ARTICLE

REMOVING BARRIERS TO STATE TAX INCENTIVE REFORM

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INTRODUCTION

Over the past few years, a Trump-era federal tax incentive—known as Opportunity Zones—has drawn extensive criticism from academics, journalists, and anti-poverty advocates. When the law was introduced in 2017, it had bipartisan support in Congress and was touted by the Trump Administration as a tool to fight poverty and revitalize distressed communities. Early research on the law suggests that it is unlikely to deliver on these goals, however, leading many experts to call for its reform. Yet, state and local governments routinely use tax incentives similar to the federal Opportunity Zones law as part of their community economic development strategies. Like Opportunity Zones, these so-called “place-based tax incentives” are used to promote development in economically distressed communities.

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1 See I.R.C. §§ 1400Z-1 to -2. For a journalistic account of how the Opportunity Zones concept became law, and the controversy that has followed, see generally DAVID WESSEL, ONLY THE RICH CAN PLAY (2021).
2 See WESSEL, supra note 1, at 89-92.
4 See, e.g., Michelle D. Layser, The Pro-Gentrification Origins of Place-Based Investment Tax Incentives and a Path Toward Community Oriented Reform, 2019 WIS. L. REV. 745, 780 [hereinafter Layser, Pro-Gentrification Origins] (noting that, by the early 1990s, thirty-eight states and the District of Columbia had adopted enterprise zone legislation).
places. And like the federal law, these state tax incentives could benefit from reform. However, state-level place-based tax incentive reforms face significant constitutional barriers that are absent at the federal level.

This Article surveys each state’s laws with respect to three common categories of state place-based tax incentives: enterprise zone laws, opportunity zone laws, and New Markets Tax Credits. In addition, this Article reviews the empirical literature about their outcomes. It demonstrates that the potential for these laws to benefit residents of distressed communities could be improved by restricting the availability of tax preferences to activities that directly benefit residents of distressed regions within the state, such as by requiring business taxpayers to hire or serve residents of the targeted areas. However, for reasons to be explained, such reforms would constitute unconstitutional discrimination against interstate commerce under the Dormant Commerce Clause—a consequence of decades of Supreme Court doctrine that has developed as a constraint to state tax competition. Tax competition refers to states’ attempts to use their tax law “to lure corporations into a state,” to convince them to stay, and to encourage them to expand through new investment in plants, equipment, or workforce.

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5 See Michelle D. Layser, How Place-Based Tax Incentives Can Reduce Geographic Inequality, 74 TAX L. REV. 1, 4 (2020) [hereinafter Layser, Geographic Inequality] (defining place-based tax incentives as “tax incentives used to drive investment to low-income areas”); Callin Slattery & Owen Zidar, Evaluating State and Local Business Incentives, 34 J. ECON. PERSPS. 90, 90 (2020) [hereinafter Slattery & Zidar, Evaluating State and Local Business Incentives] (“[T]here is now growing enthusiasm among many policymakers and academics for using place-based policies to address these regional disparities.” (citations omitted)); see generally Michelle D. Layser, A Typology of Place-Based Investment Tax Incentives, 25 WASH. & LEE J. C.R. & SOC. JUST. 403 (2019) [hereinafter Layser, Typology] (providing a typology of place-based tax incentives, including state-level incentives).


7 See infra Section II.B.

8 The Commerce Clause affirmatively grants Congress the power to regulate interstate commerce. See U.S. CONST. art. I, § 8, cl. 3. However, the Supreme Court has interpreted the clause to include a “negative command, known as the dormant Commerce Clause, prohibiting certain state taxation even when Congress has failed to legislate on the subject.” Comptroller of Treasury of Md. v. Wynne, 575 U.S. 542, 549 (2015) (quoting Oklahoma Tax Comm’n v. Jefferson Lines, Inc., 514 U.S. 175, 179 (1995)).

9 See infra Part III.

The Dormant Commerce Clause generally prohibits states from using tax incentives in ways that discriminate against interstate commerce;\footnote{See \textit{Wynne}, 575 U.S. at 549-50 (“Under our precedents, the dormant Commerce Clause precludes States from . . . impos[ing] a tax which discriminates against interstate commerce either by providing a direct commercial advantage to local business, or by subjecting interstate commerce to the burden of multiple taxation.” (quotations omitted)).} but the doctrinal distinction between legitimate tax competition and discriminatory laws is fuzzy, at best.\footnote{See \textit{infra} Section III.B.} Nevertheless, an analysis of doctrine and theory yields several clear rules that have important implications for place-based tax incentive reform. Namely, place-based tax incentives unconstitutionally discriminate against interstate commerce if they reduce benefits when the taxpayer (or third party) invests out of state, or if they are conditioned on hiring or serving residents.\footnote{See \textit{infra} Section III.C.} For reasons to be explained, these prohibitions present constitutional barriers to state place-based tax incentive reform.\footnote{See \textit{infra} Section III.C.} As such, this Article argues that the most promising path to reform would be through Congress: it should enact federal legislation to override current Dormant Commerce Clause doctrine and expressly authorize the proposed state-level statutory reforms.

This Article makes several contributions to legal scholarship, namely in the areas of tax, constitutional, and urban law. First, it contributes to tax and constitutional law literatures by connecting emerging theories about place-based tax incentives to established doctrinal and scholarly theories regarding the constitutionality of economic development incentives. In doing so, it reveals how existing constitutional law frameworks unintentionally inhibit the development of more equitable tax laws. Second, it furthers urban law scholarship by explaining how tax-specific constitutional frameworks constrain the design of state tax incentives in ways that hinder their capacity to serve as effective community economic development policy tools. In fact, a key insight of this Article is that the success of some of the most commonly used community economic development strategies depends upon changing legal frameworks to accommodate tax incentives that would be unconstitutional under current law.

The analysis proceeds as follows. Part I begins by analyzing the political economy of community economic development and place-based tax incentives. It argues that, within the political economy of community economic development, tax incentives that promote investment in distressed geographies have the potential to become an effective tool to fight poverty at the state and local level. Specifically, it sets forth a vision for so-called “community-oriented” tax incentives that aim to improve places for the
benefit of low-income residents. Next, Part II analyzes the design and empirical outcomes of common categories of state place-based tax incentives and explains how they can be reformed to promote activities that benefit low-income residents of targeted communities. It demonstrates that current place-based tax incentives often fail to benefit residents of low-income communities. It argues that their outcomes could be improved by restricting their availability to activities that directly benefit low-income residents of distressed regions within the state, such as by requiring business taxpayers to hire or serve residents of the targeted areas.

The rest of the Article explains why current Dormant Commerce Clause doctrine presents a barrier to community-oriented reform and shows how these barriers can be overcome through federal legislation. Part III shows that constitutional law applicable to state place-based tax incentives is both uncertain and likely to change in ways that further limit their use. Yet, despite that uncertainty, several clear rules can be identified—and those rules present direct barriers to reform. Subsequently, Part IV considers how states might overcome these constitutional barriers. It contends that the most promising path to reform would be for Congress to override existing Dormant Commerce Clause doctrine in the narrow context of place-based tax incentives. And Congress should do so quickly, as several newly enacted state place-based tax incentives appear ripe for constitutional challenge. Multiple states have modified their state opportunity zone laws in ways that are probably unconstitutional. Given the general controversy surrounding opportunity zones laws, it is likely that some of these new laws will be challenged in the courts. When that happens, the courts will probably strike them down, and they may do so in a way that casts doubt on many place-based tax incentives—and especially those that are most likely to help low-income communities.

I. FROM ECONOMIC GROWTH TO COMMUNITY-ORIENTED GOALS

Community economic development is a strategy that includes “a wide range of economic activities and programs for developing low-income communities such as affordable housing and small business development” in order to address localized poverty.15 The goals of community economic development include “community building and the improvement of community life beyond the purely economic,” and the strategy aims to “reconstruct” local markets “as a way of reconstituting social relations and

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building political strength.”16 In other words, these strategies seek to promote two goals: economic growth and social benefits for low-income communities. Place-based tax incentives, which are used to promote investment in low-income areas, are a common community economic development tool.17

“The stated goal of most state and local business incentives,” including place-based tax incentives, “is to stimulate local economic activity, create jobs, and boost wages.”18 Though both job creation and wage increases have the potential to benefit low-income communities, their actual impact on communities depends on who fills new jobs or receives increased wages. For reasons to be explained in Part II, low-income residents of targeted communities often do not receive the benefit from job creation or increased wages. Yet, when the goals are framed in terms of growth metrics like job creation and wage increases, the programs’ success may be evaluated without reference to downstream social welfare outcomes.

The myopic focus on economic growth and growth metrics, as opposed to social welfare metrics like reduced poverty or unemployment within the targeted community, reflects a political choice to prioritize economic growth over social welfare goals.19 However, progressive reformers may have a window of opportunity—given recent progressive movements and the current composition of the federal government20—to shift political attention toward social welfare goals. Some recent social welfare proposals, such as

16 Id.
17 See Layser, Pro-Gentrification Origins, supra note 4, at 757-59 (explaining that place-based tax incentives typically receive bipartisan support).
18 Slattery & Zidar, Evaluating State and Local Business Incentives, supra note 5, at 92. Other researchers have described the goals of economic development incentives as creating new jobs, increasing “aggregate levels of income or employment,” and increasing property values. 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, 158 (2006) [hereinafter Stark & Wilson, Effects of State Tax Incentives]; see also Edward W. De Barbieri, Lawmakers as Job Buyers, 88 FORDHAM L. REV. 15, 18-19 (2019) [hereinafter De Barbieri, Lawmakers as Job Buyers].
19 See PAUL KANTOR, THE DEPENDENT CITY VISITED: THE POLITICAL ECONOMY OF URBAN DEVELOPMENT AND SOCIAL POLICY 67-68 (1995) (“Neglecting social assistance in hopes of better promoting the local economy is a political choice.”).
20 See, e.g., Donatella della Porta, Progressive Social Movements, Democracy and the Pandemic, in PANDEMICS, POLITICS, AND SOCIETY: CRITICAL PERSPECTIVES ON THE COVID-19 CRISIS 209, 217 (Gerard Delanty ed., 2021) [hereinafter della Porta, Progressive Social Movements, Democracy and the Pandemic] (“Progressive social movements have focused on social injustice, mobilizing in moral shock against the huge disruption the pandemic has caused in the living conditions of the poorest sections of the population.”). Donatella della Porta argues that emergencies like the Covid-19 Pandemic “present particular challenges—and also opportunities—for contentious politics, their development being linked in part to the nature of the emergency itself and also in part to the political and social context, as well as to the relational dynamics of these intense times.” Id. at 209.
universal basic income (UBI),\textsuperscript{21} may be challenging to implement in a political context in which large businesses dominate. This is because, from the perspective of politically powerful businesses, cash assistance to individuals must “be low enough to keep workers looking for jobs . . . .”\textsuperscript{22} In the 1990s, the concern that cash assistance discourages work effort was a major impetus for the Earned Income Tax Credit (EITC) program, which ties welfare assistance to employment.\textsuperscript{23} More recently, during the 2021-2022 labor shortage, businesses have argued that federal unemployment supplements available during the Covid-19 Pandemic harmed the labor market.\textsuperscript{24}

However, unlike cash assistance, reformed place-based tax incentives may be a viable social welfare strategy because they work from within—rather than against—the political economy of community economic development. To understand why, it is helpful to examine the political and economic context for community economic development and social welfare policy. This Part draws on recent research about the political economy of community economic development to surface two points that are particularly relevant to place-based tax incentive reform. First, state and local governments depend on highly mobile, politically powerful businesses for economic growth.\textsuperscript{25} Anti-poverty programs that interfere with economic growth may be difficult to implement, given states’ economic dependence on private markets. Second, the modern federalist system locates the responsibility for both urban policy and social policy with state and local governments.\textsuperscript{26} However, for as long as growth is an important goal of state and local governments, their anti-poverty strategies will be constrained. For reasons to be explained, reformed place-


\textsuperscript{22} KANTOR, supra note 19, at 67.

\textsuperscript{23} See Anne L. Alstott, The Earned Income Tax Credit and the Limitations of Tax-Based Welfare Reform, 108 HARV. L. REV 533, 534 (1995) (“[T]he EITC promotes work and family responsibility among the poor, unlike traditional welfare programs, which have long attracted criticism for their putative effects on work and family structure.”); see generally MICHELLE LYON DRUMBL, TAX CREDITS FOR THE WORKING POOR: A CALL FOR REFORM (2019) (describing the history of the Earned Income Tax Credit program).

\textsuperscript{24} See Sheelah Kolhatkar, Are Government Benefits Contributing to Worker Shortages?, NEW YORKER (May 25, 2021), https://www.newyorker.com/business/currency/are-government-benefits-contributing-to-worker-shortages [https://perma.cc/Y53Y-LTFX] (“Were the worker shortages a sign that federal benefits were too generous, leading workers to choose to stay out of the workforce and collect unemployment insurance rather than finding a job? . . . A debate erupted along predictably partisan lines, with many Republicans and business groups arguing that the unemployment supplement was harming the job market.”).

\textsuperscript{25} See infra Section I.A.

\textsuperscript{26} See infra subsection I.B.1.
based tax incentives may help state and local governments shoulder their social welfare responsibilities despite such constraints.

A. Economic Growth and the Political Economy of Community Economic Development

In a recent book analyzing the political economy of community economic development and its evolution over time, political scientist Paul Kantor shows that community economic development policy has been dominated by private “markets and democratic institutions” since the earliest periods of American history.27 In the decades following the American Revolution, a political economy emerged within a new federalist system that limited the role of the federal government in social and economic development, whereby states became economically dependent on private markets.28 During that early period, economic development strategies focused on construction of canals, railroads, and other transportation projects that would improve cities’ positions with respect to trade.29

Later, during the Industrial period, local governments borrowed capital to finance massive investment in physical infrastructure like roads, bridges and sewers in the race to support large-scale industrial production.30 The dominant strategy was to “favor programs to stimulate rapid economic growth at a pace and direction driven by private sector businesses and investors.”31 Meanwhile, businesses became increasingly dependent on physical infrastructure.32 Somewhat ironically, the political power of businesses declined as they became more closely tied to specific places, and they lost the leverage which came with the threat of leaving.33

However, that trend would not last for long. Today’s multi-state and multi-national companies are no longer tied to one place, like those of earlier periods.34 Instead, parts may be produced in different locations and shipped

27 See KANTOR, supra note 19, at 17.
28 See id. at 22, 39 (explaining the “commercial character” of local government).
29 See id. at 21 (“[C]ity growth was tied to important transportation improvements . . . . Better roadways, fast river steamboats, and, most important, the construction of canals and railroads were the major transportation innovations that influenced the course of urban development.”).
30 See id. at 51 (“Large-scale industrial production could not occur unless an elaborate physical setting was in place that permitted easy and inexpensive commuter transportation . . . . [C]ity after city borrowed to invest on a massive scale in public infrastructure.”).
31 Id.
32 See id. at 55 (describing how the “lack of essential public services . . . threatened the ability of businesses” to function).
33 See id. at 56 (“[A]s business became tied to the rail heads, commercial districts, and wage-labor markets of the cities, business interests lost their most potent resource for obtaining political leverage: the threat of relocating . . . .”)
34 See id. at 91 (describing the dispersion of business operations in the postindustrial economy).
to a factory for assembly, and “production processes involving low-wage work can be located in low-wage areas rather than in labor markets having a higher standard of living.” Where the businesses of the past—which were politically powerful in their own right—were unable to walk due to their ties to place, modern businesses have “such an enormous range of locational choices for most business activities that urban economies are now highly dependent on the investment decisions of these enterprises.” As Kantor explains:

Without substantial economies stemming from geography, cities, suburbs, and even rural areas are compelled to engage in bitter competition over the capital investment decisions of large firms . . . . Today, cities are pitted against one another for jobs and dollars in a wide-ranging competition where large corporations pick and choose in an investment game where they have powerful bargaining advantages.

In short, cities and states have become increasingly dependent on businesses to sustain their local economies, and modern businesses are capable of walking away if the government does not yield to their demands.

In this modern economy, in which businesses are both politically powerful and highly mobile, state and local governments “compete to attract capital and labor by utilizing public policy in ways that assume the risks of private enterprise on a more or less continuous basis.” One way that state and local governments compete for capital is by using tax incentives to attract and retain business. Economist Charles Tiebout famously argued that firms will locate in the jurisdictions that best meet their preferences for tax rates and public services.

For example, Oracle and Hewlett Packard—two major companies in the technology sector—recently moved from Silicon Valley to Texas, partially

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35 Id. at 92.
36 Id. at 55-56.
37 Id. at 95.
38 Id.
39 Id. at 113.
40 See id. at 118 (noting how local governments use “passive strategies” such as “low taxes, particularly business-related taxes, in an effort to create a ‘positive business climate’ for industry”).
41 See Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. POL. ECON. 416, 422 (1956) (demonstrating that if residents are mobile, they will reveal their preferences by moving to communities “where the prices (taxes) of community services are set”). In other words, “taxpayers’ mobility among jurisdictions permits them to sort themselves so that each taxpayer can reside in the jurisdiction with the combination of public services and taxes he or she finds congenial.” Edward A. Zelinsky, Tax Incentives for Economic Development: Personal (and Pessimistic) Reflections, 58 CASE W. RSRV. L. REV. 1145, 1148 (2008).
motivated by lower taxes.42 In recent years, individual and business migration patterns have “generally trended from cold, high-tax northern states to warm, low-tax southern and south western states.”43 Such movement accelerated during the Covid-19 Pandemic, as the work environment shifted to operating in remote settings, and “[m]ost experts expect more people and businesses will choose to locate where they can pay lower taxes.”44

Faced with these pressures, states and localities use economic development tax incentives to create a favorable tax environment within their jurisdictions, allowing them to compete for firms, or to shift activity into otherwise distressed regions within their territory.45 In the last few years, for instance, California approved film and television tax incentives to attract and retain television studios,46 Indiana announced a long-term property tax exemptions for data centers,47 and Michigan offered targeted tax incentives to manufacturers such as General Motors.48 And when the technology company Amazon announced that it was moving its headquarters, multiple cities included tax incentive packages in their bids to attract the company to their jurisdiction.49

43 Id.
44 Id.
45 For a discussion of the economic theory behind state tax incentives and the welfare implications of state and local tax competition, see Stark & Wilson, Effects of State Tax Incentives, supra note 18, at 154-57.
47 See Will Calvert, Indiana Makes Data Center Tax Exemptions Law, DATACENTERDYNAMICS (July 1, 2019), https://www.datacenterdynamics.com/en/news/indiana-data-center-tax-exemptions-law [https://perma.cc/7M4B-P6AQ] (“The state of Indiana has signed a bill into law that provides data center operators with exemptions from sales tax in the state for up to 50 years.”).
Place-based tax incentives, which are the focus of this Article, are a subset of these economic development tax incentives used to promote investment in low-income communities. Traditionally, these incentives have had support from both conservative and progressive leaders. For progressives, place-based tax incentives may be attractive for their potential to benefit low-income communities while also delivering benefits to the politically powerful business coalitions described above. For conservatives, these incentives may be attractive for their pro-growth value and their potential to increase the tax base. As the next Section will explain, at the state level, strategies that strike this balance are necessary due to the longstanding federal policy of delegating urban and anti-poverty policy to the states. States' capacities to implement such anti-poverty policies, however, are constrained by their economic dependence on politically powerful businesses that demand economic growth.

B. Community-Oriented Goals and Place-Based Tax Incentives

1. The Problem: Anti-Poverty Programs in the Current Federalist System

The longstanding federal approach to social welfare has been to delegate responsibility for anti-poverty programs and community economic development to state and local governments. This general orientation can be seen by examining grant-based federal social welfare programs. One of the most significant federal programs to deliver cash assistance to low-income families is the Temporary Assistance for Needy Families (TANF) program. Introduced in 1996, TANF is a “work-based, time-limited” social welfare program. Under TANF, the federal government provides grants to state
governments to fund state-level programs that aid low-income families with children.\textsuperscript{55}

States use TANF funds for a variety of programs, which are not limited to safety net assistance.\textsuperscript{56} To the extent that states do use the funds to provide cash assistance, they are responsible for setting their own eligibility criteria, and “[d]espite recent increases, TANF cash benefits would still leave a family of three at or below 60 percent of the poverty line in every state.”\textsuperscript{57} In other words, TANF is insufficient to meet the full extent of the country’s anti-poverty goals.\textsuperscript{58} States are left to fill the gaps by implementing their own social welfare initiatives funded at the state level.

In the community economic development context, the federal government also grants funding to states through the Community Development Block Grant (CDBG) program, this time for the purpose of funding local development initiatives.\textsuperscript{59} Regulations issued by the Department of Housing and Urban Development require recipients of CDBG funds to prioritize low-income workers when filling new jobs, such as those created by construction projects.\textsuperscript{60} However, these so called “HUD Section 3” requirements do not require companies to hire residents of the targeted community,\textsuperscript{61} and they do not apply at all to tax-based community

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\item[56] See CTR. ON BUDGET & POL’Y PRIORITIES, POLICY BASICS: TEMPORARY ASSISTANCE FOR NEEDY FAMILIES 2 (2022), https://www.cbpp.org/sites/default/files/atoms/files/7-22-tanf2.pdf [https://perma.cc/38HE-VPTM] [hereinafter POLICY BASICS: TANF] (“Because TANF’s four purposes are so broad, states have been able to shift funds that were previously used to provide basic cash assistance toward many other uses.”).
\item[57] See POLICY BASICS: TANF, supra note 56, at 5.
\item[59] See 42 U.S.C. §§ 5301–03; see also Community Development Block Grant, HUD EXCHANGE, https://www.hudexchange.info/programs/cdbg [https://perma.cc/L9M8-TKHR] (explaining that the CDBG program supports community development activities including, among others, infrastructure, economic development projects, public facilities installation, and community centers).
\item[60] See 24 C.F.R. §§ 75.1, 75.3(a)(2), 75.9; see generally Enhancing and Streamlining the Implementation of Section 3 Requirements for Creating Economic Opportunities for Low- and Very Low-Income Persons and Eligible Businesses, 85 Fed. Reg. 61524 (Sept. 29, 2020).
\item[61] A proposed version of HUD Section 3 regulations would have prioritized residents of high-poverty “Qualified Census Tract[s],” but the geographic criteria were removed from the final regulations due to concern that “the inclusion of workers in these areas could inadvertently include individuals who are not low- or very low-income.” See Enhancing and Streamlining the
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development programs like the federal Low Income Housing Tax Credit (LIHTC). LIHTCs are tax credits to support development of affordable housing. Like the CDBG grants, LIHTCs are allocated to the states and administered by state and local housing agencies using their own criteria. But unlike the CDBG grants, they are not subject to the HUD Section 3 requirements that prioritize low-income workers when filling new jobs.

The TANF, CDBG, and LIHTC programs are relevant to understand both the context and the need for state place-based tax incentive reform. First, they reflect the federal policy of delegating responsibility for both anti-poverty and urban development initiatives to the states. Even though all three programs are federal programs, each delegates administrative responsibility to the states. This federal policy reinforces the importance of state-level reforms, which can both improve the administration of federal programs and increase the effectiveness of purely state-level programs designed to supplement federal ones. This Article is focused on the latter set of programs.

Second, federal programs are insufficient to meet states’ anti-poverty and community development needs. Recall that TANF is temporary, and when it does fund cash assistance, it leaves many recipients below the federal poverty line. States are left to fill the gaps. Community development initiatives, including those supported by state place-based tax incentives, could help fight poverty in distressed communities. However, the effectiveness of community development strategies—whether funded through grants or state and local tax incentive programs—depends on whether states design their initiatives to advance social welfare goals.

But state and local governments that are economically dependent on the business sector are poorly positioned to administer social welfare policy. Historically, state and local governments have been reluctant to implement cash assistance to the poor because it was viewed as “highly disruptive to rapid urban growth if sums paid to the poor were more than going wages and thereby pushed up wages in the private sector.” Modern state and local governments face a similar choice between protecting their “economic survival and prosperity or risk it in favor of humanitarian responsibilities.” In other words, government leaders may have to accept “slower growth, higher taxes, and forsaken private sector investment opportunities” to

62 See generally I.R.C. § 42 (West) (discussing the implementation and criteria for low-income housing tax credits).
63 See MARK P. KEIGHTLEY, CONG. RSCH. SERV., RS22389, AN INTRODUCTION TO THE LOW-INCOME HOUSING TAX CREDIT 2 (2019) (describing the allocation process for the LIHTC program).
64 KANTOR, supra note 19, at 67.
65 Id. at 196.
support social welfare programs.\textsuperscript{66} Meanwhile, state and local leaders are under tremendous pressure from constituents to create jobs and grow the local economy.\textsuperscript{67} They cannot significantly depart from these mandates without risking their political careers.\textsuperscript{68} As a result, a key challenge for progressives has been to structure social welfare programs within a political economy that is heavily tilted in favor of business coalitions.\textsuperscript{69}

With reforms, place-based tax incentives offer a partial solution to this problem, at least in the context of neighborhood poverty. As explained in greater detail below, reformed place-based tax incentives have the potential to benefit low-income residents of distressed neighborhoods, helping state and local governments shoulder their social welfare responsibilities. At the same time, an inherent feature of place-based tax incentives—even with reforms—is their capacity to provide significant benefits to businesses. While this feature may be disappointing to progressives who favor more radical, structural types of reform, it may help generate political support within the political economy of community economic development. In short, reformed place-based tax incentives would shift the focus toward social welfare goals, but they would continue to support economic growth.

That said, reforms that improve outcomes for low-income residents probably would require states to give up some economic growth. For example, researchers have noted that tax incentives are most likely to generate economic growth when they prioritize incentives to create high-skilled manufacturing and technology jobs over low-wage, low-skill jobs like retail.\textsuperscript{70} This is because these industries are most likely to produce local job multipliers,\textsuperscript{71} whereby each new job added has the potential to trigger ripple

\textsuperscript{66} Id. at 67.
\textsuperscript{67} See generally De Barbieri, Lawmakers as Job Buyers, supra note 18, at 25-33 (discussing how state and local governments use tax benefits to incentivize businesses to relocate to their districts to grow the economy, thereby acting as job buyers for their constituents).
\textsuperscript{68} See id. at 19 (“Politically, these programs shield legislators when a group of workers faces job cuts or a community lobbies to incentivize an employer to relocate from outside the state.”).
\textsuperscript{69} A consequence of these political pressures has been that current welfare programs, such as TANF and EITC, include work requirements and are not available to unemployed people. See I.R.C. § 32(c)(2)(A) (West) (defining “earned income” to mean “wages, salaries, tips, and other employee compensation, but only if such amounts are includible in gross income for the taxable year” plus other items); see also 42 U.S.C. § 607 (listing the mandatory work requirements under TANF).
\textsuperscript{70} See, e.g., De Barbieri, Lawmakers as Job Buyers, supra note 18, at 51-52 (discussing criticism that government incentives to private businesses tend to propagate low-skill jobs, and citing evidence that most state and local incentive programs focus on high-skill jobs); Timothy J. Bartik, Using Place-Based Jobs Policies to Help Distressed Communities, 34 J. ECON. PERSPS. 99, 109-10 (2020) [hereinafter Bartik, Using Place-Based Jobs Policies] (discussing the economic benefits of high-tech jobs but acknowledging that they may not match residents’ skill sets).
\textsuperscript{71} See De Barbieri, Lawmakers as Job Buyers, supra note 18, at 52 (“Using economic multipliers seems attractive. Both the Texas and Florida deal-closing funds require an economic multiplier of
effects that can help produce even more new jobs. However, low-income residents may lack the skills needed to fill newly created high-wage positions. As a result, the new jobs created in their communities may be filled with higher-income outsiders. In such cases, low-income residents may not benefit from the policy, and they may even be harmed if an influx of higher income residents leads to gentrification-induced displacement.

For reasons like these, reforming place-based tax incentives to benefit low-income communities may require lawmakers to shift away from pro-growth goals. This may be politically difficult, but it does not pose an insurmountable barrier. The traditional prioritization of economic growth has been a political choice—one that reflects the relative power of business leaders, as opposed to the unemployed and poor, to assert political power and demand change. However, the Covid-19 Pandemic has added a sense of urgency to progressive social movements that may create new openings for reform. The next subsection elaborates upon the goals of community-oriented place-based tax incentives and explains what groups may be most willing to support them.

2. A Solution: Community-Oriented Place-Based Tax Incentives

In previous works, I have referred to place-based tax incentives that aim to benefit low-income residents as “community-oriented investment tax incentives.” Similarly, Edward De Barbieri has pointed to “community-based tax incentives” as a potential place-based intervention that places the focus on community impact and “requires an articulation of the particular people

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6:1 and 5:1 respectively. The theory underlying this policy is that an economic multiplier accounts for the recycling of dollars within a community.” (citations omitted).

72 For example, “[s]uppose an incentive encourages a local McDonald’s to add jobs; this is likely to do little more than reduce sales and jobs at the local Burger King.” Bartik, Using Place-Based Jobs Policies, supra note 70, at 105. By contrast, new jobs at a manufacturing plant have the potential to increase worker demand from neighboring suppliers. Id. Export-based industries, such as manufacturing plants and technology companies, are associated with the highest job multipliers. See id. at 103, 106.

73 See Joel A. Elvery, The Impact of Enterprise Zones on Resident Employment: An Evaluation of the Enterprise Zone Programs of California and Florida, 23 ECON. DEV. Q. 44, 44-45 (2009) [hereinafter Elvery, The Impact of Enterprise Zones] (noting that place-based tax incentives target communities where people are often unskilled); Bartik, Using Place-Based Jobs Policies, supra note 70, at 110 (observing that high-tech jobs produce significant multipliers but may not address local unemployment due to skill mismatch).

74 See Jed Kolko & David Neumark, Do Some Enterprise Zones Create Jobs?, 29 J. POL’LY ANALYSIS & MGMT. 5, 13 (2010) [hereinafter Kolko & Neumark, Do Some Enterprise Zones Create Jobs?] (“[T]here is no reason to believe that enterprise zone employees are enterprise zone residents.”).

75 See KANTOR, supra note 19, at 67-68.

76 See della Porta, Progressive Social Movements, Democracy and the Pandemic, supra note 20, at 217-20 (discussing the persistent and forceful pro-worker political movements spurred on by the Covid-19 Pandemic).

77 See Layser, Pro-Gentrification Origins, supra note 4, at 798.
who will benefit from the government subsidy.” Though community-oriented goals like these have rarely driven the design of place-based tax incentives, recent progressive movements during the Covid-19 Pandemic have called for “social rights particularly to do with health, but also with social services, housing, [and] public education.” In this political climate, at least two groups may be willing to support tax incentive reforms that promote community-oriented goals. The first are lawmakers who have used community-oriented rhetoric to justify their support of place-based tax incentives in the past. The second are lawmakers and voters who support policies that benefit low-income communities, but who are also skeptical of place-based tax incentives as a policy tool.

Both conservative and progressive politicians have used anti-poverty and job-creation rhetoric to justify new place-based tax incentives. Taking politicians at their word, some researchers have designed studies to determine whether residents benefit from newly created jobs. As explained in Part II, these studies have yielded mixed results. Meanwhile, anti-poverty advocates have critiqued place-based tax incentives for failing to benefit low-income residents. Accordingly, one strategy for reformers would be highlighting the disconnect between rhetoric and reality, and pressing politicians to deliver the community benefits they promised. It seems plausible that some lawmakers are unaware that current place-based tax incentive designs often fail to benefit low-income communities. Those politicians may be especially open to reforms. Others may be willing to accept reforms as a signal to constituents with progressive ideological commitments; after all, if their constituents only cared about economic growth, there would be little need for anti-poverty rhetoric. For these reasons, some politicians may be willing to

79 See della Porta, Progressive Social Movements, Democracy and the Pandemic, supra note 20, at 217.
80 See, e.g., WESSEL, supra note 1, at 91–92 (describing how legislators and their hometown news outlets described the federal Opportunity Zones law as an anti-poverty effort, drawing skepticism from watchdog groups).
81 See generally Elvery, The Impact of Enterprise Zones supra note 73 (analyzing the effects of California and Florida enterprise zone programs on residents’ employment); Andrew Hanson, Local Employment, Poverty, and Property Value Effects of Geographically-Targeted Tax Incentives: An Instrumental Variables Approach, 39 REG'L SCI. & URB. ECON. 721 (2009) [hereinafter Hanson, Local Employment, Poverty, and Property Value Effects of Geographically-Targeted Tax Incentives] (analyzing the effect of the federal Empowerment Zone program on several metrics, including residents’ employment).
82 See infra Section II.A.
83 See, e.g., Rejane Frederick & Guillermo Ortiz, Promise and Opportunity Deferred, CTR. FOR AM. PROGRESS (Feb. 20, 2020), https://www.americanprogress.org/article/promise-opportunity-deferred [https://perma.cc/qjHK-RGJW] (“[Opportunity Zones] as currently designed fail as an equitable economic development tool and thus must be completely overhauled or fully repealed.”).
84 See Layser, Pro-Gentrification Origins, supra note 4, at 750 (“[A]lthough the political rhetoric around place-based investment tax incentives appeals to anti-poverty sentiments and helps maintain their bipartisan support, the actual laws are best understood as part of a pro-gentrification agenda.”).
support community-oriented reforms when confronted with evidence that current designs fail to benefit residents of distressed communities.

On the other hand, in light of recent controversies and critiques surrounding the federal Opportunity Zones law incentive, some political leaders have called for the law’s repeal. House Representative Rashida Tlaib (D-MI) has stated that “[o]ur communities deserve resources and programs with proven track records to thrive – the current Opportunity Zone law fails to drive real benefits to low-income communities, instead often rewarding President Trump’s donors,” and “[w]e must repeal them to stop yet another form of corporate greed from hurting our communities and tarnishing our democracy.” Given that few place-based tax incentives have a proven track record of benefiting low-income communities, reformers may need to convince skeptical politicians and their constituents that, in at least some cases, reformed versions of place-based tax incentives have the potential to advance community-oriented goals.

To do so, reformers can appeal to the theory behind place-based policies, which often seek to smooth uneven regional development by redistributing resources toward areas that are failing to thrive in the free market. Though academics have long been skeptical of place-based policies, there is “growing enthusiasm” for the approach, which may help address “widely uneven incidence of distress, the inability of natural economic forces and migration to address these disparities, and the political ramifications of growing disaffection of noncosmopolitans.” Accordingly, the continued use of such policy interventions—including place-based tax incentives—can be justified using both efficiency and equity rationales.

A commonly cited efficiency rationale in favor of place-based policies is involuntary unemployment. Involuntary unemployment refers to

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86 See GIORGIO BARBA NAVARETTI & BORISAV MARKOVIC, ORGANISATION FOR ECON. CO-OPERATION & DEV., PLACE-BASED POLICIES AND THE FOUNDATIONS OF PRODUCTIVITY IN THE PRIVATE SECTOR 3 (2021), https://sites.unimi.it/gbarbanavaretti/wp-content/uploads/2021/07/W2_S2_Giorgio_Barba_Navaretti_and_Borislav_Markovic.pdf [https://perma.cc/22BE-C67P] (“[T]he pattern of growing dispersion could be efficient in principle. Essentially, it reflects a reallocation of resources towards places and activities with the highest growth potential. Hence, place-based policies aiming at smoothing this trend and redistributing resources towards less core areas could be conflicting with federal, national . . . of productivity growth.”).

87 Slattery & Zidar, Evaluating State and Local Business Incentives, supra note 5, at 90.

88 See Bartik, Using Place-Based Jobs Policies, supra note 70, at 107 (analyzing involuntary unemployment as a type of market failure that place-based jobs policies can help correct). A second type of market failure used to justify place-based interventions points to the existence of “agglomeration economies.” See id.; see also David Neumark & Helen Simpson, Place-Based Policies, in 5 HANDBOOK OF REGIONAL AND URBAN ECONOMICS 1197, 1206 (Gilles Duranton, J. Vernon
circumstances in which individuals “are willing to work at the prevailing wage for jobs for which they are qualified” but, for whatever reason, remain unemployed. The spatial mismatch hypothesis posits that “minorities or low-skilled workers in some urban areas may face long-term disadvantage spurred by declines in employment opportunities ... coupled with housing discrimination or other constraints that restrict their mobility to locations with better employment opportunities.” Many low-income workers rely on public transportation to get to work. As a result, the Covid-19 Pandemic has the potential to exacerbate the impact of spatial mismatch, both by exposing riders to heightened health risks, and by preventing some potential riders from reaching their workplaces.

Some economists have argued that the social value of job creation is higher in distressed places experiencing involuntary unemployment than in places that are thriving. Increasing employment rates among residents in

Henderson & William C. Strange eds., 2015) [hereinafter Neumark & Simpson, Place-Based Policies] (“The efficiency-related argument for place-based policies that is most central to urban economics is that there exist agglomeration economies, through which the dense population of urban areas has an independent effect on the productivity of resources.”). Agglomeration economies refer to “cost savings that accrue to firms in a particular industry in larger cities ... or in cities that have more of that industry ... “ Timothy J. Bartik, The Market Failure Approach to Regional Economic Development Policy, 4 ECON. DEV. Q. 361, 364 (1990) [hereinafter Bartik, Market Failure].

90 See Fredrik Andersson, John C. Haltiwanger, Mark J. Kutzbach, Henry O. Pollakowski & Daniel H. Weinberg, Job Displacement and the Duration of Joblessness: The Role of Spatial Mismatch, 100 REV. ECON. & STAT. 203, 203 (2018) (“The spatial mismatch hypothesis (SMH) encompasses a wide range of research questions, all focused on whether a worker with locally inferior access to jobs is likely to have worse labor market outcomes.”).

91 Neumark & Simpson, Place-Based Policies, supra note 88, at 1190.


94 Some potential riders may be reluctant to ride due to the health risks, while others may be prevented from riding if access to public transportation declines. See Wilbur et al., supra note 92, at 1, 3 (noting the decline in ridership during the Covid-19 Pandemic “created pressing operational challenges,” which may lead to a reduction in routes even while those most dependent on public transit still have to use it).

95 See Bartik, Using Place-Based Jobs Policies, supra note 70, at 107 ("Involuntary unemployment makes it likely that benefits from jobs are higher in distressed places. The social benefits from a higher employment rate include both the private benefits to individuals who otherwise would not
distressed areas not only benefits the newly employed, but can also create positive spillover effects for their communities.\textsuperscript{96} These social benefits might include reduced crime rates, improved outcomes for children and families, and stronger local budgets.\textsuperscript{97} If the value of these external benefits is higher than the cost of the tax preferences, then place-based policies that lower unemployment rates among residents of distressed communities may be justified as efficiency-enhancing interventions.

Community-oriented incentives can also be justified on distributive grounds. For example, I have argued elsewhere that place-based policies can be used to reduce geographic inequality.\textsuperscript{98} Geographic inequality is the unique characteristics of places—“their proximity to employers, their built environment, their institutions and local infrastructure”—that “constitute spatial conditions that affect residents’ social and economic outcomes.”\textsuperscript{99} Place-based policies can reduce geographic inequality in distressed areas by increasing their proximity to employers, improving the built environment, or strengthening local infrastructure—as long as they are designed “with the intent and structure of helping disadvantaged residents.”\textsuperscript{100}

Thus, academic theory supports the use of place-based tax incentives to produce efficient and equitable outcomes by benefitting residents of distressed communities. Emphasizing this potential may help reformers garner support from progressives who have grown skeptical of place-based tax incentives. However, the long-term success of this community economic development strategy will depend on changing the design of place-based tax incentives to realize their theoretical potential.

The next Part will analyze the design of current incentives and their empirical outcomes to identify specific, state-level statutory changes that would improve their capacity to benefit low-income residents. Since, as discussed in Part III, some of these statutory changes would be unconstitutional under the current Dormant Commerce Clause doctrine, implementing these reforms will require modifications to both state and federal law. Part IV revisits the political economy barriers to such reform strategies.

\textsuperscript{96} See id.
\textsuperscript{97} Id.
\textsuperscript{98} See generally Layser, \textit{Geographic Inequality}, supra note 5, at 1 (offering “a standard for designing place-based tax incentives that can reduce geographic inequality in urban geographies”).
\textsuperscript{99} Id. at 3.
\textsuperscript{100} See Neumark & Simpson, \textit{Place-Based Policies}, supra note 88, at 1198, 1249-50 (finding that enterprise zones, although not definitively effective, are supported by some studies as having positive effects).
II. REFORMS NEEDED TO PROMOTE COMMUNITY-ORIENTED GOALS

So far, this Article has demonstrated that the politics surrounding place-based tax incentives have traditionally prioritized economic goals over community-oriented goals. These priorities are reflected in the design of place-based tax incentives. I have compiled fifty-state surveys of three common categories of such incentives: state enterprise zone, opportunity zone, and New Markets Tax Credit laws. This Part analyzes the design and outcomes of these three examples and explains how they can be reformed to promote community-oriented goals. The analysis demonstrates that current incentives often fail to benefit residents of distressed communities because they either omit safeguards to ensure benefits flow to residents of targeted communities or fail to narrowly target incentives to distressed communities within the state. However, it would be possible for states to reform their place-based tax incentives to advance community-oriented goals, assuming they can overcome certain constitutional barriers to reform.

A. Evaluating the Outcomes of Current State Place-Based Tax Incentives

1. State Enterprise Zone Laws

Enterprise zone laws—the first category of place-based incentives analyzed in this Part—have been used by states since the 1980s and specify that various forms of tax incentives and regulatory relief are available in certain low-income communities within the state.101 Though there are similarities across states’ enterprise zone programs, each is unique and the specific incentives vary widely from state to state.102 As of January of 2022, thirty states have active enterprise zone laws providing tax incentives to firms that own property or operate businesses in designated areas within the state.103 The enterprise zone statutes set forth criteria that must be considered when designating enterprise zones. In most cases, the criteria include census tract poverty rates, unemployment rates, income level, or other indicators of

102 See Enterprise Zone Survey, supra note 6 (surveying the enterprise zone laws across all fifty states).
103 Id. Of these states, the following twenty-five states are accepting new program applicants: District of Columbia (counted as a state for the purpose of this discussion), Colorado, Connecticut, Delaware, Georgia, Hawaii, Illinois, Louisiana, Maryland, Michigan, Minnesota, Nevada, New Hampshire, New Jersey, New Mexico, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, and Wisconsin. Id. In addition, five states—Alabama, Florida, Indiana, Missouri, and Utah—have enterprise zone laws but are not accepting new applicants to the program. Id.; see also infra Appendix A (providing a summary of current state enterprise zone laws).
distress.\textsuperscript{104} In the twenty states that include poverty rates among the criteria to be considered, nine specify that the poverty rate should be at least twenty or twenty-five percent.\textsuperscript{105}

The tax incentives available within the zones vary, but investment tax incentives to induce taxpayers to purchase new property in the zones, or to expand existing businesses, are common.\textsuperscript{106} Also common are incentives to invest in human capital.\textsuperscript{107} In twenty-three states, the package of tax incentives includes some form of hiring tax incentives.\textsuperscript{108} In some cases, all tax incentives available in the enterprise zones are contingent on meeting certain job creation requirements.\textsuperscript{109} For example, in Hawaii, most businesses’ eligibility for enterprise zone tax preferences is contingent on the taxpayer hiring employees at the enterprise zone establishment.\textsuperscript{110} Similarly, in Texas, businesses located in enterprise zones are only eligible for tax preferences if twenty-five percent of new permanent jobs are held by enterprise zone residents, economically disadvantaged individuals, or veterans.\textsuperscript{111}

Empirical studies of job creation within enterprise zones suggest that these hiring tax incentives probably do induce at least some firms to expand and create new employment opportunities within enterprise zones. First, several survey and interview-based studies “have shown some success with job creation in enterprise zones.”\textsuperscript{112} Though response bias could skew the results in such studies,\textsuperscript{113} other studies have demonstrated similar results using quantitative methods. For example, one study found that enterprise zone tax credits in Colorado generated more employees for both new and

\begin{footnotes}
\item[104] See Enterprise Zone Survey, supra note 6.
\item[105] Id.
\item[106] Id.
\item[107] Id.; see also infra Appendix A.
\item[108] Enterprise Zone Survey, supra note 6.
\item[109] See, e.g., D.C. CODE §§ 2-219.01-05 (2022) (providing that all tax incentives are contingent on the taxpayer’s agreement that the first opportunities for employment go to disadvantaged district residents); GA. CODE ANN., §§ 36-88-3 to -4 (2022) (providing that all tax incentives are contingent on the taxpayer creating jobs within the zone, and that, where possible, a portion of those jobs went to low or moderate income individuals); HAW. REV. STAT. § 209E-9(a)(3) (2022) (providing that all tax incentives are contingent on the taxpayer hiring employees at the enterprise zone establishment or increasing agricultural production in the region); TEX. GOV’T CODE § 2303.402 (2021) (stating that to receive any enterprise zone benefits, at least 25% or 35% of the taxpayer’s employees must be zone residents, veterans, or economically disadvantaged individuals).
\item[110] See HAW. REV. STAT. § 209E-9(a)(3) (2022). Note that agricultural businesses can alternatively qualify by increasing the gross sales of agricultural crops produced or processed. Id.; see also TEX. GOV’T CODE § 2303.402 (2021).
\item[111] See TEX. GOV’T CODE § 2303.402(a)(1) (2021). Note that businesses located outside of Texas enterprise zones may be eligible for similar incentives if thirty-five percent of new jobs are held by these groups. Id. § 2303.402(a)(2).
\item[113] See id. ("However, response bias is always a key concern with surveys and interviews.").
\end{footnotes}
existing establishments located within enterprise zones. Another study found that, in the 1990s, job growth in California enterprise zones grew three percent faster than in comparable tracts considered most similar that were not designated as enterprise zones. Others found evidence that “providing [enterprise zone] incentives tied to the number of new jobs created is the only policy variable that marginally affects the employment baseline growth rate.”

These outcomes suggest that enterprise zone incentives may be effective at generating job creation within enterprise zone boundaries.

However, there is little evidence that the newly created jobs are filled by enterprise zone residents. One team of researchers found an increase in zone employment but noted that “there is no reason to believe that enterprise zone employees are enterprise zone residents.” Professor Andrew Hanson tested the effect of enterprise zones on residents’ employment rates and concluded that, although some measures suggest that residents’ employment rates improve in zones, those findings were likely an over-estimate of the enterprise zones’ effect as other measures produced null results, evidenced by large standard errors. Similarly, Joel Elvery found “no evidence that the programs had significant effects on the employment of zone residents.” These results suggest that while enterprise zone laws may help promote the goal of economic growth within enterprise zones, current incentives are not effective at decreasing unemployment among low-income residents.

One reason for these disparate outcomes is that the hiring tax incentives rarely tie benefits to hiring zone residents. There is evidence that states that tie hiring incentives to the employees’ residency produce improved outcomes for zone residents. Under current law, two states specify that the tax incentives are only available to firms that employ enterprise zone

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114 See Stephen Billings, Do Enterprise Zones Work?: An Analysis at the Borders, 37 PUB. FIN. REV. 68, 70 (2009) (“Results find that EZ tax credits in Colorado insignificantly impact an establishment’s location decision. They do however, generate between 1.5 and 1.8 more employees for new establishments locating within an EZ and 0.0 to 0.3 more employees for existing establishments located within an EZ.”).


118 See Hanson, Local Employment, Poverty, and Property Value Effects of Geographically-Targeted Tax Incentives, supra note 81, at 728 (“The IV results suggest that the OLS specifications over-estimate the effect of the [enterprise zone] program on increasing resident employment and decreasing poverty, the effect of the program is smaller and quite uncertain as shown by the large standard errors.”).

119 Elvery, The Impact of Enterprise Zones, supra note 73, at 45.

120 See Enterprise Zone Survey, supra note 6; see also infra Appendix A.
residents: Indiana and Tennessee.\textsuperscript{121} In Indiana, the hiring tax incentives are tied to job creation for “qualified employee[s],” who must have their “principal place of residence in the enterprise zone in which the individual is employed.”\textsuperscript{122} Similarly, to qualify for tax preferences under the Tennessee law, a “qualified business in an enterprise zone shall employ at least thirty percent (30\%) of qualified zone residents meeting the requirements of new jobs created by such business.”\textsuperscript{123}

Though no empirical research exists to evaluate the outcome of the Tennessee law, a study of the Indiana program suggests that it has been effective at increasing employment rates among zone residents.\textsuperscript{124} Specifically, the study of the impact of the Indiana enterprise zone program estimated that unemployment claims among zone residents declined “by about 19 percent following designation,” corresponding to “about 1,500 fewer claims per year.”\textsuperscript{125} Moreover, the researcher found that “evidence for a permanent effect on unemployment claims [was] stronger than that for capital.”\textsuperscript{126} Another study examined the outcomes of a (now expired) enterprise zone program in Texas that provided hiring tax credits to firms that hired from “three pools of employees, one of which includes those who reside within zones.”\textsuperscript{127} That law helped increase resident employment in the zones by one to two percent per year.\textsuperscript{128} These studies suggest that reforming enterprise zone laws to tie benefits to employees’ place of residence may improve community-oriented outcomes.

It is notable, therefore, that extremely few state enterprise zone laws tie hiring tax incentives to employee residency, or otherwise include features intended to limit benefits to locals. Only eleven states include employees’ residency within the zone as one of several possible qualifying criteria, and of those, only the two states referenced above—Indiana and Tennessee—require firms to hire zone residents.\textsuperscript{129} This Section suggests that the

\footnotesize{\textsuperscript{121} See Enterprise Zone Survey, supra note 6; see also infra Appendix A.}

\footnotesize{\textsuperscript{122} IND. CODE § 6-3-3-10 (2022).}

\footnotesize{\textsuperscript{123} TENN. CODE ANN. § 13-28-208 (2022).}

\footnotesize{\textsuperscript{124} See Leslie E. Papke, Tax Policy and Urban Development: Evidence from the Indiana Enterprise Zone Program, 54 J. PUB. ECON. 37, 48 (1994).}

\footnotesize{\textsuperscript{125} Id.}

\footnotesize{\textsuperscript{126} Id.}

\footnotesize{\textsuperscript{127} Layser, Typology, supra note 5, at 441; see also TEX. GOV’T CODE § 2303.402 (2021) (providing that businesses outside of the enterprise zone are considered qualified businesses eligible for benefits if thirty-five percent of their newly created positions are held by residents of an enterprise zone, veterans, or economically disadvantaged persons).}

\footnotesize{\textsuperscript{128} See Matthew Freedman, Targeted Business Incentives and Local Labor Markets, 48 J. HUM. RES. 311, 312 (2013) (“EZ designation increases resident employment in block groups with poverty rates near 20 percent by 1–2 percent per year.”).}

\footnotesize{\textsuperscript{129} See, e.g., CONN. GEN. STAT. § 12-217e(a) (2023); FLA. STAT. § 212.096 (2022); IND. CODE § 6-3-3-10 (2022); LA. STAT. ANN. § 51:1787(A)(2) (2023); MICH. COMP. LAWS § 207.777 (2023);
capacity of enterprise zone laws (and other place-based tax incentives) to advance community-oriented goals could be improved by tying incentives to the residency of workers, contractors, customers, or people served. However, as Part III will explain, the implementation of such changes would require reformers to overcome significant constitutional barriers, as these conditions would unconstitutionally discriminate against interstate commerce under the Dormant Commerce Clause doctrine.

2. State Opportunity Zone Laws

State opportunity zone laws are a new category of state place-based tax incentives that raise many of the same issues as enterprise zone laws, as well as some unique problems. State opportunity zone laws parallel a federal law that provides capital gains tax relief to taxpayers who invest in low-income communities designated as “opportunity zones.”

Many of these states incorporated these laws into their income tax codes when the federal Opportunity Zones law was enacted with the Tax Cuts and Jobs Act at the end of 2017.

Currently, twenty-eight of the thirty-seven states with opportunity zones laws strictly conform to the federal Opportunity Zones law. In these states, taxpayers who make investments in opportunity zones not only qualify for the federal tax preference under I.R.C. §1400Z-2, but also qualify for identical state tax preferences. Normally, both corporate and individual taxpayers in these states would be subject to state capital gains taxes on asset

MO. REV. STAT. § 135.110 (2023); NEV. REV. STAT. § 274.270 (2023); OHIO REV. CODE ANN. §§ 5709.64-.65 (West 2023); R.I. GEN. LAWS ANN. § 42-64.3-6 (West 2023); TENN. CODE ANN. § 13-18-208 (2022); TEX. GOV’T CODE § 2303.402 (2021).

130 See Michelle Chaing Perry, A State-Level Response to Ineffective Federal Place-Based Investment Tax Incentives, 62 B.C. L. REV. 1969, 1973 (2021) (“The 2017 Tax Cuts and Jobs Act (TCJA), for example, includes a new provision permitting individuals to avoid paying taxes on profits from the sale of capital assets when invested in low-income areas known as ‘Opportunity Zones.’”).

131 Nearly every state income tax code incorporates the federal income tax law to some degree in a process called “tax conformity.” See Kirk J. Stark, The Federal Role in State Tax Reform, 30 VA. TAX REV. 407, 423 (2010) [hereinafter Stark, The Federal Role in State Tax Reform] (describing how states use the federal income tax base as a starting point to calculate tax liability). States take different approaches to tax conformity, but a common approach under state law is to adopt a federal definition of income (usually, adjusted gross income or taxable income) as the starting point for state-level adjustments such as deductions and exemptions. See Ruth Mason, Delegating Up: State Conformity with the Federal Tax Base, 62 DUKE L.J. 1267, 1269 (2013) [hereinafter Mason, Delegating Up]. A consequence of income tax conformity is that tax incentives structured as deductions or exemptions, which affect the federal definitions of income, are often incorporated in state tax law. See id. (“When states incorporate by reference federal income definitions, states automatically import federal tax policies into state law.”).

132 See OZ Survey, supra note 6; see also infra Appendix B.
sales. However, under the opportunity zones laws, such taxpayers may be able to defer capital gains tax by investing their capital gains in a specialized entity that owns property in an opportunity zone (a “qualified opportunity fund”). In addition, they may be eligible for capital gain exclusions if certain holding period requirements are met.

At the outset, it is worth noting that state tax conformity to federal law has both advantages and disadvantages as a matter of tax policy. The most significant advantage of tax conformity is administrative convenience for both states and taxpayers. However, these benefits come at the costs of diminished democratic control, lost state autonomy, and lack of regulatory diversity. These democratic concerns arise as state voters are not the same group as national voters, and they may have different local preferences. In the context of place-based tax incentives, conformity reduces states’ autonomy to decide the best way to implement their place-based poverty reduction policies.

State opportunity zone laws that conform to the federal law may fail to promote projects that benefit low income populations simply because the federal law includes few safeguards to ensure that subsidized investment benefits low-income communities. Early assessments of the federal Opportunity Zones law suggests that a significant proportion of opportunity zone investment has flowed to luxury real estate projects, storage facilities, and other projects that confer little direct benefit to residents of designated distressed communities.

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135 Id.

136 See Stark, The Federal Role in State Tax Reform, supra note 131, at 423 (describing the incentives for state conformity with the federal tax system). Because the federal government has already established a detailed legal framework for income taxes, conformity ensures that states do not have to spend their own resources to form a separate system. Id. In addition, the Internal Revenue Service (IRS) helps state agencies exchange taxpayer data, which can save time and reduce administrative costs. Meanwhile, from a taxpayer’s perspective, conforming federal and state regimes provide various benefits, such as simplified recordkeeping, tax return filing, and tax planning. See Amy B. Monahan, State Individual Income Tax Conformity in Practice: Evidence from the Tax Cuts and Jobs Act, 11 COLUM. J. TAX 57, 65 (2019).

137 See Mason, Delegating Up, supra note 131, at 1296 (“[F]ederal-state tax-base conformity raises democratic concerns when the preferences of state voters differ from those of national voters.”).

138 See Layser, Pro-Gentrification Origins, supra note 4, at 770 (noting that, since opportunity zones tax incentives do not include any requirement that businesses benefit local residents, “there is no reason to think that Opportunity Zones tax incentives will be any more beneficial to low-income communities”).

139 See WESSEL, supra note 1, at 229–231.
the federal Opportunity Zones tax preference is not tied to hiring, housing, or otherwise serving zone residents. For this reason and others, many critics worry that the federal law accelerates gentrification in communities to the detriment of low-income residents, since higher-value real estate is associated with attracting higher-paying tenants.\footnote{See Johnson, Repeal Opportunity Zones, supra note 3, at 625 (“Opportunity Zone investments drive out poor people by increasing rents. Opportunity Zone investments increase the value of real estate. The poor are usually renters, not landowners, and renters have no tenure and do not share in property value increases.”).} State laws that conform to the federal Opportunity Zones law may exacerbate these outcomes.

In addition, strict conformity to the federal law may undermine local democratic control. For example, strict conformity may cause states to target places that state voters would not approve; states may undermine their own legislative goals by providing tax benefits for out-of-state investments. A striking example is illustrated by the way that state opportunity zone laws define the tax-preferred zones. States that strictly conform to the federal law implicitly adopt the federal definition of tax preferred zones as “qualified opportunity zones.”\footnote{See OZ Survey, supra note 6 (listing states that strictly conform to federal law’s definition).} As a result, these states fail to limit tax benefits to in-state zones. Instead, zones can be located throughout the country, as defined under the federal statute. This feature of state opportunity zones laws is at tension with local democratic control. Simply put, it is unlikely that residents of Illinois would readily approve tax breaks earned by investing in Michigan. Yet, that is exactly what may happen under strict conformity.\footnote{Illinois is a rolling conformity state that automatically incorporates the federal definition of “adjusted gross income” when defining the state income tax base. See 35 ILL. COMP. STAT. §203(a)(1) (2022) (defining “base income” as “adjusted gross income,” with Illinois-specific modifications); 35 ILL. COMP. STAT. §203(e) (2022) (defining “adjusted gross income” with reference to federal law). The federal Opportunity Zones law excludes certain capital gain income from the federal definition of gross income. See I.R.C. §1400Z-2(a)(1). Since Illinois has not taken affirmative steps to modify its definition of “base income” to add gains excluded under the Opportunity Zones law, it has effectively conformed to the federal opportunity zones law without modification.} In other words, an Illinois taxpayer could receive an Illinois capital gains deferral for investing in an Opportunity Fund that invests in a qualified opportunity zone located in Michigan—just as it would under federal law.

Moreover, strict conformity to the federal definition of “qualified opportunity zones” may also create inefficiencies in state social welfare programs. Again, strict conformity may result in subsidies for out-of-state investment. Few state-level efficiency gains would be derived from that investment. Rather, these tax preferences would cost states revenue without returning any meaningful benefit for the state. This could also have important equity implications, particularly in states that struggle to compete with coastal agglomeration economies like New York or San Francisco. Tax
preferences awarded for out-of-state investment constitutes lost revenue that could otherwise be used to fund necessary in-state anti-poverty initiatives.

There are also other ways that strict conformity may create inefficiencies. Studies of the federal law suggest that, in many cities, federal Opportunity Zone subsidies have flowed disproportionately to eligible census tracts that exhibit signs of gentrification.\textsuperscript{143} Gentrifying areas usually have high-profit potential and thus are attractive to investors even without tax subsidies.\textsuperscript{144} Since tax laws that subsidize activities that would be performed without the subsidies are generally understood to be inefficient,\textsuperscript{145} these investment patterns suggest inefficiencies at the federal level. They also may suggest that the federal law is failing to target places that need subsidies. State tax laws that conform to the federal Opportunity Zones program by adopting the federal opportunity zone designations are likely to subsidize similar patterns of investments, failing to target places with the highest need.

This analysis suggests that state opportunity zone laws could benefit from two types of reform. First, states should redefine the scope of targeted areas to better reflect local anti-poverty goals. This may mean limiting the tax preference to in-state opportunity zones, redefining the criteria for opportunity zones designation, or both. Second, state opportunity zone reform would require states to amend their opportunity zone statutes to incorporate features that more closely tie benefits to community-oriented outcomes, such as local hiring or serving opportunity zone residents. Implementing these reforms would require states to depart from the federal model in a process called “decoupling.”\textsuperscript{146} For reasons to be explained in Part III, state efforts to decouple from the federal model would raise many of the same constitutional issues as enterprise zone reforms, as well as some issues that may be unique to the opportunity zones context.


\textsuperscript{144} See Kennedy & Wheeler, supra note 143, at 15 (acknowledging that there is a “higher investment in OZ tracts with relatively greater pre-existing economic opportunity”).

\textsuperscript{145} David M. Schizer, Limiting Tax Expenditures, 68 TAX L. REV. 275, 295 (2015) (“Although claimants should be responsive, they should not be too responsive. We should not pay for what taxpayers would do anyway. For example, subsidizing the first dollar of charity is wasteful if everyone would give this amount without a subsidy.” (citations omitted)).

\textsuperscript{146} Decoupling refers to the process by which state legislatures affirmatively amend the state tax code to avoid incorporating certain elements of federal law. See Mason, Delegating Up, supra note 131, at 1314-16.
3. State New Markets Tax Credit Laws

A third common type of state level place-based tax incentives are state New Markets Tax Credits (state NMTCs). Like state opportunity zone laws, state NMTC laws are often—but not always—modeled closely after federal law. Currently, twelve states have active state NMTC statutes that mirror the federal law to some extent, and two states are considering proposals to enact such laws. Under the federal New Markets Tax Credit law (federal NMTC), certified Community Development Entities (CDEs) are eligible to apply to the federal Community Development Financial Institution Fund (CDFI Fund) for tax credit allocations. If a CDE is awarded an allocation, it solicits investments from taxpayers who make equity contributions to the CDE (a so-called “qualified equity investment”), which the CDE uses to finance projects in qualified low-income communities. The taxpayer is then entitled to claim a tax credit equal to thirty-nine percent of the amount of the qualified equity investment, earned over a seven-year period.

Most state NMTC statutes are similar in structure, and all incorporate parts of the federal law by reference to definitions and requirements set forth under I.R.C. § 45D. For example, with one exception, state NMTCs are earned during the same seven-year period as the federal NMTC. The credits are always earned by making a qualified equity investment in a qualified CDE that has received a tax credit allocation from the applicable state agency. Many states initially define “qualified equity investment”

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147 See generally ALA. CODE §§ 41-9-216 to -217 (2021) (implementing the Alabama New Markets Development Act); ARK. CODE ANN. § 15-4-3601 (2022) (implementing the New Market Jobs Act of 2013); FLA. STAT. § 288.991 (2022) (implementing the New Markets Development Program Act); 20 ILL. COMP. STAT. 663/1 (2022) (implementing the New Markets Development Program Act); KY. REV. STAT. ANN. § 141.434 (West 2023) (implementing the New Markets Development Program tax credit); LA. STAT. ANN. § 47:6016.1 (2023) (implementing the Louisiana New Markets Jobs Act); ME. STAT. tit. 10, § 1100-Z (2022) (implementing the Maine New Markets Capital Investment Program); MISS. CODE ANN. § 57-105-1 (2023) (implementing the Qualified Equity Investment Tax Credits); NEB. REV. STAT. § 77-1101 (2022) (implementing the New Markets Job Growth Investment Act); NEV. REV. STAT. § 231A.010 (2022) (implementing the Nevada New Markets Jobs Act); OHIO REV. CODE ANN. § 5725.33 (West 2023) (implementing the New Markets Tax Credit); OR. REV. STAT. § 315.526 (2023) (implementing the Oregon Low Income Community Jobs Initiative).


149 See generally I.R.C. § 45D.

150 See id. §§ 45D(a)-(c).

151 See id. §§ 45D(b), (d).

152 See id. § 45D(a)(2) (permitting five percent for each of the first three years, and six percent for the remaining four years).

153 See NMTC Survey, supra note 6 (listing state NMTC periods); see also MISS. CODE § 57-105-1(1)(c) (indicating that Mississippi has a three-year credit period).

154 See NMTC Survey, supra note 6 (noting how credits are earned).
(QEI) with direct reference to the federal definition, or by using language that mirrors the federal definition. As under the federal law, qualified CDEs are required to use the cash received from the QEI to invest in low-income areas. This overall program structure is generally consistent with the federal program.

However, there are important ways that state NMTCs depart from the federal model—and additional ways in which they could depart, but typically do not. First, all state NMTCs target different geographies than the federal law by including provisions that tie the tax credit to in-state investment. For example, some states specify that the cash from the QEI must be used to invest in projects located in the state. Many states specify that to qualify, a CDE must have an allocation agreement with the CDFI Fund that includes a commitment to serve the state. Others specifically limit eligible census tracts to in-state tracts. These geographic limitations may encourage in-state federal NMTC investors to invest in CDEs that serve the state. Moreover, at least one state has specified that a purpose for its NMTC program is to “[a]ttract investment dollars from the New Markets Tax Credit Program of the United States Department of the Treasury.”

In addition to limiting the geographic target to in-state census tracts, states could—but usually do not—define tax-credit eligible census tracts using criteria that differ from the federal eligibility requirements. Under federal law, census tracts are eligible for NMTC investment if the poverty rate in the tract is at least twenty percent or the tract’s median family income is no more than eighty percent of the area’s median family income. In many cities, these eligibility criteria are met by a large portion of census tracts, including those that may already be gentrifying. Because the geographic

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155 See id. (showing that all states with NMTC credits have either full or partial conformity with the federal definition of QEI).

156 See id.

157 See I.R.C. § 45D (providing the details of federal tax credit under the New Markets Tax Credit program).


162 See I.R.C. § 45D(e).

163 See Layser, Geographic Inequality, supra note 5, at 48 (identifying Chicago as an example of a city with many census tracts experience that qualifies for the NMTC, and noting that nonetheless, investment in some of these tracts might not mitigate the spatial mismatch—a mismatch between the skills of immobile residents and available jobs).
target is so broad, the federal law often fails to direct NMTC investment to the most severely distressed census tracts.164  

Prior research I conducted on the federal NMTC program demonstrated that a disproportionate share of NMTC investment has taken place in census tracts that show signs of gentrification.165 Those investment patterns may reflect inefficiencies, such as inframarginal investment or a general failure to subsidize investment in places that need support.166 Disproportionate NMTC investment in gentrifying areas may also suggest the program is not as equitable as it could be if it more consistently served "severely distressed" neighborhoods.167 In fact, the program could inadvertently harm low-income communities if it accelerates gentrification and contributes to displacement.168 For these reasons, I have suggested that the federal law be amended to restrict the incentive to severely distressed census tracts that do not show signs of gentrification.169  

States could also improve their NMTC programs by making such changes, but almost none have done so. Instead, nearly every state incorporates the same tract eligibility criteria as set forth under the federal law.170 Under current law, the only state that departs from the federal requirements is Nevada. In Nevada, at least thirty percent of the QEI must be used to invest in a "severely distressed census tract[]," which is defined as a tract in which more than thirty percent of households have (1) income below the federal poverty line; (2) a median household income of less than sixty percent of the median household income in the State; or (3) a rate of unemployment that was equal to or greater than one hundred and fifty percent of the national average.171 This departure from the federal design has the potential to improve the targeting of NMTC subsidies in Nevada, and could serve as a rough model for other states. However, to date there have
been no published empirical studies analyzing the outcome of state NMTC laws, making it difficult to assess the impact of such variations.

A second way that states could depart from the federal model is by including incentives to invest in types of projects that are most likely to benefit the state. The federal NMTC statute contains few substantive restrictions on the types of projects that are eligible to receive NMTC funding. The federal law requires CDEs to use substantially all of the taxpayer’s qualified equity investment for “qualified low-income community investments,” which includes capital or equity investment in any “qualified active low-income community business” (QALICB).172 The definition of QALICB includes qualified businesses that derive at least fifty percent of their income from an eligible census tract, have a substantial portion of their property and employees located in the tract, and hold only a de minimis amount of certain disqualified types of property.173

Most states incorporate the definitions of QALICB with few, if any, modifications that are clearly intended to improve outcomes for low-income communities.174 Notable exceptions include Arkansas, Florida, Louisiana, and Nevada. Arkansas and Florida require QALICBs to agree to retain or create jobs that pay an average wage of at least one hundred and fifteen percent of the federal poverty income guidelines for families within the census tract.175

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173 See id. § 45D(d)(2). In particular, no more than five percent of property held by a QALICB can be a “collectible[]”—defined to include works of art, rugs or antiques, metals or gems, stamps or coins, or alcoholic beverages—or nonqualified financial property. See id. §§ 45D(d)(2)(A)(iv); 408(m)(2). These property holding restrictions implicitly disqualify certain types of businesses. In addition, a QALICB must be a “qualified business,” which excludes businesses that develop intangibles, farming business, and so-called sin businesses (i.e., golf courses, country clubs, massage parlors, hot tub facilities, suntan facilities, racetracks, gambling facilities, and liquor stores). See Treas. Reg. § 1.45D-1(d)(3)(iii) (2021); see also I.R.C. § 45D(d)(3) (defining “qualified business” by reference to I.R.C. § 1397C(d)); I.R.C. § 1397C(d)(3)(A) (excluding businesses listed in I.R.C. § 144(c)(6)(B)); I.R.C. § 144(c)(6)(B) (listing excluded businesses). Finally, QALICBs are prohibited from earning more than twenty percent of their income from rents or sale of real property. See I.R.C. § 45D(d)(3) (defining “qualified business” by reference to I.R.C. § 1397C(d)); I.R.C. § 1397C(d)(2)(A) (disqualifying residential rental property, defined by reference to I.R.C. § 168(e)); I.R.C. § 168(e) (defining “residential rental property” as “any building or structure if 80 percent or more of the gross rental income from such building or structure for the taxable year is rental income from dwelling units”). Apart from these narrow exceptions, any trade or business (including nonprofits) located within an eligible census tract is eligible to receive NMTC financing under the federal law.

174 Three states adopt the federal definition of QALICB in its entirety. See ALA. CODE § 41-9-218(6) (2021); MISS. CODE ANN. § 57-105-1(1)(e) (2023); ME. STAT. tit. 10, § 1100-Z(2) (2022). The rest make at least some modifications. The most common modification is to further restrict the amount of income that a business can derive from residential rental property. Four states limit the allowable amount to fifteen percent, as compared to twenty percent under the federal law. See, e.g., FLA. STAT. § 288.9913(5) (2022); 20 ILL. COMP. STAT. 663/5 (2022); KY. REV. STAT. ANN. § 141.432(5) (West 2022); NEB. REV. STAT. § 77-1108 (2022).

These requirements may help ensure that newly created jobs are also high-quality jobs that could help residents achieve economic stability. However, neither of these states requires QALICBs to employ or serve residents of the targeted communities—a shortcoming discussed above—nor do they impose any additional restrictions on the types of businesses that can qualify as QALICBs.

Louisiana and Nevada, on the other hand, do modify the types of businesses that can qualify as a QALICB. Louisiana limits QALICBs to small businesses that participate in one of fourteen specified sectors, thereby imposing some additional restrictions on the types of businesses that can qualify. In addition, Louisiana requires CDEs to invest at least fifty percent of their QEIs in “impact businesses.” An “impact business” is a QALICB “located in Louisiana that is either located in a rural parish or in the recovery zone or is more than fifty percent owned by women, minorities, or military veterans.” In Nevada, QALICBs are limited to fresh food retailers (e.g., groceries and farmers markets) and certain small businesses. Departures like these may increase the likelihood that the state NMTCs are used to subsidize projects that serve specific needs within the state, though further empirical research would be necessary to evaluate their impact.

A third way that state NMTC laws could depart from the federal model is through their administration. As explained above, the federal NMTC program is administered by the CDFI Fund through a competitive application process. Similarly, state NMTC programs are administered by state regulators—usually by a department responsible for economic development, and occasionally by the department of revenue. Taxpayers wishing to participate in state NMTC programs must apply to their state regulator to certify their QEI under state law. However, unlike the federal

176 See LA. STAT. ANN. § 47:6016.1(B)(8) (2021). The statute limits QALICB to businesses in an industry assigned a primary North American Industry Classification System code within the following sectors: 11 (Agriculture, Forestry, Fishing and Hunting); 21 (Mining, Quarrying, and Oil and Gas Extraction); 23 (Construction); 31 (Manufacturing); 32 (Manufacturing); 33 (Manufacturing); 42 (Wholesale Trade); 48 (Transportation and Warehousing); 49 (Transportation and Warehousing); 54 (Professional, Scientific, and Technical Services); 56 (Administrative and Support and Waste Management and Remediation Services); 62 (Health Care and Social Assistance); 72 (Accommodation and Food Services); or 81 (Other Services (except Public Administration)). See id.; see also Economic Census: NAICS Codes & Understanding Industry Classification Systems, U.S. CENSUS BUREAU (Aug. 19, 2022), https://www.census.gov/programs-surveys/economic-census/year/2022/guidance/understanding-naics.html [https://perma.cc/ZzHL-NVLC] (listing the twenty sectors included in the NAICS).


180 See NMTC Survey, supra note 6 (listing the regulatory agency responsible for each state's NMTC administration).
application process, most states administer the state NMTC through a noncompetitive process, certifying qualifying projects on a first come, first serve basis until the tax credit allocation cap is reached.\textsuperscript{181} In addition, in most states, the application process is open only to CDEs that have already received an allocation under federal law.\textsuperscript{182} As a result, often, the only types of projects that will be eligible for the state NMTCs are those that have already been approved by the federal government.

To the extent that federal application procedures prevent some CDEs from receiving allocations or influence the types of projects they pursue, these effects will trickle down to state NMTC programs. Though the federal NMTC frequently supports pro-social investment that benefits low-income communities,\textsuperscript{183} that program is also occasionally used to subsidize investment that is unlikely to produce such benefits.\textsuperscript{184} As a result, states that piggy-back on the federal application process may inadvertently amplify and replicate inefficiencies in the federal law. Currently, Nevada is the only state that does not make eligibility for state NMTCs contingent on whether a CDE has an active allocation agreement with the CDFI Fund.\textsuperscript{185}

Though it may be more burdensome for states, decoupling the administration of these programs from the federal process would have important benefits. Namely, it would level the playing field for tax credits. The federal application process tends to favor large, highly resourced CDEs.\textsuperscript{186} Smaller regional CDEs and those that specialize in serving marginalized groups often struggle to receive NMTC awards in a program that is oversubscribed and highly specialized.\textsuperscript{187} State-level competitions may be less crowded than the federal competition, and they may create new opportunities for CDEs to serve communities that are passed over by the CDFI Fund. As a result, decoupling the administration of these programs could enable state NMTCs to serve as important correctives to the federal program, enabling similar benefits to reach a wider variety of communities.

\textsuperscript{181} See id. (outlining the NMTC application process for each state, and whether the application process is competitive or noncompetitive).

\textsuperscript{182} See id. (describing the specific eligibility criteria for each state’s NMTC program).

\textsuperscript{183} See Michelle D. Layser, Nonprofit Participation in Place-Based Tax Incentive Transactions, 48 FORDHAM URB. L.J. 1131, 1138 (2021) (“[N]ot all of the projects supported by the NMTC program were likely to generate significant profit for investors, and many appeared to be predominantly mission-driven.”).

\textsuperscript{184} See Roger M. Groves, The De-Gentrification of New Markets Tax Credits, 8 FLA. TAX REV. 213, 225-26 (2007) (noting that many NMTC programs credit many projects that are not within their target population).

\textsuperscript{185} See NEV. REV. STAT. § 231A.180 (2022) (requiring that the CDE has had an allocation agreement with the CDFI Fund but specifying that the agreement can be from any year); see also NMTC Survey, supra note 6 (identifying that Nevada’s statute requires under its eligibility criteria that a CDE have received federal allocations, but from any previous year).

\textsuperscript{186} Statement based on interview data subject to Institutional Review Board confidentiality agreement.

\textsuperscript{187} Statement based on interview data subject to Institutional Review Board confidentiality agreement.
B. Reforms to Increase Benefits for Low-Income Residents

So far, this Part has analyzed three common categories of state place-based tax incentives—enterprise zones, opportunity zones, and state NMTCs—and it has identified several specific ways that incentives like these could be reformed to promote community-oriented goals. This Section elaborates on these state-level statutory reform proposals. Stated broadly, the analysis in the prior Section points to four types of reform: (i) tying tax preferences to investment in types of projects that are likely to benefit low-income residents; (ii) targeting locations that stand to benefit most from tax subsidies; (iii) conditioning the tax preferences on providing benefits (e.g., employment or services) directly to residents of the targeted communities; and (iv) limiting the tax subsidies to projects that serve distressed communities within the state. Of these, the first two reforms are relatively minor in the sense that they could be implemented through state-level statutory changes without any further changes to the current legal framework. The third and fourth reform proposals are more significant. Not only would these reforms constitute a sharp departure from current incentive designs, but they would also raise significant constitutional questions that will be discussed in subsequent Parts of this Article. Successful implementation of these reforms will depend upon Congressional action to override current constitutional doctrine.

1. Minor Reforms

The analysis in Section II.A suggests that many state place-based tax incentives can be improved by: (a) tying tax preferences to investment in types of projects that are likely to benefit low-income residents; and (b) targeting locations that stand to benefit most from tax subsidies. In referring to these proposed statutory amendments as minor reforms, I do not mean to suggest that they lack promise. To the contrary, in other works, I argue that reforms like these would greatly improve the capacity of all place-based tax incentives to reduce geographic inequality. However, for reasons that will become clear later in this Article, these two reforms are minor in the sense that they present no serious constitutional issues and may be more easily implemented than the reforms described in subsection II.B.2. Accordingly, this subsection elaborates upon how these proposed reforms might be implemented, and it will explain the limitations of this approach.

The first of the minor reforms would amend the laws to limit tax preferences to investment into projects that are most likely to benefit low-income residents. States could restrict tax preferences to investment in

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188 See generally Layser, Geographic Inequality, supra note 5.
mission-driven projects intended to benefit low-income populations, such as community facilities, youth centers, or food kitchens.\footnote{See id. at 34 ("[T]here is no one-size-fits-all prototype for drafting place-based tax incentives. Instead, the appropriate incentive design will vary depending on the desired programmatic benefit and the benefit should match the geographic inequality (or inequalities) experienced in the targeted places.").} This could be accomplished through statutory amendments that narrow the categories of approved projects, or through active administration by local regulators.\footnote{See id. at 34, 37 (noting the difficulties that arise with vague statues that do not define funded projects and suggesting that developers should study the impact of projects on the neighborhood and its residents).} These types of changes would help increase the likelihood that subsidized projects address the needs of low-income people, but they would not necessarily ensure that they address the needs of residents of the targeted community.

The second minor reform would be to amend laws to target the benefits to geographies that stand to benefit most from the tax subsidies. For example, incentives to create jobs should specifically target neighborhoods with high unemployment rates and low job access.\footnote{See id. at 14-19, 34-36 (suggesting that place-based tax incentives targeting areas experiencing spatial mismatch should promote creation of low-skilled jobs and tie incentives to the employees’ residence).} Incentives to rehabilitate the built environment should target neighborhoods with high concentrations of distressed properties.\footnote{See id. at 36-38 (suggesting that placed-based tax incentives that target areas experiencing disinvestment should prioritize that projects that improve environmental conditions for low-income residents such as redeveloping abandoned property.)} And, consistent with the first reform, the incentives should promote rehabilitation for the benefit of low-income people, such as affordable housing rehabilitation.\footnote{Id.} Incentives to invest in grocery stores might target food deserts, and incentives to invest in medical clinics might target medically underserved communities.\footnote{See id. at 33, 39 (noting that the CDFI Fund considers food deserts and medically underserved communities as factors for development proposals).} Here, too, these reforms could be accomplished through statutory amendments that define targeted areas with reference to specific metrics indicative of need, such as unemployment rates, the rate of abandoned properties, or indices that describe access to food or medical services.\footnote{See id. at 19, 25, 33 (noting examples of incentive designs using metrics indicative of need).}

These two reforms have the potential to improve outcomes by narrowly targeting activities and places that are most likely to benefit low-income communities.\footnote{See id. at 47-48 (noting that existing tax incentives often do not benefit low-income people).} However, these reforms—standing alone—may not be enough to ensure that residents of the targeted communities benefit from the new investment. Even if the new investment more effectively serves people with low income levels, there is no assurance that the beneficiaries would be residents of the targeted community. This may be an acceptable distributive
outcome. But if the goal of a policy is to serve low-income people no matter where they live, then there is no obvious reason to employ a place-based approach. Strategies that provide assistance directly to individuals, no matter where they live, would arguably be more effective.\textsuperscript{197} For this reason, place-based strategies should be used to improve outcomes for people who live in the targeted community.

Moreover, contrary to the approach embodied by these two reforms, there may be good reasons to retain flexible laws that can adapt to the unique needs of distressed communities.\textsuperscript{198} Since the needs of distressed communities vary, the types of investment that would benefit them may also vary. In addition, political economy considerations probably counsel against reform efforts that would foreclose the use of tax incentives to support a range of business activity. For the reasons explained above, business lobbies have significant political power at the state and local levels, and overly restrictive incentives may lack political viability in that context.\textsuperscript{199} These considerations may favor an alternate approach that would continue to allow a range of economic activities.

Given their limitations, these minor reforms may be less effective than reforms that permit a range of activities but condition tax preferences on performance of activities (e.g., hiring or serving) that benefit residents of the distressed communities within the state. The rest of this Section will elaborate upon these more significant reform proposals.

\section*{2. Major Reforms}

In addition to the minor reforms described above, the analysis in Section II.A identified two other potential reforms. These reforms would: (a) condition the tax preferences on providing benefits (e.g., employment or services) to residents of the targeted communities; and (b) limit the tax subsidies to projects that serve distressed communities within the state. These proposals are more significant than the previous reforms because, for reasons to be explained in Part III, these proposed statutory changes are almost certainly unconstitutional under current Dormant Commerce Clause doctrine. As a result, making these statutory changes would require not only statutory amendments, but also Congressional override of longstanding

\begin{footnotesize}
\begin{enumerate}
\item \textsuperscript{197} Economists have long preferred policies that deliver support directly to individuals in order to increase their mobility. \textit{See, e.g.}, WESSEL, supra note 1, at 71 (citing to arguments that subsidies helping poor people directly instead of to poor locations will naturally flow to such places without incentivizing people to remain in dysfunctional economies).
\item \textsuperscript{198} \textit{See generally} Layser, \textit{Geographic Inequality}, supra note 5 (discussing different types of geographic inequality that may be experienced by distressed communities, and the need to adapt incentives to the specific needs of places).
\item \textsuperscript{199} \textit{See supra} Section I.A (discussing the role of political economy in modern economic development).
\end{enumerate}
\end{footnotesize}
constitutional doctrine. This Section will elaborate upon the proposed statutory changes, and Part III will explain the constitutional barriers to their implementation.

a. Reforms to Target Benefits to Low-Income Residents

The first of the major reforms would condition benefits on activities that directly benefit low-income residents of targeted communities. For example, place-based tax incentives could condition benefits on the taxpayer hiring zone residents. As explained in Section II.A, incentives that contain such conditions are more effective at reducing unemployment among zone residents than incentives that do not include such conditions. One would expect similar outcomes from incentives that are conditioned on other activities that benefit zone residents. For instance, job training centers might be required to train workers who live in the zone, charter schools might be required to serve students who live in the zone, and community and social services centers might be required to serve zone residents. Ideally, such conditions would be incorporated in states’ enterprise zone incentives, state opportunity zone laws, and state NMTC programs. Under current law, such conditions are extremely rare in all three contexts—perhaps in part due to their questionable constitutional status.

b. Reforms to Target Benefits to Local Distressed Places

In the case of state opportunity zones, additional reforms may be necessary to ensure that state subsidies are directed toward distressed communities within the state. Recall that in most states, the geographic scope of the state opportunity zone laws conform to the federal law; and, as a result, the tax preferences are not limited to investment in in-state zones.\(^\text{200}\) However, this design feature is not only contrary to federalist ideals that would favor state autonomy and local democratic control, but also creates inefficiencies and stands to undermine states’ social welfare efforts. As such, there may be good reasons for states to reform their state opportunity zone laws to limit the incentives to in-state zones—and some states have already taken steps to do so. The approaches taken in these states may serve as partial templates for others.

At least two states and the District of Columbia have adopted their own state-level definitions of “opportunity zone” that limit the incentive to in-state census tracts or provide enhanced benefits for in-state investments.\(^\text{201}\)

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\(^{200}\) See supra subsection II.A.2.

\(^{201}\) These states include Arkansas, Ohio, and the District of Columbia. See ARK. CODE ANN. § 26-51-460 (2022); OHIO REV. CODE ANN. § 122.84 (West 2023); D.C. CODE § 47-1803.03(a)(20)(E)(IV) (2022).
For example, in Arkansas, the definition of “opportunity zone” is modified to mean “a population census tract located in Arkansas that is designated as a qualified opportunity zone under 26 U.S.C. § 1400Z-1 . . .”202 Similarly, in Ohio, a taxpayer that invests in one or more Ohio-qualified opportunity funds may apply for a nonrefundable income tax credit, where “Ohio qualified opportunity fund” means “a qualified opportunity fund that holds one hundred percent of its invested assets in qualified opportunity zone property situated in an Ohio opportunity zone.”203

Other states supplement the federal Opportunity Zones law incentive with additional state-level tax breaks. For example, Wisconsin provides for supplemental, enhanced benefits for taxpayers that invest in Wisconsin opportunity zones.204 Specifically, Wisconsin conforms to the federal Opportunity Zones law—thereby allowing tax deferrals and exclusions regardless of the location of the investment—and permits taxpayers to take a deduction equal to any capital gains exempt under the federal law when the investment is in-state.205

Maryland also offers supplemental tax incentives, and it does so in a manner that is consistent with community-oriented goals. Under the Maryland law, qualifying businesses may receive enhanced benefits if they maintain accountability to zone residents through representation on their governing or advisory boards, or through use of a community benefit agreement (CBA) or strategic industry partnership negotiated with community groups.206 Community benefits agreements are contracts between developers and community coalitions that require developers to provide “economic benefits such as affordable housing, local hiring, and living wages to communities where major developments are located.”207 To qualify for the enhanced benefits, the investment must be in a Maryland opportunity zone.208

The modified opportunity zones laws seen in states like Arkansas, Ohio, Maryland, and Wisconsin are probably more efficient and consistent with local democratic control than their counterparts. They are also more likely to

202 ARK. CODE ANN. § 26-51-460(b) (2022) (emphasis added).
203 OHIO REV. CODE ANN. § 122.84 (West 2023).
204 See WIS. STAT. § 71.05 (2022).
206 See MD. CODE ANN., ECON. DEV. § 6-1001 (West 2022); see also Maryland Opportunity Zone Enhancement Credits, MD. DEP’T OF COM., https://commerce.maryland.gov/fund/programs-for-businesses/opportunity-zone-enhancement-credits [https://perma.cc/YBX3-MSY3] (explaining the “enhancements to several of [Maryland’s] economic development tax credit programs for businesses located in Maryland Opportunity Zones that meet certain requirements”).
208 See MD. CODE ANN., ECON. DEV. § 6-1001(d) (West 2022).
effectively target distressed communities within the states' jurisdiction than incentives that are not restricted to in-state investment. For these reasons, all states should arguably enact reforms like these in addition to adding conditions to ensure benefits flow to low-income residents of targeted places. In this respect, the Maryland law serves as a good model. Nonetheless, as Part III will explain, these reforms would probably be unconstitutional under current Dormant Commerce Clause doctrine.

* * *

So far, this Article has argued that the political economy surrounding place-based tax incentives has produced laws that lack safeguards for residents of targeted communities. Based on a careful review of the empirical literature about the laws' outcomes, this Part has identified several reform possibilities. Though some reforms would require only slight statutory changes, some of the most promising reform proposals would require more than that—they would require changes to current constitutional frameworks. This Article now turns to the constitutional issues raised by state place-based tax incentive reform.

III. CONSTITUTIONAL BARRIERS TO PLACE-BASED TAX INCENTIVE REFORM

A. State Taxation and the Dormant Commerce Clause

This Part analyzes the constitutional issues presented by state place-based tax incentive reform in order to surface two key findings. First, the law surrounding state place-based tax incentives is both uncertain and likely to change in ways that further limit their use. Specifically, an analysis of relevant case law suggests that many place-based tax incentives are at risk of being declared unconstitutional by future courts. Such a ruling would deprive state and local governments of an important place-based policy tool, and reformers should work preemptively to avoid such a result.

Second, despite considerable uncertainty in the Dormant Commerce Clause doctrine, several clear rules can be identified—and those rules present direct barriers to some of the community-oriented reforms discussed above. For reasons to be explained, current doctrine would prohibit tax incentives that restrict tax preferences to activities that directly benefit residents of targeted communities within the state. As a result, implementation of some of the most promising reforms would require not only statutory changes, but also changes to the current constitutional framework.
To understand the constitutional issues presented by state place-based tax incentive reform, it is helpful to start at the beginning. This Article is specifically concerned with place-based tax incentives used to promote economic development in distressed places. However, place-based tax incentives are subject to the same constitutional frameworks that govern all other state economic development tax incentives.\(^\text{209}\) Most constitutional problems raised by economic development incentives implicate the Dormant Commerce Clause.

The Commerce Clause in Article I of the United States Constitution gives Congress the power to regulate interstate commerce.\(^\text{210}\) The United States Supreme Court has interpreted the Commerce Clause to impose certain restrictions upon states’ regulation of interstate commerce in instances when Congress has not yet chosen to regulate an activity through legislation (i.e., the so-called Dormant Commerce Clause).\(^\text{211}\) The leading case for evaluating the constitutionality of tax laws under the Dormant Commerce Clause is Complete Auto Transit v. Brady.\(^\text{212}\) Courts have interpreted Complete Auto as creating a four-prong test that asks whether a tax: (i) is applied to an activity with a substantial nexus with the taxing state; (ii) is fairly apportioned; (iii) does not discriminate against interstate commerce; and (iv) is fairly related to the services provided by the state.\(^\text{213}\) In application, cases are nearly always decided on nexus, discrimination, or apportionment analyses. The fair relationship prong is, for all practical purposes, dead letter law.\(^\text{214}\)

In the context of economic development incentives, the discrimination prong of Complete Auto plays an outsized role in the case law. Nondiscriminatory tax laws are “almost automatically considered constitutional, even if they impose significant burdens on interstate commerce,” as long as they have substantial

\(^{209}\) Economic development tax incentives provide tax preferences to firms that engage in new or expanded business activities within the state (or within a distressed part of the state), such as through investment in plants, equipment, or workforce. See Brunori, supra note 10, at 25. State and local governments currently forgo approximately forty-six billion dollars of tax revenues per year on economic development incentives, an amount that has tripled since the 1990s. See Timothy J. Bartik, Should Place-Based Jobs Policies Be Used to Help Distressed Communities? 10 (Upjohn Inst., Working Paper No. 19-308, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3430374 [https://perma.cc/FzUK-338B]; see also Slattery & Zidar, Evaluating State and Local Business Incentives, supra note 5, at 90.

\(^{210}\) See U.S. CONST. art. I, § 8, cl. 3.


\(^{213}\) See Wynne, 575 U.S. at 547 (citing Complete Auto Transit, 430 U.S. at 279).

\(^{214}\) See Adam B. Thimmesch, The Unified Dormant Commerce Clause, 92 TEMP. L. REV. 331, 359 (2020) [hereinafter Thimmesch, The Unified Dormant Commerce Clause] (explaining that the fair relationship prong has long been “dead letter law”). Thimmesch additionally argues that the nexus prong is “functionally dead” after the Supreme Court’s decision in South Dakota v. Wayfair, Inc., 138 S. Ct. 2080 (2018). See id. at 358.
nexus to the taxing state and are fairly apportioned. On the other hand, tax laws that discriminate against interstate commerce violate the nondiscrimination prong of Complete Auto and are always unconstitutional. Accordingly, as the next Section will demonstrate, the constitutionality of economic development incentives often turns on whether the law discriminates against interstate commerce.

B. Constitutional Uncertainty and Economic Development Incentives

1. A Fuzzy Distinction: Discrimination vs. Competition

a. The Doctrine

Analyses of whether and when economic development incentives discriminate against interstate commerce typically begin with Boston Stock Exchange vs. State Tax Commission, which was decided the same year as Complete Auto, in 1977. In Boston Stock Exchange, the Court considered a New York tax scheme that provided exemptions to a transfer tax on security sales. As originally drafted, the transfer tax applied to all security sales involving a transfer in New York, such as sales made through a New York broker,
regardless of the location of the sale itself.\textsuperscript{219} However, New York lawmakers worried that the New York Stock Exchange would choose to relocate outside of New York to avoid the transfer taxes.\textsuperscript{220}

In order to retain their business, the legislature amended the law to provide for two deviations from the general rule.\textsuperscript{221} First, the law provided nonresidents with a tax rate reduction for any sales that took place in New York.\textsuperscript{222} This reduction was not available to New York residents or to nonresidents that sold their securities outside of New York.\textsuperscript{223} Second, the law placed a limit on the maximum tax that could be levied on sales taking place in New York.\textsuperscript{224} The limit was available to both residents and nonresidents.\textsuperscript{225} There was no cap on out-of-state sales.\textsuperscript{226}

The Court found that the scheme violated the Dormant Commerce Clause because no state may “impose a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business.”\textsuperscript{227} The Court noted that prior to the amendment, the New York transfer tax was “neutral as to in-state and out-of-state sales” because “the burden fell equally on all transactions regardless of the situs of the sale,” and the amendment “upset this equilibrium” in favor of New York sales.\textsuperscript{228} In other words, the law was unconstitutional because it shifted the balance in favor of New York, providing the state with a direct commercial advantage.

Given this reasoning, a possible implication of \textit{Boston Stock Exchange} could have been to render all economic development tax incentives unconstitutional. After all, economic development tax incentives are specifically designed to create tax advantages for in-state activity. However, in language that would be picked up by subsequent courts, the Court expressly limited its holding, saying that it did \textit{not} “hold that a State may not compete with other States for a share of interstate commerce[,]” and that “such competition lies at the heart of a free trade policy.”\textsuperscript{229} Accordingly, the Court stated: “We hold only that in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State.”\textsuperscript{230}

\begin{flushright}
\textsuperscript{219} Id. at 322.
\textsuperscript{220} Id. at 324.
\textsuperscript{221} Id.
\textsuperscript{222} Id.
\textsuperscript{223} Id.
\textsuperscript{224} Id. at 324-25.
\textsuperscript{225} Id.
\textsuperscript{226} Id.
\textsuperscript{227} Id. at 329 (citing Nw. States Portland Cement Co. v. Minnesota, 358 U.S. 450, 457 (1959)).
\textsuperscript{228} Id. at 330.
\textsuperscript{229} Id. at 336-37.
\textsuperscript{230} Id. at 337 (emphasis added).
\end{flushright}
At least two points are worth noting about these statements. First, as courts and experts have long noted, the Supreme Court’s language expressly reserved the possibility that states might implement economic development incentives without violating the nondiscrimination principle. In the decades after *Boston Stock Exchange*, courts and academic observers have struggled to define the line between permissible tax competition and unconstitutional discrimination.231 Second, the Court’s reasoning in *Boston Stock Exchange* was consistent with what Professor Cass Sunstein has referred to as a “shallow and narrow” minimalist decision.232 The Court narrowly decided that the particular New York law discriminated against interstate commerce, but provided no theoretical explanation to guide future courts in identifying the line between permissible tax competition and unconstitutional discrimination—it left the foundational issues undecided.233

A similar minimalist approach is reflected by subsequent cases, which provide examples of incentives that discriminate against interstate commerce but offer no clear guidance to determine which incentives are safely constitutional.234 Two cases decided in 1984 struck down tax incentives intended to benefit local industry, making it clear that intent to burden out-of-state industry is not required under the constitutional analysis.235 The first of these cases was *Bacchus Imports v. Dias*.236 In that case, the Court considered a tax scheme that imposed a twenty percent excise tax on wholesale liquor sales, with an exemption for locally produced alcoholic beverages.237

The Court noted that the exemption was intended “to encourage development of the Hawaiian liquor industry,”238 but its analysis placed no

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234 See generally Denning, *Cuno and the Court*, supra note 231 (defending minimalism as the ideal approach for tax incentive cases).


236 *Bacchus*, 468 U.S. at 263.

237 Id. at 265.

238 Id.
constitutional significance on the intent. Instead, the Court applied an equal treatment standard that simply asked whether the tax treated in-state and out-of-state activities differently. The Court found that the tax violated equal treatment principles, stating that it was “irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the makers of the locally produced beverage rather than to harm out-of-state producers.”

The Court held that the exemption unconstitutionally discriminated against interstate commerce because the statute “allocates benefits or burdens unequally.”

The second case decided that year was Westinghouse Electric Corp. v. Tully. In that case, New York imposed an entity level tax on so-called Domestic International Sales Corporations (DISCs), paired with a partially offsetting tax credit. The tax credit was based on gross receipts from export products shipped from a regular place of business of the taxpayer within New York. The purpose of the tax preference was to “provide a positive incentive for increased business activity in New York.” Adopting the same approach as in Bacchus Imports, the Court applied an equal treatment standard, noting that that tax credit had “the effect of treating differently” certain taxpayers that were “similarly situated in all respects except for the percentage of . . . activities conducted from New York.”

Bacchus Imports and Westinghouse Electric provide examples of tax incentives that discriminate against interstate commerce, but they offer little theoretical analysis to explain why differential treatment violates the Dormant Commerce Clause. Another case, decided four years later, offers some clues about the Supreme Court’s reasoning. In New Energy, the Court considered an Ohio tax credit used to subsidize the state’s ethanol industry. For each gallon of ethanol sold by fuel dealers, the law provided a tax credit against the state’s motor vehicle fuel sales tax, but only if the ethanol was produced in Ohio or in a State that grants similar tax advantages to ethanol produced in Ohio. In striking down the tax credit, the Court emphasized

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239 Id. at 273.
240 See id. (declining to ask whether the different treatment is intended to benefit in-state commerce or burden out-of-state commerce).
241 Id.
242 Id.
244 Id. at 393.
245 Id.
246 Id. (quotation omitted).
247 Id. at 400.
248 For reasons explained below, most courts and commentators assume that differential treatment must be constitutional in at least some contexts. See supra subsection III.B.1.
250 Id. at 271.
that the scheme placed out-of-state products at “a substantial commercial
disadvantage,” echoing the language used in *Boston Stock Exchange*.  

The Court in *Westinghouse* noted that “[w]hether the discriminatory tax
diverts new business into the State or merely prevents current business from
being diverted elsewhere, it is still a discriminatory tax that ‘forecloses tax-
neutral decisions and creates an advantage’ for firms operating in New York
by placing ‘a discriminatory burden on commerce to its sister States.’”  

Unlike the analyses in *Bacchus Imports* and *Westinghouse Electric*, which asked
whether the tax treated in-state and out-of-state commerce differently, the
*New Energy* Court asked whether that differential treatment created a
commercial disadvantage for out-of-state firms. In other words, the Court did
not view unequal treatment itself as the evil to be constitutionally prohibited,
but rather its impact on markets. Like the more formalistic unequal treatment
test, the “market distortion” analysis also casts doubt on most economic
development incentives.

It is worth pausing to reiterate that all economic development incentives
have the potential to place other states at a disadvantage. Again, a literal
interpretation of these opinions “might suggest that all state inducement
programs are likely to be unconstitutional.” However, lower courts have
deprecated to articulate such a sweeping conclusion, opting instead for the more
minimalist approach. Accordingly, lower courts have taken a case-by-case
approach to analyzing economic development incentives that sometimes
reach the contrary conclusion.

For example, in *Jefferson Smurfit Corporation v. Department of Treasury*, the
Court of Appeals of Michigan upheld a tax deduction for capital investment
in real property located in the state.  

Though lower courts struck down the
deduction as discriminatory, the Court of Appeals declined to do so. Instead,
the court said: “[W]e believe that such discussions regarding the goal of
encouraging investment in Michigan fall in line with repeatedly approved
intent and practice . . . .” The court, citing precedent, concluded that “[i]t
is a laudatory goal in the design of a tax system to promote investment that
will provide jobs and prosperity to the citizens of the taxing State. States are

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251 Id. at 275.
*Boston Stock Exch. v. State Tax Comm’n*, 429 U.S. 318, 331 (1977)).
253 *Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives,
supra* note 217, at 802 (quotation omitted).
254 See *Hickman & Bunce, DaimlerChrysler v. Cuno and the Constitutionality of State Tax Incentives for
Economic Development, supra* note 217, at 21 (“The Court has acknowledged that its case-by-case
approach . . . has resulted in much room for controversy and confusion and little in the way of precise
guid[ance] . . . .” (quotation omitted)).
256 Id.
free to ‘structure their tax systems to encourage the growth and development of intrastate commerce and industry.’”

The court noted that the deduction was “not dependent on the initial location of the taxpayer’s assets” but instead turned on “the taxpayer’s election to increase its Michigan investment.” Accordingly, the Jefferson Smurfit court concluded that the provision was “not designed to punish multistate taxpayers” who chose not to increase their Michigan presence, and therefore did not discriminate against interstate commerce. This reasoning appears to be in conflict with Bacchus Imports and Westinghouse Electric, both of which rejected the distinction between benefits and burdens. Thus, current law features unclear doctrine, inconsistent opinions, and a practical reality in which economic development incentives are a prominent feature of state tax law despite their tenuous constitutional status.

b. The Theories

Against this backdrop, tax experts and legal scholars have set forth several theories to help make sense of the doctrine and, perhaps more importantly, to predict when a state tax incentive may unconstitutionally discriminate against interstate commerce. Many of these commenters proceed from an instinct that the mere fact that state tax incentives distinguish between in-state and out-of-state activity “probably should not be considered unconstitutional discrimination against protected commerce.” However, the theories differ in their answers as to what further is required to render an otherwise legitimate tax incentive unconstitutional.

Philip Tatarowicz and Rebecca Mims-Velarde have argued that “the key to finding a tax incentive unconstitutionally discriminatory appears to be a reliance by the state tax provision on both a taxpayer’s in-state and out-of-state activities in determining the taxpayer’s effective tax rate.” Such a tax

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258 Id.

259 Id.

260 See Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 805 (“Our view rests in part on an instinctive sense that virtually all state tax incentives cannot really be unconstitutional.”).


262 Id. at 929. The authors set forth an analytical approach comprised of six questions to evaluate the constitutionality of state tax laws. Id. at 886. The six questions are: “(1) Is the state tax subject to commerce clause scrutiny? (2) Is there disparate tax treatment? (3) Is the inequality being challenged caused by the state tax statute? (4) Does the unequal treatment weigh against a protected class of commerce? (5) Does the unequal treatment weigh in favor of local commerce? (6) Can any other law alter the commerce clause result?” Id.
incentive “clearly has a negative impact on interstate commerce,” as it “penalize[s] out-of-state activity.” Conversely, under the Tatarowicz and Mims-Velarde framework, an incentive that “relies exclusively on a taxpayer’s in-state activities in determining an effective tax rate” does not discriminate against interstate commerce. In effect, this theory of discrimination turns on whether the law benefits in-state activity (constitutional) or burdens out-of-state activity (unconstitutional). Though this distinction may be coherent in some cases, the question of whether an incentive benefits in-state activity or penalizes out-of-state activity is often a matter of perspective. As the Bacchus Imports Court noted, “[v]irtually every discriminatory statute allocates benefits or burdens unequally; each can be viewed as conferring a benefit on one party and a detriment on the other, in either an absolute or relative sense.”

For these reasons and others, some commentators have criticized the burden-based theory as insufficient to explain the nondiscrimination doctrine. An alternative theory set forth by Walter Hellerstein and Dan Coenen posits that the two “core principles” underlying the Court’s decisions are: (1) “the provision must favor in-state over out-of-state activities;” and (2) “the provision must implicate the coercive power of the state.” They argue that courts should not invalidate a state tax incentive under the Commerce Clause unless both conditions are met. Under their in-state favoritism/coercion framework, a state tax incentive favors in-state over out-of-state activities only if it provides tax advantages related to in-state activity without taking into account other states’ tax regimes. Such favoritism may or may not arise from the inclusion of collateral requirements

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263 Id. at 929, 936.
264 Id. at 929.
265 See Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 806 (”[T]wo core principles . . . underlie the Court’s state tax incentive decisions and should guide their proper interpretation and future application. First, the provision must favor in-state over out-of-state activities; second, the provision must implicate the coercive power of the state. If, but only if, both of these conditions are met, courts should declare the tax incentive unconstitutional.”).
267 Id.
268 Walter Hellerstein and Dan Coenen advocate for a coercion based analysis over the burden based theory. See Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 813-14. According to them, the burden based theory fails to meaningfully distinguish a tax incentive that benefits in-state activity and one that penalizes out-of-state activity, the Court has acknowledged that a rule distinguishing between a reward and benefit is futile, and the burden based analysis does not consider the coercive power of the state. See id.
269 Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 806.
270 Id.
271 See id. at 807-08 (“[T]he Court generally has refused to consider other states’ taxing regimes in determining the constitutionality of a state’s taxing statutes.”).
that the taxpayer favor in-state residents in its operations, such as in purchasing and hiring decisions.\footnote{272 See id. at 827 (”[T]hese tax incentives say to the taxpayer that the state will refrain from imposing taxes on the taxpayer’s property only if, in addition to acquiring property in the state, the taxpayer invests a certain amount of money in the state, or hires a certain number of employees in the state, or conducts operations of a certain size in the state.”).}

This first prong of the in-state favoritism/coercion analysis is consistent with the Court’s “internal consistency” test, which “looks to the structure of the tax at issue to see whether its identical application by every State in the Union would place interstate commerce at a disadvantage as compared with commerce intrastate.”\footnote{273 Id. at 808 (quoting Oklahoma Tax Comm’n v. Jefferson Lines, Inc., 514 U.S. 175, 185 (1995)).} For example, to test whether a property tax exemption favors in-state activity over out-of-state activity, apply the following thought experiment. If every state in the country provided that same property tax exemption, would the taxpayer be subject to a greater tax burden if it participates in interstate commerce? The answer must be no. Regardless of where the taxpayer owns property, it will receive a tax exemption. Table 1 illustrates this result, demonstrating that if all states provide an identical property tax exemption, then a taxpayer’s total state tax liability will be unchanged under scenarios in which: (1) the taxpayer purchases property entirely in-state; or (2) the taxpayer purchases some property out of state. Therefore, without more, the property tax exemption does not favor in-state activity under the test.

Table 1: Internal Consistency of Property Tax Exemptions

<table>
<thead>
<tr>
<th></th>
<th>State A</th>
<th>State B</th>
<th>Total State Tax Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxpayer purchases $10,000 property in State A</td>
<td>$0 Property Tax</td>
<td>$0 Property Tax</td>
<td>$0</td>
</tr>
<tr>
<td>Taxpayer purchases $5,000 in property in State A and $5,000 property in State B</td>
<td>$0 Property Tax</td>
<td>$0 Property Tax</td>
<td>$0</td>
</tr>
</tbody>
</table>
On the other hand, an income tax credit earned through in-state investment would fail the internal consistency test. For example, assume that: (a) a taxpayer has $100,000 in income in State A and $0 in income in State B; and (b) both states (i) impose a corporate income tax of 10%, and (ii) provide a nonrefundable income tax credit equal to the amount spent on new in-state investment. In this case, compare the taxpayer’s total tax liability under the following two scenarios: (1) the taxpayer makes a $10,000 investment entirely in State A; and (2) the taxpayer makes a $10,000 investment, 50% in State A and 50% in State B. As shown in Table 2, even if all states adopted the same tax scheme, the taxpayer will pay more total state taxes if it chooses to invest out-of-state.

Table 2: Internal Consistency of Investment Tax Credits

<table>
<thead>
<tr>
<th>Scenario</th>
<th>State A</th>
<th>State B</th>
<th>Total State Tax Due</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1)</td>
<td>Taxpayer invests entire $10,000 in A</td>
<td>$10,000 income tax</td>
<td>$0 income tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>($10,000) investment credit</td>
<td>$0 investment credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$0 State A Tax</td>
<td>$0 State B Tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>(2)</td>
<td>Taxpayer invests $5,000 in A and $5,000 in B</td>
<td>$10,000 income tax</td>
<td>$0 income tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>($5,000) investment credit</td>
<td>($5,000) investment credit</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$5,000 State A tax</td>
<td>$0 State B tax</td>
</tr>
<tr>
<td></td>
<td></td>
<td>$5,000</td>
<td>$5,000</td>
</tr>
</tbody>
</table>

If the tax favors in-state activity under analyses like these, then Hellerstein and Coenen would invalidate the tax incentive only if it also implicates the coercive power of the state. By this, they refer to the state’s power to tax—a power that exists only to the extent that the state already has nexus over the taxpayer. In other words, if a state has taxing nexus over a taxpayer (and, therefore, has the power to tax the taxpayer) but offers a tax reduction in exchange for in-state activity (e.g., expansion of a business or in-state job creation), then the state will have exercised its coercive power.

274 See id. at 830 (“[S]ales and similar transaction tax incentives—like all other tax incentives—ought to survive Commerce Clause scrutiny if they do not simultaneously favor in-state over out-of-state activity and implicate the coercive power of the state.”).

275 See id. For an explanation of the constitutional standard for establishing nexus, see supra note 215 and accompanying text.
Such a tax would be unconstitutional under the Hellerstein and Coenen framework. Conversely, under the Hellerstein and Coenen framework,

At least one significant category of tax incentives . . . should escape invalidation: those tax incentives framed not as exemptions from or reductions of existing state tax liability but rather as exemptions from or reductions of additional state tax liability to which the taxpayer would be subjected only if the taxpayer were to engage in the targeted activity in the state.\textsuperscript{276}

Thus, Hellerstein and Coenen reject the most expansive interpretation of the Court’s anti-discrimination cases and identify a category of state economic development incentives that may survive constitutional scrutiny—but their framework still casts a cloud over many common types of incentive. As they explain, virtually all incentives structured as income tax credits and deductions would violate their test.\textsuperscript{277} Both sales tax exemptions and property tax exemptions for new investment will often be constitutional under their test—but not if the benefits are tied to “collateral requirements,” such as job creation or in-state hiring.\textsuperscript{278} The constitutionality of collateral requirements like these is of particular significance to the topic of state place-based tax incentive reform, many of which depend on adding such conditions to the tax scheme.

A third theory, set forth by Michael Knoll and Ruth Mason, posits that the constitutional prohibition against discriminatory taxes—and, likely, tax incentives—is motivated by a principle they call “competitive neutrality.”\textsuperscript{279} Knoll and Mason define competitive neutrality as “the idea that states should not use their tax systems to distort the competitive advantages of residents of different states.”\textsuperscript{280} They further argue that the Supreme Court’s internal consistency test “accurately identifies state tax rate structures that violate competitive neutrality.”\textsuperscript{281} Practically speaking, Knoll and Mason would apply the internal consistency test in the same way that Hellerstein and Coenen would apply it; but unlike Hellerstein and Coenen, they would not require an additional showing of coercion. As such, if fully embraced by the Court, the test proposed by Knoll and Mason would potentially invalidate a larger

\textsuperscript{276} Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 807.

\textsuperscript{277} See id. at 817 (“[U]nder the broadest reading of the Court’s state tax incentive decisions, these [income tax] credits cannot survive scrutiny because they fail the test of strict ‘tax neutrality’ articulated by the Court in \textit{Boston Stock Exchange} and its progeny.”).

\textsuperscript{278} See id. at 825 (“[T]ax incentives that offer an exemption or abatement for new investment in the state (without collateral requirements discrete from the use or location of the property itself) will survive scrutiny under these criteria.” (citation omitted)).


\textsuperscript{280} Id.

\textsuperscript{281} Id. at 315.
field of tax incentives than would be invalidated under the framework proposed by Hellerstein and Coenen.

There is at least some indication that the Supreme Court may be leaning in favor of Knoll and Mason's approach. Though the internal consistency test had not played a major role in Dormant Commerce Clause analysis for at least thirty years—and has never been applied in a case analyzing economic development incentives—the Court recently reaffirmed its centrality to the discrimination analysis in *Comptroller of Treasury of Maryland v. Wynne.*

The law at issue in *Wynne* was a tax scheme that imposed an income tax on residents’ worldwide income, without providing a credit for taxes paid to other states. The Court analyzed the tax scheme using an internal consistency analysis—similar to previously discussed—and concluded that it unconstitutionally discriminated against interstate commerce. Since *Wynne,* some lower courts have reasoned that the internal consistency test is both necessary and sufficient to identify taxes that discriminate against interstate commerce.

It is unclear whether *Wynne'*s internal consistency test will be used to determine whether state economic development incentives discriminate against interstate commerce. But it is worth noting that the *Wynne* Court cited both *Boston Stock Exchange* and *Bacchus Imports* in its opinion. As such, there is a strong probability that state Dormant Commerce Clause doctrine is developing in ways that would threaten to upend the landscape of state economic development incentives. And if history is any guide, at least some lower courts may be willing to issue such sweeping rulings, despite their potential to disrupt the economic landscape—as demonstrated by the Sixth Circuit’s ruling in *Cuno v. DaimlerChrysler.*

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282 See id. at 313 (noting how the Supreme Court in *Comptroller of Treasury of Maryland v. Wynne,* 575 U.S. 542 (2015), repeatedly referenced the two filed amicus briefs that “presented the economic case for the internal consistency test”); see also *Comptroller of Treasury of Md. v. Wynne,* 575 U.S. 542, 563 (2015) (declaring that the internal consistency test has been invoked in at least seven cases).

283 *Wynne,* 575 U.S. at 545. In addition, Maryland imposed a tax on nonresidents with income earned from a Maryland source. See id. at 546.

284 See id. at 564-66 (finding that Maryland’s tax scheme operated as a tariff).

285 See, e.g., Steiner v. Utah State Tax Comm'n., 449 P.3d 189, 197 (Utah 2019) (holding that “Utah’s tax regime must satisfy the internal consistency test” according to “the guidelines laid out in *Wynne*”).

286 See *Wynne,* 575 U.S. at 549, 555.

287 See generally *Cuno v. DaimlerChrysler,* Inc., 386 F.3d 738 (6th Cir. 2004).
2. A Sleeping Bear: Cuno v. DaimlerChrysler

In 2004, in a closely watched case called Cuno v. DaimlerChrysler, the Sixth Circuit struck down an Ohio investment tax credit as discriminatory. The Cuno decision threatened to upset the landscape of economic development incentives in Kentucky, Michigan, Ohio, and Tennessee. It would have called into question general economic development incentives nationwide, and it would have cast doubt on many place-based tax incentives, such as investment tax incentives available in state enterprise zones. The sweeping holding turned heads from across the tax academy and prompted court challenges to economic development incentives outside the Sixth Circuit. It also motivated federal legislators to introduce a Bill that was poised to overturn Cuno, preserving states’ rights to use economic development incentives.

The case was ultimately vacated by the Supreme Court for lack of standing; and the Bill, no longer needed, was left to die in committee. States have continued to include investment tax credits in their menu of economic development tax incentives, and state tax competition has continued unabated. Nevertheless, because the Cuno case lurks below the surface of the already-shaky legal foundation of state economic development incentives, there are at least two good reasons to look closely at it despite its overturned status.

288 See id. at 746-48 (rejecting the argument that the state’s power to tax should be treated similarly to a direct subsidy).

289 See Brent B. Nicholson & Sue Mota, The Dormant Commerce Clause Rises Again: Cuno v. DaimlerChrysler, 5 HOUS. BUS. & TAX L.J. 322, 323-24 (2005) (arguing that the Cuno court may put other Sixth Circuit states at a “competitive disadvantage”); see also Hickman & Bunce, DaimlerChrysler v. Cuno and the Constitutionality of State Tax Incentives for Economic Development, supra note 217, at 24 (“The Sixth Circuit’s opinion calls into question existing tax statutes and economic development policies of many if not most states, as well as the future of state tax policy, and raises important questions about the role of the courts in guiding state tax decision-making.”).

290 See Hickman & Bunce, DaimlerChrysler v. Cuno and the Constitutionality of State Tax Incentives for Economic Development, supra note 217, at 25 (“The Cuno decision thus leaves open the possibility that a whole host of state tax credits, deductions, and programs intended to encourage economic development are constitutionally suspect.”).

291 See id. at 24 (noting that some states outside of the Sixth Circuit could “face litigation similar to the Cuno case”); see also Morgan L. Holcomb & Nicholas Allen Smith, The Post-Cuno Litigation Landscape, 58 CASE W. RES. L. REV. 1157, 1172-83 (2008) (considering the litigation in Minnesota and North Carolina regarding tax incentive programs post Cuno).


293 See DaimlerChrysler Corp. v. Cuno, 547 U.S. 332, 354 (2006) (“Because plaintiffs have no standing to challenge that credit, the lower courts erred by considering their claims against it on the merits.”).
First, the reasoning in *Cuno* was largely consistent with the theory set forth by Hellerstein and Coenen, suggesting that a coercion-based framework may eventually be adopted by courts. In other words, the substantive reasoning in *Cuno* may foreshadow future decisions—when similar tax incentives are challenged by plaintiffs who can establish standing—where courts will invalidate some common forms of economic development incentives. Second, the circumstances surrounding *Cuno* may foretell likely legislative response to any future judicial effort to invalidate common economic development incentives: Congress may act to preserve states’ rights to use state economic development incentives. In such case, the scope of the judicial doctrine and the legislative “fix” may have significant implications for tax-based community economic development strategies, including place-based tax incentive reform.

Therefore, it is essential to examine the facts and reasoning in *Cuno*. In *Cuno*, the court considered two state economic development tax incentives. The first was a nonrefundable credit against the state’s corporate franchise tax that was available if the taxpayer purchased new manufacturing equipment and installed it in Ohio. The tax credit was “equally available to in-state and out-of-state businesses.” Nevertheless, the plaintiffs—a group of Michigan and Ohio taxpayers who were not personally subject to the tax—challenged the law under the Dormant Commerce Clause.

The *Cuno* court began by observing that the Supreme Court’s holdings in *Boston Stock Exchange*, *Bacchus Imports*, *Westinghouse Electric*, and *New Energy* had failed to “delineate[] the scope of the doctrine that bars discriminatory taxes.” It noted that a “case-by-case analysis” is used to determine whether a tax law discriminates against interstate commerce by providing a direct commercial advantage to local business. Nevertheless, the court scoured the precedent for a coherent definition of “discrimination,” finally concluding that it “simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter.”

Applying its version of the equal treatment standard to the Ohio investment tax incentive, the court held that the incentive was

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294 *See generally* Cuno v. DaimlerChrysler, Inc., 386 F.3d 738 (6th Cir. 2004).
295 *Id.* at 741-42.
296 *Id.* at 743.
297 *Id.* at 742-43.
298 *Id.* at 743.
299 *Id.*
unconstitutional.\textsuperscript{300} In doing so, it reasoned that “as between two businesses, otherwise similarly situated and each subject to Ohio taxation, the business that chooses to expand its local presence will enjoy a reduced tax burden, based directly on its new in-state investment” relative to a competitor who expands out-of-state.\textsuperscript{301} This holding is consistent with the Hellerstein and Coenen in-state favoritism/coercion analysis. First, the credits favored in-state over out-of-state activity because the credit was only available to companies that invested in Ohio.\textsuperscript{302} Second, a taxpayer with Ohio income tax exposure could “reduce its state tax bill only by engaging in in-state activity,” thereby implicating the coercive power of the state.\textsuperscript{303}

That said, the court reached a different conclusion when analyzing the second challenged incentive: a personal property tax exemption that permitted municipalities to offer “specified incentives to an enterprise that agrees to establish, expand, renovate, or occupy a facility and hire new employees, or preserve employment opportunities for existing employees in economically depressed areas.”\textsuperscript{304} Citing Hellerstein and Coenen’s research on the topic, the court distinguished the property tax exemption from the income tax credit, noting that “[u]nlike an investment tax credit that reduces pre-existing income tax liability, the personal property exemption does not reduce any existing property tax liability.”\textsuperscript{305} As such, the court sustained the property tax exemption, concluding that “any discriminatory treatment between a company that invests in Ohio and one that invests out-of-state cannot be attributed [to] the Ohio tax regime or its failure to reduce current property taxes.”\textsuperscript{306}

However, under the Hellerstein and Coenen framework, an exemption structured like the Ohio incentive would almost certainly be considered coercive because it “improperly link[s] the tax benefit—exemption from local property taxes—to local activity distinct from the investment in the in-

\begin{itemize}
\item \textsuperscript{300} See id. at 750 (“For the reasons set out above, we reverse that portion of the district court’s judgment upholding as constitutional the investment tax credit provision of Ohio Rev. Code Ann. § 5733.33, and we enjoin its enforcement.” (emphasis omitted)).
\item \textsuperscript{301} Id. at 743.
\item \textsuperscript{302} Id. The fact that the credit was available to both in-state and out-of-state taxpayers was irrelevant, as the “Commerce Clause precludes discrimination against interstate commerce, not just discrimination against out-of-state taxpayers.” Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 815.
\item \textsuperscript{303} See Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 817.
\item \textsuperscript{304} Cuno, 386 F.3d at 741 (quotation omitted).
\item \textsuperscript{305} Id. at 747.
\item \textsuperscript{306} Id. (citing Hellerstein & Coenen, Commerce Clause Restraints on State Business Development Incentives, supra note 217, at 808-09).
\end{itemize}
state property.” Under the in-state favoritism/coercion test, any hiring conditions placed on a tax preference would render the incentive coercive and, as a result, unconstitutionally discriminatory. The *Cuno* court acknowledged that conditions that “require the creation of new jobs, or encourage a beneficiary to engage in an additional form of commerce independent of the newly acquired property” may violate the Dormant Commerce Clause. Nevertheless, the court characterized the conditions in the Ohio law as “minor collateral requirements” that “raise no constitutional issues.”

Thus, the *Cuno* case—had it been allowed to stand—would have partially endorsed the Hellerstein and Coenen theory, but it would have raised important questions relevant to the discussion of place-based tax incentive reform. Specifically, what exactly is the distinction between constitutional “minor collateral requirements” and other, unconstitutional collateral requirements? Without an answer to this question, it seems likely that *Cuno* would have disrupted the landscape of state economic development incentives without meaningfully clarifying the constitutional doctrine, which some academic observers have described as “incoherent” and “illogical.” In the wake of *Cuno*, lawsuits were filed in several states that would have continued to test the contours of the doctrine and the expanded the reach of the principles in *Cuno* beyond the Sixth Circuit.

307 Hellerstein & Coenen, *Commerce Clause Restraints on State Business Development Incentives*, supra note 217, at 826. The *Cuno* court apparently found it constitutionally redeeming that the conditions were “directly linked to the use of the exempted personal property.” *Cuno*, 386 F.3d at 747. In an Article analyzing *Cuno*, Edward Zelinsky noted that although the Sixth Circuit implied that the link “makes the employment conditions constitutional,” Hellerstein and Coenen “come to the opposite conclusion: linking tax exemption to employment levels makes the exemption unconstitutionally coercive under the dormant Commerce Clause.” See Edward A. Zelinsky, *Cuno: The Property Tax Issue*, 4 GEO. J.L. & PUB. POL’Y 119, 129-30 (2006) [hereinafter Zelinsky, *Cuno: The Property Tax Issue*]. Zelinsky noted that the “Sixth Circuit never explains why it cherry picks from the Hellerstein and Coenen article in this fashion . . . .” Id. at 129.

308 See Hellerstein & Coenen, *Commerce Clause Restraints on State Business Development Incentives*, supra note 217, at 826 (noting property tax incentives with job-creation requirements as an example of an incentive that violates constitutional principles, as those do not limit tax incentives to parties with a certain economic presence in a state).

309 *Cuno*, 386 F.3d at 747.

310 See id. at 746-47.

311 See Denning, *Cuno and the Court*, supra note 231, at 33 (“The Sixth Circuit’s decision to strike down Ohio’s investment tax credit exposes some of the fault lines that have always made aspects of the Dormant Commerce Clause doctrine (DCCD) appear incoherent or illogical.”).

One of these challenges was set forth in *Northwest Airlines, Inc. v. Wisconsin Department of Revenue*.\(^{313}\) In that case, the challenged law was a property tax exemption for certain air carrier companies operating in the state.\(^{314}\) The stated purpose of the incentive was “to maintain Wisconsin’s air transportation system, protect existing jobs, encourage the development of additional air transportation facilities, and preserve the state’s competitiveness in attracting and retaining business and industry.”\(^{315}\) The case reached the Wisconsin Supreme Court, which held that Dormant Commerce Clause review was preempted by a federal statute that outlined the scope of prohibited taxation of air carriers.\(^{316}\) With the *Cuno* decision vacated and the *Northwest Airlines* court declining to make a similar analysis, the last major chapter in this line of case law came to an end.

However, the *Cuno* case remains a sleeping bear within the current legal framework. As previously mentioned, the case was vacated on the grounds that the plaintiffs—a group of Ohio taxpayers whose only claim to injury was the depletion of tax revenue attributable to the tax preferences—lacked standing to challenge the law.\(^{317}\) The Supreme Court did not reach the substantive analysis, leaving open the question of whether the merits of the Sixth Circuit’s holdings would have been affirmed. Meanwhile, as discussed above, the Sixth Circuit’s holding was only partially consistent with academic theories. To the extent that the holding was not consistent with the leading academic theories, it was because the court’s holding did not go far enough, suggesting that future courts could go even further.

It is only a matter of time before a new plaintiff can establish standing in a similar challenge. For example, a firm may have standing to sue—and an incentive to do so—if it would qualify for tax breaks but for the failure to increase investment in the state, or its failure to hire state residents. In fact, for reasons to be explained in the next Section, the scene for such a challenge is already being set. Namely, several states have enacted controversial—and probably unconstitutional—modifications to their state opportunity zone laws. Given the general controversy surrounding opportunity zones laws, it seems likely that some state opportunity zones laws will be challenged in court, potentially waking *Cuno* and calling into question other commonly used economic development incentives, including many place-based tax incentives.

\(^{313}\) *Nw. Airlines, Inc. v. Wis. Dep’t of Revenue*, 717 N.W.2d 280 (Wis. 2006).
\(^{314}\) Id. at 282–83.
\(^{315}\) Id. at 282.
\(^{316}\) Id. at 297.
C. Clear Rules that Limit Place-Based Tax Incentive Reform

As the discussion above demonstrates, many state economic development incentives are on shaky constitutional ground, and no coherent theory has been fully adopted by the courts. Nevertheless, the law is not lacking in clear rules altogether. Rather, courts and commentators alike have recognized that certain tax schemes are almost certainly unconstitutional. This Section highlights two rules that are relevant to analyzing the constitutionality of place-based tax incentives. These rules specify that incentives unconstitutionally discriminate against interstate commerce if they: (i) reduce benefits when the taxpayer (or a third party) invests out of state; or (ii) are conditioned on hiring or serving residents. As this Section will demonstrate, these rules are in direct conflict with some of the most promising reform proposals.

1. Tax Incentives and In-State Investment

Tax benefits that decrease as the taxpayer’s out-of-state investment increases are unconstitutional. 318 Recall that in Westinghouse Electric, the law at issue provided a tax credit based on gross receipts from export products shipped from New York. 319 The effect of the law was to decrease the credit amount as the taxpayer increased the percentage of its shipments from outside New York. The Court noted that this scheme effectively penalized taxpayers from doing business out of state. 320 This rule can be interpreted to prohibit “any tax incentive that would require a taxpayer to maintain a certain percentage of its work force or invest a certain percentage of its property in the state, because percentage-based rules necessarily disadvantage the taxpayer based on an increase in out-of-state activity.” 321 Stated more simply, under Westinghouse Electric, tax incentives that reduce benefits when the taxpayer invests out of state are unconstitutional.

Similarly, tax benefits that decrease when a third-party’s out-of-state investment increases are constitutionally prohibited. 322 In Fulton Corp. v.

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318 See Hellerstein, Cuno and Congress, supra note 292, at 82-84 (explaining that a prohibition on tax incentives that are reduced as out-of-state activity increases "embodies the narrowest aspect of the Court’s holding in Westinghouse Electric Corp. v. Tully").


320 See Westinghouse Elec. Co. v. Tully, 466 U.S. 388, 400-01 (1984) ("[N]ot only does the New York tax scheme provide a positive incentive for increased business activity in New York State, but also it penalizes increases in . . . shipping activities in other States." (quotation omitted)).

321 Hellerstein, Cuno and Congress, supra note 292, at 84 (explaining that a prohibition on tax incentives that are reduced as a third-party’s out-of-state activity increases "encapsulate[s] the holding of Fulton Corp. v. Faulkner").

322 See id. at 84-85.
Faulkner, the Supreme Court struck down a tax scheme that reduced benefits as a third party’s out-of-state activity increased. The tax scheme at issue in Fulton Corp. was an “‘intangibles tax’ on a fraction of the value of corporate stock owned by North Carolina residents inversely proportional to the corporation’s exposure to the State's income tax . . . .” Practically speaking, this meant that the amount of intangibles tax that a shareholder owed decreased as a corporation’s in-state activities (and, accordingly corporate tax exposure) increased. Conversely, if the corporation increased its out-of-state activities relative to its in-state activities, the shareholder would pay a higher intangibles tax. This scheme was deemed to unconstitutionally discriminate against interstate commerce.

As a direct consequence of these rules, reforms to limit state opportunity zones laws to in-state investment almost certainly discriminate against interstate commerce. To see why, consider the Arkansas opportunity zone law. Recall that in Arkansas, the definition of “opportunity zone” was modified to mean “a population census tract located in Arkansas that is designated as a qualified opportunity zone under 26 U.S.C. § 1400Z-1, as of January 1, 2019.” If an Arkansas taxpayer sells an asset and realizes capital gains and then the taxpayer reinvests those gains in an Opportunity Fund that invests in a qualified Opportunity Zone located in Arkansas, then the taxpayer will be permitted to defer tax on the capital gains and, eventually, claim other tax benefits. However, if the same taxpayer invests in an Opportunity Fund that has out-of-state investments, the taxpayer’s investment would not qualify for the tax benefits. In other words, the Arkansas law may reduce or eliminate benefits as a result of the Opportunity Fund increasing its out-of-state activity, a result that violates the principles set forth in Westinghouse Electric and Fulton Corp.

For the same reasons that the Arkansas law is probably unconstitutional, courts would probably strike down similar incentive schemes in Maryland, Ohio, and Wisconsin, as described in subsection II.B.2 above. Given the controversial nature of opportunity zone laws in general, the laws in each of these states seem ripe for constitutional challenge—and such challenges have the potential to revive the Cuno decision, especially in Ohio. The outcome

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324 Id. at 327.
325 See Hellerstein, Cuno and Congress, supra note 292, at 84-85 n.69 (“Under this taxing regime, the stock of a corporation doing all of its business in North Carolina would be subject to no North Carolina intangible property tax; the stock of a corporation doing fifty percent of its business in North Carolina would be subject to an intangible property tax on fifty percent of the stock's value; and the stock of a corporation doing no business in North Carolina would be subject to an intangible tax on its full value.”).
326 Fulton Corp., 516 U.S. at 346.
327 ARK. CODE ANN. § 26-51-460(b) (2022).
could have serious implications for many common economic development incentives beyond opportunity zone laws. A sweeping ruling striking down these state opportunity zones laws may have the effect of also striking down state NMTCs—which also limit tax preferences to in-state investment—as well as income tax incentives included in enterprise zone laws. Meanwhile, these rules prevent other states from implementing similar reforms, even though doing so could enhance democratic autonomy, efficiency, and equity outcomes.

2. Tax Incentives Conditioned on Hiring or Serving Residents

Finally, tax incentives conditioned on hiring or serving residents are almost certainly unconstitutional. In *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, a taxpayer challenged a residence-based limitation to Maine’s property tax exemption for charities. Specifically, the state provided a general exemption from real estate and personal property taxes for “benevolent and charitable institutions incorporated” in Maine. However, charities that were “conducted or operated principally for the benefit of persons who are not residents of Maine,” would receive only a partial exemption, if the charity also met certain conditions. The plaintiff taxpayer was a Maine nonprofit entity that operated a summer camp with ninety-five percent of its campers from out-of-state. Because of this, the nonprofit did not qualify for the full property tax exemption.

In striking down the statute as unconstitutionally discriminatory, the Supreme Court observed that the Maine statute “functionally serves as an export tariff that targets out-of-state consumers by taxing the businesses that principally serve them.” In addition, the Court noted that “the statute provides a strong incentive for affected entities not to do business with nonresidents if they are able to so avoid the discriminatory tax.” Thus, the decision in *Camps Newfound* appears to prohibit tax incentives that “depend[] on the residence of an individual, for example, a tax incentive to a corporation contingent on the hiring of state residents.”

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328 See Hellerstein, Cuno and Congress, supra note 292, at 79-81 (“[O]ne of the bedrock principles of the Court’s Commerce Clause jurisprudence [is] that states may not favor local over out-of-state taxpayers . . .”).
330 Id. at 568 (quotation omitted).
331 Id. at 568 n.2 (quoting ME. REV. STAT. ANN. tit. 36, § 652(1)(A) (1996)).
332 Id. at 567.
333 Id. at 568-69.
334 Id. at 580-81.
335 Id. at 578.
336 Hellerstein, Cuno and Congress, supra note 292, at 80.
Similarly, in *Pelican Chapter, Associated Builders & Contractors, Inc. v. Edwards*, the Fifth Circuit struck down a tax exemption “because it required beneficiaries to give a preference to in-state manufacturers, suppliers, and laborers.”337 The Fifth Circuit reasoned that incentives conditioned on residency are unconstitutional unless they are justified by a “legitimate local purpose” that could not be served by nondiscriminatory means.338 However, it expressly rejected the argument that reducing unemployment constitutes a legitimate local purpose, stating that “[r]educing unemployment by discouraging the use of out-of-state labor and products constitutes the patent economic protectionism that the Commerce Clause forbids.”339

Later, in *Cuno*, the Sixth Circuit pointed to both *Camps Newfound* and *Pelican Chapter* as standing for the proposition that tax incentives could not be conditioned on “the individuals employed or served.”340 Though the Supreme Court vacated *Cuno* on standing grounds, it is likely that at least some courts would similarly interpret this precedent as prohibiting conditions that require businesses to hire or serve local residents. Under these cases, reforms to add residence-based restrictions to state place-based tax incentives are almost certainly unconstitutional. The same logic that prohibited the state in *Camps Newfound* from tying tax exemption to serving state residents would also prohibit place-based tax incentives contingent on hiring or serving residents of the targeted zone. Thus, the legal system presents a significant barrier to community-oriented reforms that adopt this approach.

**D. Evaluating Other Constitutional Constraints**

This Part has identified several constitutional barriers to state place-based tax incentive reform. Before turning to the question of how states can overcome these barriers, it is worth noting that the Dormant Commerce Clause is not the only constitutional provision that prohibits states from discriminating based on residence. Plaintiffs could use two other constitutional provisions “to challenge an allegedly discriminatory state tax: the Privileges and Immunities Clause of Article IV; [and] the Equal


338 See *Pelican Chapter*, 128 F.3d at 917; see also *Cuno*, 386 F.3d at 743 (“A state tax provision that discriminates against interstate commerce is invalid unless it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives.” (quotation omitted)).

339 *Pelican Chapter*, 128 F.3d at 918.

340 See *Cuno*, 386 F.3d at 747.
Protection Clause . . .". For the reasons explained in this Section, neither of these provisions are likely to constrain state place-based tax incentive reform to the same degree as the Commerce Clause.

1. Privileges and Immunities Clause

Tax laws that discriminate based on residence are prohibited under the Privileges and Immunities Clause of Article IV, Section 2 of the United States Constitution, which states that the “Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.” The Privileges and Immunities Clause has been interpreted to prohibit certain state tax laws that discriminate between residents and nonresidents. One might argue that conditioning tax preference on the “residence of an individual,” as in the case of resident hiring preferences would be unconstitutional under the Privileges and Immunities Clause, which “generally bars tax discrimination against individual nonresidents.”

However, there are several reasons why the Privileges and Immunities Clause may not present barriers to reform. First, the right to claim tax benefits under place-based tax incentives would not ordinarily turn on the residency of the taxpayer. Instead, eligibility turns on the location of the investment. This preference for in-state investment is relevant under the Commerce Clause, which focuses on discrimination against interstate commerce (regardless of whether the law discriminates based on taxpayer residence). However, it is not relevant under the Privileges and Immunities Clause, which instead focuses on whether the law provides “substantial equality of treatment” for resident and nonresident taxpayers . . . . Moreover, since “the Privileges and Immunities Clause is inapplicable to corporations,” place-based tax incentives structured as corporate tax incentives generally would not violate the Clause even if they do distinguish between resident and nonresident taxpayers.

Second, even if the conditions are found to discriminate against individuals on the basis of residence, laws are struck down under the Privileges and Immunities Clause “only when those laws were enacted for the protectionist purpose of burdening out-of-state citizens.” Courts have

342 See U.S. CONST. art. IV, § 2.
343 See, e.g., Austin v. New Hampshire, 420 U.S. 656, 668 (1975) (finding that a law that caused “disparate treatment of residents and nonresidents” violated the Privileges and Immunities Clause).
344 See Hellerstein, Cuno and Congress, supra note 292, at 80-81.
345 Kaye, Tax Discrimination, supra note 341, at 83 (emphasis added) (citing Austin, 420 U.S. at 665).
346 Id. at 84 (citing Bank of Augusta v. Earle, 38 U.S. (13 Pet.) 519, 586 (1839)).
therefore noted that “a mere ‘facial distinction’ between residents and nonresidents is insufficient to support an inference of protectionist purpose; courts should instead give weight to the purpose of the law.” Here, states might argue they are not using residence restrictions on place-based tax incentives for a protectionist purpose, but rather to ensure that tax-subsidized investment will benefit residents of distressed communities, thereby advancing poverty reduction goals.

Third, and relatedly, the standard of review for testing whether the law violates the Privileges and Immunities Clause is substantially lower than the standard of review in Dormant Commerce Clause cases. Where tax laws that discriminate against interstate commerce are virtually per se unconstitutional in the Dormant Commerce Clause context, a state may defend a tax law against Privileges and Immunities challenge by “demonstrating that (i) there is a substantial reason for the difference in treatment; and (ii) the discrimination practiced against nonresidents bears a substantial relationship to the State’s objective.”

Accordingly, states could argue that the poverty reduction goals of the incentives are dependent on how well the benefits of investment flow to residents of the targeted, distressed areas. When new jobs flow to outsiders, or when new housing is developed for outsiders, the residents of distressed communities are unlikely to benefit from improvements to their neighborhoods. In fact, they may even be harmed if such improvements lead to gentrification-induced displacement. The residence-based restrictions are therefore necessary to prevent harm to low-income communities and strengthen the link between place-based investment and poverty reduction. For these reasons, the Privileges and Immunities Clause should not present a constitutional barrier to such conditions.

2. Equal Protection Clause

A third constitutional doctrine that prohibits discrimination against outsiders is the Equal Protection Clause set forth in the Fourteenth Amendment to the United States Constitution. The Clause states that no “State shall make or enforce any law which shall . . . deny to any person within its jurisdiction the equal protection of the laws.” The Equal Protection Clause limits—but does not prohibit—the extent to which states can create classifications under the law. Accordingly, the Clause has occasionally, but only rarely, been used to strike down classifications created under state tax

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350 U.S. CONST. amend. XIV, § 1.
To survive an equal protection challenge, the state law must advance a legitimate state interest, and the classification must be rationally related to serving that interest. This rational basis standard of review is such that a “statute will be upheld as long as there is a plausible policy reason for the classification, plausible legislative facts on which a rational legislator could rely, and ‘the relationship of the classification to its goal is not so attenuated as to render the distinction arbitrary or irrational.’” Given this permissive standard, the “Supreme Court has rarely invalidated state tax laws on the sole basis that they are in violation of the Equal Protection Clause.” In the case of place-based tax incentives, classifications arising from conditions that tie tax preferences to activities that benefit residents of targeted communities would almost certainly meet this rational basis standard.

For example, courts would probably consider poverty reduction to be a legitimate state interest; and the classifications created by residency-restrictions would almost certainly be viewed as rationally related to serving that interest. First, such restrictions are supported by both empirical evidence and theory. Second, one of the leading Equal Protection tax cases, Nordlinger v. Hahn, specifically reasoned that a tax policy “to inhibit displacement of lower income families by the forces of gentrification” satisfied rational basis review. For these reasons, it is extremely unlikely that the Equal Protection Clause would present any barriers to reform.

IV. THE PATHS TO STATE TAX INCENTIVE REFORM

A. Overcoming Constitutional Barriers

Part III identified several constitutional barriers to state place-based tax incentive reform. These findings have serious implications not only for the equity and efficiency of the state tax landscape, but also for community development law. Place-based tax incentives are a commonly used

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351 See, e.g., Allegheny Pittsburgh Coal Co. v. Cty. Comm’n, 488 U.S. 336, 345-46 (1989) (holding that a county assessor’s choice to apply different property valuation to new versus old property owners violated the Equal Protection Clause because its methods were contrary to state statute and reflected “intentional systemic undervaluation” of property).

352 See Nordlinger v. Hahn, 505 U.S. 1, 11 (1992) (setting forth the appropriate standard of review under the Equal Protection Clause).

353 Kaye, Tax Discrimination, supra note 341, at 84-85 (quoting Nordlinger, 505 U.S. at 11); see also Fitzgerald v. Racing Ass’n of Cent. Iowa, 539 U.S. 103, 108-09 (2003) (noting that rational basis review is a deferential standard and “not every provision in a law must share a single objective”).

354 Kaye, Tax Discrimination, supra note 341, at 85.

355 See supra Section II.A.

356 Nordlinger, 505 U.S. at 12.
community economic development tool, but their success depends upon changing legal frameworks to accommodate reformed incentives that would be unconstitutional under current law. This Part argues that the most promising way to overcome the constitutional barriers described in Part III is to lobby Congress to override current Dormant Commerce Clause doctrine by enacting legislation.

It is well established that “[j]udicial review of state taxes under the [Dormant] Interstate Commerce Clause is intended to ensure that States do not disrupt or burden interstate commerce when Congress' power remains unexercised: it protects the free flow of commerce, and thereby safeguards Congress' latent power from encroachment by the several States.” 357 When Congress has exercised its power to regulate interstate Congress, “courts are not free to review state taxes under the dormant Commerce Clause since it is Congress, and not the courts, that has struck the balance that it deems appropriate.” 358 A closer look at Northwest Airlines illustrates the effect of congressional legislation. In that case, the tax scheme at issue was a property tax exemption for air carriers that operate a hub facility in Wisconsin. 359 The purpose of the exemption was “to maintain Wisconsin’s air transportation system, protect existing jobs, encourage the development of additional air transportation facilities, and preserve the state’s competitiveness in attracting and retaining business and industry.” 360 The lower court had held that “the hub exemption was a facial violation of the dormant Commerce Clause because it benefited instate air carriers while imposing an extra burden on out-of-state air carriers.” 361

On appeal, the Wisconsin Supreme Court considered the effect of a federal statute that created two classes of taxes on air carriers: those that were prohibited, and those that were authorized. 362 Under the statutory scheme, taxes that were not prohibited were expressly authorized by the statute. 363 The Wisconsin Supreme Court concluded that the statute at issue “demonstrate[d]—with unmistakable clarity— congressional consent to allow states to impose differential taxes among air carriers . . . .” 364 The Dormant Commerce Clause was inapplicable in this context, which was governed

359 Nw. Airlines, Inc. v. Wis. Dep't of Revenue, 717 N.W.2d 280, 284 (Wis. 2006).
360 Id. at 282.
361 Id. at 284.
362 Id. at 290.
363 Id.
364 Id.
entirely by statute. The Wisconsin Supreme Court analyzed the hub exemption in light of the statutory scheme, and it concluded that since the hub exemption was not prohibited by statute, then it was authorized despite being discriminatory.

Northwest Airlines illustrates that, unlike the states, Congress is not bound to the prohibition against discriminatory taxes, and Congress can allow states to treat in-state and out-of-state firms differently. This principle may be key to overcoming constitutional barriers to state place-based tax incentive reform. For the reasons explained below, the most promising path for state tax incentive reform would be to overcome constitutional barriers by changing the law through federal legislation. This Section explains how such federal legislation could be drafted, and it considers alternative approaches if such legislative changes are untenable.

1. Changing the Law Through Federal Legislation

Congress has already demonstrated an openness to enacting legislation to authorize state economic development incentives that would otherwise violate the Dormant Commerce Clause. In 2005, when the Cuno case was pending before the Supreme Court, states successfully lobbied Congress to introduce bipartisan legislation that would have preserved their ability to use economic development tax incentives. The proposed Bill—the Economic Development Act of 2005 (EDA of 2005)—would have provided “Congressional authorization for states to provide tax incentives that might otherwise be unconstitutionally discriminatory under the Court’s dormant Commerce Clause doctrine while at the same time leaving undisturbed the balance of the Court’s dormant Commerce Clause doctrine barring discriminatory taxes.” The EDA of 2005 was left to die in committee after the Supreme Court overturned Cuno on standing grounds, rendering the impetus for the legislation temporarily moot. Nevertheless, the history surrounding the EDA of 2005 is instructive for at least two reasons.

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365 See id. at 293 (“Congress intended to replace the uncertainty and quagmire of dormant Commerce Clause review with the relative certainty of statutory tests that protect against discriminatory taxation.”).
366 Id. at 294.
367 Id.; see also Prudential Ins. Co. v. Benjamin, 328 U.S. 408, 422-23 (1946) (noting that the "commerce clause is in no sense a limitation upon the power of Congress over interstate and foreign commerce," and rejecting the taxpayer’s argument that Congress lacks the power to authorize a tax that would discriminate against interstate commerce).
369 Hellerstein, Cuno and Congress, supra note 292, at 75.
First, this history provides insight as to what might happen when *Cuno* is revived. As discussed in Part III, the Supreme Court overturned *Cuno* for lack of standing, but it did not criticize the substantive holdings, many of which were consistent with leading theories about how the nondiscrimination doctrine should be applied. As such, it is only a matter of time before courts are asked to revisit the constitutionality of economic development incentives in a case where the taxpayer has standing. And when they do, it is likely that some common categories of economic development incentives (e.g., income tax incentives) will be struck down as unconstitutional. In this likely turn of events, Congress may be willing—as it was in 2005—to intervene and prevent a perceived change in constitutional law from disrupting the economic landscape.

Second, this history provides a partial template for reformers who can begin lobbying Congress now. The EDA of 2005 included a broad initial authorization, whereby states were expressly authorized “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.” However, the broad authorization was limited by seven exceptions, three of which would have codified the prohibitions against incentives that reduce benefits when the taxpayer (or a third party) invests out of state, and against incentives conditioned on hiring or serving residents. These exceptions were purportedly intended to preserve the nondiscrimination principle. However, their effect would have been to affirm states’ rights to engage in tax competition, but to foreclose the possibility of using place-based tax incentives to implement effective community-oriented policies.

Setting aside the broader question of whether tax competition should be authorized by Congress, this Article argues that the success of place-based tax incentive reform depends on whether legal frameworks can adapt to authorize well-designed place-based tax incentives—the opposite of what was proposed under the EDA of 2005. For example, the EDA of 2005 would have codified rules set forth in *Camps Newfound* prohibiting tax incentives that were “dependent upon . . . residence of an individual.” However, this rule—whether set forth by statute or doctrine—presents a barrier to reforms to ensure that place-based tax incentives target benefits to residents of distressed communities.

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Similarly, the EDA of 2005 would have codified rules set forth in *Westinghouse Electric* by prohibiting tax incentives that were “reduced or eliminated as a direct result of an increase in out-of-State activity by the recipient of the tax incentive.” It also would have prohibited tax incentives that were “reduced or eliminated as a result of an increase in out-of-State activity by a person other than the recipient of the tax incentive or as a result of such other person not having a taxable presence in the State.” Both of these prohibitions would present barriers to reforms that would limit opportunity zone tax preferences to in-state investment.

To support state place-based tax incentive reform, Congress should instead authorize place-based tax incentives that are conditioned upon a threshold level of hiring or serving residents of targeted low-income communities. The legislation should require states to define a threshold level of hiring or service. Importantly, economic development tax incentives that do not target low-income communities could be excluded from the authorization and, therefore, could remain subject to the Supreme Court’s nondiscrimination doctrine. This narrow authorization would clear the path for place-based tax incentive reform, while continuing to prohibit discriminatory laws that are not specifically designed to benefit low-income communities.

In addition, Congress could authorize states to decouple their state-level incentives from federal laws to target local distressed places. The text may read: “In the case of place-based tax incentives created by conforming with federal law, states are authorized to limit the incentive to in-state activities; provided that such incentives are further conditioned upon meeting specified targets for hiring or serving residents of targeted low-income communities.” In this way, Congress could clear a path for states to target local distressed places, while also ensuring incentives are designed to only benefit residents of those communities.

2. Replacing Tax Incentives with Direct Subsidies

Though this Article is focused on place-based tax incentive reform, one other aspect of the legal framework is worth mentioning: the legal framework applicable to direct subsidies. Both economists and tax scholars have long recognized the economic equivalence of tax preferences and direct

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subsidies.\textsuperscript{374} To illustrate this principle, a “firm that is relieved of paying $10,000 in income taxes ends up with exactly as much cash in the till as the firm that pays the full tax levy, but then gets a $10,000 subsidy check.”\textsuperscript{375} Given this equivalence, one might expect that subsidies and economic development incentives would be afforded similar treatment under the Dormant Commerce Clause. They are not.

In \textit{New Energy}, the Court stated in dicta that “[d]irect subsidization of domestic industry does not ordinarily run afoul” of the Dormant Commerce Clause, whereas “discriminatory taxation of out-of-state manufacturers does.”\textsuperscript{376} Recall that in \textit{New Energy}, the Court struck down an Ohio tax credit used to subsidize the state’s ethanol industry.\textsuperscript{377} In doing so, the Supreme Court remarked that “[i]t has not escaped our notice that the appellant here, which is eligible to receive a cash subsidy under Indiana’s program for in-state ethanol producers, is the potential beneficiary of a scheme no less discriminatory than the one that it attacks, and no less effective in conferring a commercial advantage over out-of-state competitors.”\textsuperscript{378}

Yet, rather than criticizing the direct subsidy scheme, the Court reiterated that “[t]he Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description \textit{in connection with the State’s regulation of interstate commerce}.”\textsuperscript{379} In \textit{Cuno}, the Sixth Circuit expanded upon this language to explain that “the distinction between a subsidy and a tax credit, in the constitutional sense, results from the fact that the tax credit involves state regulation of interstate commerce through its power to tax.”\textsuperscript{380} Citing \textit{New Energy} for the proposition that direct subsidies “do not 'ordinarily run afoul of the Commerce Clause,'” the \textit{Cuno} court reasoned that “the state’s power to tax are to be treated differently from direct subsidies despite their similarity in terms of end-result economic impact.”\textsuperscript{381}

\begin{footnotesize}
\textsuperscript{375} Hellerstein & Coenen, \textit{Commerce Clause Restraints on State Business Development Incentives}, supra note 217, at 835.
\textsuperscript{376} New Energy Co. of Ind. v. Limbach, 486 U.S. 269, 278 (1988).
\textsuperscript{377} See supra notes 248–252 and accompanying text.
\textsuperscript{378} \textit{New Energy}, 486 U.S. at 278.
\textsuperscript{379} \textit{Id}.
\textsuperscript{380} \textit{Cuno v. DaimlerChrysler}, Inc., 386 F.3d 738, 746 (6th Cir. 2004).
\textsuperscript{381} \textit{Id} (alterations omitted) (quoting \textit{New Energy}, 486 U.S. at 278).
\end{footnotesize}
Thus, while discriminatory tax laws are clearly unconstitutional under the Dormant Commerce Clause, there is a serious doctrinal question as to whether discriminatory direct subsidies are also unconstitutional. The dicta set forth in both *New Energy* and *Cuno* suggests that direct subsidies may be permissible even when their tax-based counterparts would not be. Scholars have had mixed reactions to this contradictory treatment. Professor Edward Zelinsky has argued that the distinction lacks any principled basis.\(^{382}\) Hellerstein and Coenen, on the other hand, have argued that it is possible to treat direct expenditures differently from tax expenditures.\(^{383}\) They argue that the constitutionality of direct subsidies should be evaluated under a “unitary ‘anti-tariff principle’” and concluded that “[i]n contrast to [their] position on tax incentives,” courts “should uphold almost all state subsidies.”\(^{384}\)

In sum, courts and scholars have both proceeded on the assumption that direct expenditures receive a presumption of constitutionality not afforded to economic development tax incentives. This difference in treatment may prove useful to reformers if they are unable to overcome constitutional barriers to place-based tax incentive reform. If reformers are unable to convince Congress to change the legal framework applicable to place-based tax incentives, they may have an alternative: replace place-based tax incentives with direct subsidies that contain residence-based restrictions. In fact, this move would appear to be the simplest way to achieve community-oriented reform goals, since it does not require changes to the existing legal framework.

That said, the approach may not be as simple as it seems. Replacing tax expenditures with direct grants may require changes to program administration and regulation that would not be necessary if the laws continued to be structured as tax incentives. Structuring the incentives as direct grants would also convert the program into a spending program that would be reported as such on states’ budgets.\(^{385}\) This increase in salience could have the unintended consequence of reducing political support. In short, the increased tax revenues would *look* like a tax increase that funds new government spending—even if the tax “increase” was solely attributable to the eliminated tax expenditure and the “spending” was happening all along.

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382 See Zelinsky, *Cuno: The Property Tax Issue*, supra note 307, at 131 (“It consequently makes no sense to apply the dormant Commerce Clause nondiscrimination principle to economically comparable tax incentives freighted with such clawback conditions.”).


384 Id. at 836.

385 See Surrey, *Tax Incentives as a Device for Implementing Government Policy*, supra note 374, at 726 (criticizing tax incentives as lacking transparency with respect to budget impact).
To be sure, from the perspective of democratic control, the increased budget transparency is arguably desirable. But the increased transparency may come at the cost of decreased bipartisan support. Conservatives may be inclined to support tax incentives as business tax reductions, even if they function as social spending. In contrast, direct expenditures are readily understood as government spending and are less likely to maintain widespread support.\textsuperscript{386} Thus, while there may be good legal and theoretical reasons to convert place-based tax incentives into direct subsidies, the political challenges may make this approach untenable. For this reason, the more politically viable approach remains reform of place-based tax incentives themselves. That said, place-based tax incentive reform also faces political barriers. The next Section explains how these challenges can be overcome.

\textbf{B. Overcoming Political Barriers to Reform}

Thus far, this Part has explained how reformers might overcome constitutional barriers to state place-based tax incentive reforms. Namely, states and reformers could clear a path for reform by lobbying Congress to change existing legal frameworks, or by replacing tax incentives with direct subsidies. However, these strategies may face additional political barriers. These problems arise at two levels: the state and the federal level.

\textbf{1. State Level Political Considerations}

At the state level, reformers must work to convince state legislators to enact community-oriented incentives. One of the largest barriers to place-based tax incentive reform is that community-oriented goals often compete with goals related to economic growth. As explained in Part I, place-based tax incentives have often enjoyed bipartisan support because the dual goals of economic growth and community benefits attract supporters from both sides of the political aisle. Pro-growth conservatives may support place-based tax incentives because they reduce firms’ tax burdens, while progressives may support such incentives on social policy grounds.\textsuperscript{387}

However, some of the community-oriented reforms identified in this Article may shift the balance away from economic growth goals. For example, restrictions that require taxpayers to employ workers from a targeted community may have the consequence of promoting lower-skilled workers.\textsuperscript{386} Cf. Susannah Camic Tahk, \textit{The Tax War on Poverty}, 56 ARIZ. L. REV. 791, 825 (2014) (collecting studies demonstrating that similar programs are more likely to gain support as tax incentives rather than as expenditures).

\textsuperscript{387} See Layser, \textit{Pro-Gentrification Origins}, \textit{supra} note 4, at 757-59 (discussing how both progressive and conservative groups support such incentives on different grounds); \textit{WESSEL, supra} note 1, at 4-5, 278 (discussing progressive groups’ motivations for supporting such programs).
industries that produce fewer job multipliers. As the goals of the incentives shift, the bipartisan support they enjoy may deteriorate. Meanwhile, state governments may be susceptible to pressure from industry and business lobbyists, some of which are likely to oppose laws that restrict access to tax credits. Nevertheless, some states’ political climate may be sufficiently progressive to overcome the political economy challenges.

In addition, it seems likely that in some cases industry representatives would also support these changes. For example, the community economic development financing industry includes a wide range of mission-driven actors who may welcome such reforms as providing a competitive edge. In addition, some businesses may find that supporting pro-social policies that still provide the possibility of tax breaks helps their company image and reputation. In other words, the state-level political constraints on community-oriented reform are real but not insurmountable.

2. Federal Level Political Considerations

To overcome constitutional barriers to place-based tax incentive reform, reformers must also succeed at convincing Congress to change the current legal framework. As a result, reformers must overcome political constraints at the federal level. For the same reasons community-oriented reforms may face challenges at the state level, such changes face political challenges at the federal level—sometimes to an even greater degree. The deeply polarized composition of Congress makes it difficult to garner bipartisan support for social policies. Yet, community-oriented reforms would shift place-based tax incentives out of the “economic policy” realm and into the “social policy” realm. At first blush, this would seem to present a serious impediment to implementing federal legislation in this area. But the federal political problem is not as large as it appears.

While it is likely that community-oriented federal incentives (e.g., federal Opportunity Zones and federal NMTCs) would face serious political barriers, the reform of state incentives may not. This is because state-level reformers could call on Congress to expand—not restrict—states’ rights to use economic development incentives. The legislative fixes described above would not require states to implement community-oriented reforms; it would merely clear a path for them to do so, if they choose. In contrast, the current legal framework limits states’ rights to implement community-oriented incentives. Progressive lawmakers may support the expansion for its

388 See WESSEL, supra note 1, at 125-126, 198 (providing examples of state leaders responding to lobbying related to opportunity zones); see also Layser, Pro-Gentrification Origins, supra note 4, at 804 (explaining how powerful developer lobbies have influenced place-based tax policy).
potential social benefit, while conservative lawmakers may support it as an expansion of states’ rights.

In addition, in some conservative states, tax-based social welfare may be easier to enact than direct welfare programs, and lawmakers in those states may welcome legislation that makes it easier to implement such policies at the state level. Moreover, the general approach of focusing on states’ rights to implement place-based policy is generally consistent with longstanding federal policy with regard to housing and community development.\textsuperscript{389} As discussed in subsection I.B.1, the federal approach to most economic development problems has been to delegate power to the states to enact their own economic development policies. Therefore, the legislative fix described above may be supported as an extension of this general orientation, as it would expand states’ capacity to enact community economic development policies as they see fit.

Finally, the current political environment under the Biden Administration may present new opportunities for Congress to act. The Biden Administration is under pressure from progressive voters to enact social policies that address poverty but also faces steep opposition from conservatives in Congress. State place-based tax incentive reform may be an area in which the Biden Administration could advance progressive social policy with minimal pushback from opponents.

At the same time, the federal Opportunity Zones law has drawn sharp criticism from observers, and lawmakers from both sides of the aisle may be willing to enact legislation to address this criticism. By enacting legislation authorizing states to modify their versions of the federal Opportunity Zones law, progressive leaders can confer power to states to leverage the federal scheme in ways that are more likely to benefit low-income communities. Some conservative lawmakers may view such legislation as protecting a tax incentive that is championed by conservative leaders, constituents, and business lobbies. In fact, it would almost certainly be easier for Congress to clear a path for state-level reform of place-based incentives than to enact legislation that reforms the federal Opportunity Zones law itself.

\textsuperscript{389} See generally Carla Flink, Rebecca J. Walter & Xiaooyang Xu, Policy Diffusion in a Redistributive Policy: Affordable Housing and State Housing Trust Funds, \textit{53 ST. & LOC. GOV’T REV.} 187, 188 (2021) (describing how the federal government shifts affordable housing policy to the states); Charles M. Lamb & Jim Twombly, Taking the Local: The Reagan Administration, New Federalism, and Fair Housing Implementation, \textit{21 POL’Y STUD. J.} 589, 589 (1993) (discussing the shifting of fair housing policy to states under the Reagan Administration).
CONCLUSION

State place-based tax incentives can be reformed to improve outcomes for residents of low-income communities. Through a careful analysis of relevant statutory law, constitutional doctrine, and political economy considerations, this Article has presented a roadmap for state place-based tax incentive reform. Although some reforms can be achieved entirely through state-level statutory amendments, some of the most promising reform proposals would require changes to federal constitutional frameworks. This Article has shown how constitutional barriers to reform can be overcome through Congressional legislation.

In doing so, this Article has revealed the full extent of the state place-based tax incentive reform project. Successful reform of the tax incentive landscape will require changes to both state and federal law, involving lawmakers at every level of government. It has also revealed the urgency. If reformers fail to take steps to change the constitutional framework in ways that enhance their capacity to implement community-oriented reforms, there is a real and imminent risk that the constitutional frameworks will continue to evolve in ways that render many place-based tax incentives unconstitutional, including those that could otherwise be reformed to benefit low-income communities.
## Appendix A. Enterprise Zone Laws

### Table 3: Fifty-State Survey of Enterprise Zone Laws

<table>
<thead>
<tr>
<th>State</th>
<th>Statute</th>
<th>Hiring Incentives Required</th>
<th>Requires Engagement with Low-Income Community</th>
<th>Requires Engagement with Zone Residents</th>
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## Removing Barriers to State Tax Incentive Reform

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# APPENDIX B. STATE OPPORTUNITY ZONE LAWS

## Table 4: Fifty-State Survey of Opportunity Zone Laws

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<th>State</th>
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### APPENDIX C. STATE NEW MARKETS TAX CREDIT LAWS

**Table 5: Fifty-State Survey of New Markets Tax Credit Laws**

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