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Tax Tidbits

Looking Ahead: Are Michigan Tax Incentives in Jeopardy?

By Mark Hilpert, Tax and Economic Incentives Manager, Honigman Miller Schwartz and Cohn LLP

Recently, the Sixth Circuit Court of Appeals invalidated part of a \$280 million tax incentive package provided to DaimlerChrysler by the State of Ohio and the City of Toledo, finding that it violated the Commerce Clause of the U.S. Constitution. The request to reconsider was denied.

The *Cuno v. DaimlerChrysler* case has quickly gained national attention because, if allowed to stand, the constitutionality of tax incentives offered by many states, including Michigan, could be challenged. DaimlerChrysler and the State of Ohio will appeal this decision to the U.S. Supreme Court and the issue will not be resolved for quite some time. However, it is worth considering what options might be available to Michigan's policy makers, if the case is ultimately upheld.

Investment Tax Credit

The *Cuno* court found the investment tax credit within Ohio's Franchise tax violated the Commerce Clause because the credit encouraged economic activity in Ohio by allowing a franchise tax reduction for those who expand in Ohio, but not elsewhere. Hence, a taxpayer that owes tax in both Ohio and Michigan, for example, could reduce its Ohio tax if it expanded in Ohio but not if it expanded in Michigan. The court viewed the result as discriminatory.

As a modified value-added tax, Michigan's Single Business Tax (SBT) can be distinguished from Ohio's Franchise tax, but its investment tax credit works in a similar way. Given the *Cuno* court's reasoning, it seems unlikely that the SBT's investment tax credit would pass constitutional muster if the case is upheld.

However, policy makers could rely upon the decision in *Jefferson Smurfit* upholding the site-specific capital acquisition deduction to distinguish the SBT from *Cuno* and continue to offer the investment tax credit. This strategy could work until the Michigan credit is challenged directly, which may never happen.

Property Tax Abatements

The court held that the property tax exemption part of the package did not violate the Commerce Clause because it did not alter existing tax burdens based on where the investment was made. In other words, if the property was not located in Ohio, there would be no Ohio property tax owed. Thus, the exemption does not discriminate against taxpayers that place property outside of Ohio.

Generally, the court's findings mean that Michigan's property tax abatement programs

including the Industrial Facilities abatement (*PA 198*), *Obsolete Property Rehabilitation Act* and the *Personal Property Exemption (PA 328)* are not in legal jeopardy.

However, the court did suggest there are limits to the "strings" a taxing entity may attach to such an abatement before it does become discriminatory. As such, requirements involving a minimum level of investment or employment, included in typical tax abatement agreements may become suspect.

MEGA/Brownfield Credits/Renaissance Zones

The SBT credits offered under the MEGA program as well as the Brownfield program could be affected by *Cuno* because both credits reduce SBT liability for businesses expanding or investing in Michigan, but not elsewhere. Businesses already subject to the SBT will only benefit from the credits if they expand in Michigan, not outside the state.

Due to the fact that the Renaissance zone SBT credit effectively exempts the business activity within the zone (and does not reduce the tax the business paid prior to locating in the zone), it may be viewed differently. Generally, SBT liability would be equal for a taxpayer whether it expanded in a Renaissance zone or located out of state. Hence, it operates more like an exemption than a credit, which is a distinction the *Cuno* Court found to be important when finding the property tax exemption did not discriminate against interstate commerce.

Grants

The *Cuno* court makes a distinction between tax credits and a direct subsidy, and stated that the courts have noted direct subsidies do not "ordinarily run afoul of (the Commerce Clause) because they are not generally connected with the State's regulation of interstate commerce." Presumably, states could bypass the Commerce Clause problem brought to light by the *Cuno* decision by simply replacing certain offending tax credits with direct investment subsidies.

In Michigan, such a grant program would have to be consistent with the constitutional requirements prohibiting the state from lending its credit (Art. 9, Sec. 18) and the requirement that a two-thirds majority of the legislature must approve the appropriation of public money for private purposes (Art. 9, Sec. 30). Michigan courts have found the state and its political subdivisions may not give anything away without adequate consideration. It is debatable whether long-term, future contributions to the tax base and economy would be viewed as adequate consideration. In addition, there are some practical and perhaps political challenges associated with a program allowing the state to write checks to corporations in exchange for locating in the state.

In summary, if the Supreme Court upholds the *Cuno* decision, it will likely mean Michigan will have to either defy the Sixth Circuit ruling based on *Smurfit* or modify a number of its SBT tax credit programs, perhaps making them work more like exemptions for the business activity being induced. To the extent that exemptions do not provide a large enough incentive, there is the possible alternative of direct state subsidies.