioner, Zelinsky v. Tax Appeals Tribunal, 541 U.S. 1009 (2004) (No. 03-1177); The Telecommuter Tax Fairness Act of 2007, S. 785, 110th Cong. (2007); The Telecommuter Tax Fairness Act of 2007, H.R. 1360, 110th Cong. (2007).

26 See THE TIEBOUT MODEL AT FIFTY (William A. Fischel ed., 2006).

27 For my own ruminations on this subject, see Edward A. Zelinsky, Metropolitanism, Progressivism, and Race, 98 Colum. L. Rev. 665 (1998).

28 I do not. For example, I share, on tax policy grounds, the skepticism of the Cuno plaintiffs about the kind of targeted tax credits they challenged. I disagree with them that, as a matter of law, such credits are unconstitutional. Edward A. Zelinsky, Cuno: The Property Tax Issue, 4 Geo. J. of L. and Pub. Pol'y 119 (2006); Edward A. Zelinsky, Ohio Incentives Decision Revisited, 37 State Tax Notes 859 (2005).
to judicial decision making under the Commerce Clause. For now, I simply observe that Congress has ample authority to address any problem vis-à-vis retaliatory state tax policies, assuming such a problem exists.

Professor Denning's third major argument is that I misapply the concept of discrimination by conflating taxpayers who should be treated separately. Discrimination occurs, he plausibly contends, when distinctions are made among "similarly-situated parties." 29 Since taxpayers located outside any given state are beyond that state's "taxing jurisdiction," 30 there is no discrimination when the state reduces its general tax rates to benefit in-state residents and firms since out-of-state citizens are not similarly-situated to those in-state.

Under this eminently reasonable approach, every dormant commerce clause nondiscrimination tax case is wrongly decided: if in-state firms and residents are dissimilarly situated in the context of general rate reductions, they must also be dissimilarly situated when more targeted tax benefits are at issue. If so, the in-state firms benefiting from "discriminatory" tax subsidies are, by virtue of their in-state locations, situated differently from their out-of-state competitors. The tax subsidies stricken as "discriminatory" should instead pass constitutional muster since the in-state recipients of those subsidies are not situated similarly to their out-of-state competitors.

Consider, again, Hawaii's tax exemption subsidizing certain locally-produced beverages, 31 an exemption invalidated by the United States Supreme Court as discriminating against interstate commerce. In the context of general tax rate reductions, Professor Denning tells us, out-of-state manufacturers are, by virtue of their out-of-state locations, not situated similarly to Hawaii's in-state producers. Hawaii can thus adopt a broad tax reduction which benefits only in-state firms. If so, Hawaii should also be able to extend more narrow tax subsidies to particular Hawaii firms since in-state industry is not situated similarly to its out-of-state competitors. In the context of targeted

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29 Denning, supra note 5 at 642.
30 Id.
tax benefits also, non-Hawaii firms fall outside the state’s tax jurisdiction and are thus not situated similarly to the in-state businesses within that jurisdiction. The *Bacchus* Court was thus wrong to declare that the dormant commerce clause requires Hawaii’s tax laws to treat in-state firms in the same way as their dissimilarly situated out-of-state competitors.

Likewise, out-of-state goods shipped into Hawaii are, by virtue of their geographic origin, not similarly situated to products manufactured in-state. Again, the holding of *Bacchus*—Hawaii discriminates unconstitutionally when it extends tax subsidies only to locally-produced beverages—proves unpersuasive if, in the context of general rate reductions, products manufactured in-state are not situated similarly to products brought to Hawaii from out-of-state.

Consider as a second example Ohio’s sales tax credit for ethanol produced in-state, another tax subsidy invalidated by the Court as discriminating against interstate commerce for dormant commerce clause purposes. The Court’s decision is correct under Professor Denning’s test of similar situation only if Ohio must treat out-of-state ethanol manufacturers and their product as situated similarly to Ohio’s domestic producers of ethanol and their Ohio-based output. If so, are not these in-state and out-of-state producers and products also situated similarly for purposes of evaluating non-tax subsidies and general tax reductions? Suppose Ohio benefits a domestic manufacturer of ethanol by building roads and sewers to the manufacturer’s new plant or by providing job training for its Ohio workforce. If tax-based assistance limited to this Ohio manufacturer discriminates because this domestic manufacturer is similarly situated to its out-of-state competitors, the dormant commerce clause must also proscribe these other forms of assistance, given to this domestic firm but not to its similarly situated out-of-state rivals.

In short, Professor Denning’s similarly situated test does not extract us from the doctrinal morass which is dormant commerce clause tax nondiscrimination. If in-state firms can receive general tax rate reductions because such firms are dif-

ferently situated from their out-of-state competitors, such in-
state firms should also be able, by virtue of that geographical
difference, to receive the narrowly targeted tax benefits which
have been stricken by the Court as discriminatory.

Consider, finally, Professor Denning's misgivings about
Congress as the ultimate regulator of interstate commerce. Of
course, the text of the Constitution is explicit: It is the job of
Congress, not the judiciary, "[t]o regulate Commerce . . . among
the several States."\textsuperscript{33}

The Framers' decision to assign to Congress the authority
to supervise interstate commerce has a particularly contempo-
rary ring since the national legislature has far greater institu-
tional capacity to supervise a complex modern economy than do
the courts. The courts can, at best, give episodic attention to
specific cases brought to them by litigants. Because they are
limited to particular "Cases...[and] Controversies,"\textsuperscript{34} the courts
cannot engage in sustained and continuous oversight. The
courts lack specialized expertise and staff. Taxation is a matter
of balancing the interests of different constituencies and fash-
ioning compromises among competing interests and concerns.
The judiciary is poorly-suited for such political and often arbi-
trary decision making.

In all these respects, Congress is better positioned than the
courts to exercise final authority over interstate commerce in-
cluding oversight of the states' tax policies affecting such com-
merce. Congress has specialized committees and expert staff as
well as the ability to undertake sustained and ongoing superin-
tendence and study. Taxation is an inherently political topic.
Political decision making is best confided to the political branch.

This is not to say that Congress's performance in this, or in
any other area, is ideal. If the relevant comparison is between
the messy realities of congressional decision making and an ide-
alized notion of judicial performance, it is easy to pick a winner.
If, however, we confront the more sober choice between the leg-
islative process as it actually exists and the realities of judicial
decision making under the dormant commerce clause, Congress

\textsuperscript{33} U.S. Const. art. I, § 8.
\textsuperscript{34} U.S. Const. art. III, § 2.
emerges as the better forum for resolving disputes about "discriminatory" state tax policies.

Professor Denning indicts Congress for many of the laws it has enacted under the Commerce Clause. As to some of these laws, I share Professor Denning's policy preferences. On the other hand, I confess that I am not alarmed by Congress's approval of state laws favoring resident hunters and fishermen.

In any event, my disagreement with some of Congress's choices under the Commerce Clause does not imply that the courts are better for resolving issues of interstate commerce and state tax policy. Indeed, a fundamental paradox arises in Professor Denning's analysis: He dismisses the courts' bad decisions as "wrongheaded" applications of the dormant commerce clause's nondiscrimination principle, rather than as evidence that the principle itself is flawed. In contrast, when Congress adopts legislation with which Professor Denning disagrees, he cites such legislation, not as evidence of similar misapplication, but rather as proof that Congress is inadequate to the task of regulating interstate commerce. Why do the courts' mistakes not similarly suggest that something is fundamentally amiss with their decision making capacity?

Professor Denning also criticizes Congress for using the Commerce Clause to grant "concentrated benefits to well-organized interest groups" and to focus upon "issue[s] of interest to a very broad group of states." But this is how democracy works. Legislators respond to organized interests and to salient issues. In this respect, there is nothing special about Congress acting under the Commerce Clause.

It is, moreover, these same "well-organized interest groups" which bring the expensive and time consuming litigation claiming discrimination under the dormant commerce clause, e.g., regional stock exchanges, ethanol producers, tax-exempt

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35 Denning, supra note 5, at 648-50.
36 Id. at 648-49.
37 Id. at 643.
38 Id. at 649.
39 Id.
bond investors. If there is something untoward about the ability of these groups to obtain succor from Congress under the Commerce Clause, there should also be something unsettling about the demonstrated capacity of these groups to achieve their goals in the courts.

At the end of the day, Congress is better positioned than are the courts to provide the kind of ongoing, inherently political supervision of interstate commerce and state taxation required by an integrated modern economy.

CONCLUSION

Like a once-great champion who refuses to leave the ring, the dormant commerce clause prohibition on discriminatory taxation stumbles along well past its prime. In Professor Denning, this time-honored prohibition has an energetic and erudite defender. However, in the final analysis, the champ's best days are in the past.

Whatever the historical value of the dormant commerce clause principle of tax nondiscrimination, the principle today is doctrinally incoherent. Any tax incentive can be converted into an economically and procedurally equivalent direct spending program. Moreover, no convincing border can be drawn between those tax provisions which are to be deemed discriminatory and those which are not. Consequently, today an arbitrary subset of government policies and programs, i.e., certain ill-defined tax provisions, are declared unconstitutionally discriminatory under the dormant commerce clause while other taxes and direct spending programs pass Commerce Clause muster, even though these other taxes and programs are procedurally and economically equivalent to the taxes invalidated on constitutional grounds and, in protectionist fashion, benefit in-state residents and actors just like the taxes stricken as discriminatory. Disputes over "discriminatory" taxation are best resolved politically, in Congress and the state legislatures.

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The constitutional precept of dormant commerce clause nondiscrimination performed honorable and useful service to the nation in tax cases. It is now time for the former champ to lay down his gloves.