Comparative Fiscal Federalism: United States and European Union
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Reading Materials

The U.S. cases have been edited to limit their length. Deletions are indicated with ***. Many of the cases decided by the U.S. Supreme Court are prefaced by a Syllabus written by the Reporter of Decisions. The syllabus is not authoritative and cannot be cited as authority, but it is usually a good summary of the issues and reasoning of the Court. The full text of these cases is available on various on-line legal databases, such as Westlaw.

The ECJ cases are presented unedited, but they, too, are prefaced by a summary where available. The full text of ECJ cases can be downloaded from the Europa website. Notes about the holdings relevant for our discussion follow:

1. U.S. Constitution. The sections in bold are particularly relevant to federalism and taxation.

2. Marbury v. Madison, 5 U.S. 137 (1803) (*the Supreme Court has competence to interpret the U.S. Constitution*).

3. Chalker v. Birmingham, 249 U.S. 522 (1919) *(Privileges & Immunities Clause forbids higher privilege taxes on firms or individuals with their chief office out-of-state. This was discriminatory because non-citizens tend to have out-of-state chief offices).*

4. Case C-330/91 Commerzbank (1993) *(under the freedom of establishment, a host Member State cannot deny non-resident taxpayers interest on tax refunds if it grants resident taxpayers such refunds. Non-residents tend to be non-nationals).*

5. Shaffer v. Carter, 252 U.S. 37 (1920) (*Privileges & Immunities and Equal Protection Clauses not violated when a State permits residents to deduct from gross income not only losses incurred within the State but also those sustained outside the State, while nonresidents may deduct only losses incurred within the State*).

6. Case C-234/01, Gerritse (2003) (*host Member State must allow non-resident taxpayer to offset expenses related to earning income from services in that State under the freedom to provide services, but host State was not required to grant him the personal exemption*).

7. Travis v. Yale & Towne Mfg. Co, 252 U.S. 60 (1920) *(host State violated the Privileges & Immunities Clause by categorically denying non-residents who earned income in the host State the benefit of personal exemptions from income tax).*

8. Case C-279/93 Schumacker (1995) (*although non-residents and residents are not generally similarly situated for tax purposes, when a non-resident taxpayer earns all or almost all his income in the host Member State, he is similar to a resident taxpayer, and must be granted personal and family deductions*).

9. Lunding v. New York Tax Appeals Tribunal, 522 U.S. 287 (1998) (*Under the Privileges & Immunities Clause, host State cannot deny a non-resident taxpayer a pro rata deduction for alimony expenses on the basis of his non-residence when it grants alimony deductions for resident taxpayers*).

10. Case C-403/03, Schempp (2005) (*Germany violated neither the Article 12 prohibition on nationality discrimination nor the Article 18 freedom of movement when it denied its resident the ability to deduct alimony payments paid to a former spouse in Austria because Austria did not include the alimony in former spouse's income*).

11. Metropolitan Life Ins. Co. v. Ward, 470 U.S. 869 (1985) (*host State's higher tax rates on premiums paid to out-of-state insurance companies violated the Equal Protection Clause*).

12. (Recommended non-tax case) City of Philadelphia v. New Jersey, 437 U.S. 617 (1978) (*New Jersey cannot close private landfills situated within its borders to out-of-state garbage, even where the ostensible reason for the ban is to protect the environment of the state and the safety of its residents*).

13. (Recommended non-tax case) Bibb v. Navajo Freight Lines, 359 U.S. 520 (1959) (*State safety regulation, and especially state road safety regulation are given due deference in Commerce Clause cases. But the burden imposed by Illinois' requirement that trucks use contoured mudguards, about which there were safety doubts, was too great, especially in light of the fact that at least forty-five other states permitted straight mudguards, and one state, Arkansas, required straight flaps*).

14. Moorman Manufacturing Co. v. G.D. Bair, 437 U.S. 267 (1978) (*upholding a single-factor apportionment formula, even though the majority of states used the 3-factor "Massachusetts" formula taking equal account of in-state property, payroll, and sales to determine how much of the unitary income of a line of business should be apportioned to the state. The single factor formula, although out-of-line with other State formulas, did not lead to a "grossly distorted result" and therefore did not violate the Commerce Clause*).

15. (Recommended non-tax case) Dean Milk Co. v. Madison, 340 U.S. 349 (1941) (*City's strict milk controls that banned milk produced more than five miles outside the city from being sold as pasteurized violated the Commerce Clause. State's goal of protecting citizens from tainted milk could have been achieved by less restrictive means*).

16. (Recommended non-tax case) The Washington Apple Case, 432 U.S. 333 (1977) (*North Carolina's requirement that apples shipped in its territory bear the USDA grade or no grade at all unreasonably burdened interstate commerce by forcing Washington growers to obliterate Washington's stricter grading labels. North Carolina could have required USDA grade to be shown in addition to any other grades if consumer protection was the goal*).

17. Camps Newfound v. Town of Harrison, 520 U.S. 564 (1997) (*Even though a charity did not make a profit, it was engaged in interstate commerce as a purchaser of goods and provider of services. Allowing deductions for contributions to domestic charities that service domestic residents, but denying deductions for contributions to domestic charities that service out-of-state residents violated the Commerce Clause*).

18. Case C-156/98, Commission v. Germany (2000) (*Germany violated the freedom of establishment by limiting certain permissible state aids to companies that both did business in the former East German states and were established there. It did not matter that some German companies were also denied the aid*).

19. General Motors Corp. v. Director of Revenue, 981 SW2d 561 (Mo. 1998) (*Missouri Supreme Court held that the requirement that an affiliated group derive 50 percent or more of its income from Missouri in order to be entitled to file a consolidated return violated the Commerce Clause*).

20. Joined Cases C-397/98 and C-410/98, Metallgesellschaft & Hoechst (2001) (*United Kingdom violated the freedom of establishment by conditioning deferral of ACT upon filing for group relief, since only domestic subsidiaries with domestic parents could file for group relief*).

21. Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984) (*exemption from 20% alcohol excise tax for domestically produced liquors and wines discriminated against out-of-state products in violation of the Commerce Clause*).

22. New Energy Co. of Indiana v. Limbach, 486 U.S. 269 (1988) (*credit against Ohio's motor fuel tax for each gallon of gasohol sold that contained ethanol produced in Ohio was invalid under the Commerce Clause because it discriminated against out-of-state commerce*).

23. *Cuno v. DaimlerChrysler*, 386 F.3d 738 (6^{th} Cir. 2004) (*Sixth Circuit invalidated an investment tax credit as contrary to the Commerce Clause because by granting a tax benefit for new in-state investment, Ohio "coerced" DaimlerChrysler into investing in Ohio rather than in another state. Certiorari has been granted by the U.S. Supreme Court; oral arguments were heard earlier this year*).

24. West Lynn Creamery v. Healy, 512 U.S. 186 (1994) (*by levying a milk tax on in-state and out-of-state milk wholesalers, but granting a subsidy funded by the milk tax only to in-state dairy producers, Massachusetts violated the Commerce Clause*).

CONSTITUTION FOR THE UNITED STATES OF AMERICA[1]

Preamble

We the People of the United States, in Order to form a more perfect Union, establish Justice, insure domestic Tranquility, provide for the common defence, promote the general Welfare, and secure the Blessings of Liberty to ourselves and our Posterity, do ordain and establish this Constitution for the United States of America.

Article. I.

Section. 1. All legislative Powers herein granted shall be vested in a Congress of the United States, which shall consist of a Senate and House of Representatives.

Section. 2. The House of Representatives shall be composed of Members chosen every second Year by the People of the several States, and the Electors in each State shall have the Qualifications requisite for Electors of the most numerous Branch of the State Legislature.

No Person shall be a Representative who shall not have attained to the Age of twenty five Years, and been seven Years a Citizen of the United States, and who shall not, when elected, be an Inhabitant of that State in which he shall be chosen.

Representatives and **direct Taxes shall be apportioned among the several States**[2] which may be included within this Union, according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons. The actual Enumeration shall be made within three Years after the first Meeting of the Congress of the United States, and within every subsequent Term of ten Years, in such Manner as they shall by Law direct. The Number of Representatives shall not exceed one for every thirty Thousand, but each State shall have at Least one Representative; and until such enumeration shall be made, the State of New Hampshire shall be entitled to chuse three, Massachusetts eight, Rhode-Island and Providence Plantations one, Connecticut five, New-York six, New Jersey four, Pennsylvania eight, Delaware one, Maryland six, Virginia ten, North Carolina five, South Carolina five, and Georgia three.

When vacancies happen in the Representation from any State, the Executive Authority thereof shall issue Writs of Election to fill such Vacancies.

The House of Representatives shall chuse their Speaker and other Officers; and shall have the sole Power of Impeachment.

Section. 3. The Senate of the United States shall be composed of two Senators from each State, chosen by the Legislature thereof, for six Years; and each Senator shall have one Vote.

Immediately after they shall be assembled in Consequence of the first Election, they shall be divided as equally as may be into three Classes. The Seats of the Senators of the first Class shall be vacated at the Expiration of the second Year, of the second Class at the Expiration of the fourth Year, and of the third Class at the Expiration of the sixth Year, so that one third may be chosen every second Year; and if Vacancies happen by Resignation, or otherwise, during the Recess of the Legislature of any State, the Executive thereof may make temporary Appointments until the next Meeting of the Legislature, which shall then fill such Vacancies.

No Person shall be a Senator who shall not have attained to the Age of thirty Years, and been nine Years a Citizen of the United States, and who shall not, when elected, be an Inhabitant of that State for which he shall be chosen.

The Vice President of the United States shall be President of the Senate, but shall have no Vote, unless they be equally divided.

The Senate shall chuse their other Officers, and also a President pro tempore, in the Absence of the Vice President, or when he shall exercise the Office of President of the United States.

The Senate shall have the sole Power to try all Impeachments. When sitting for that Purpose, they shall be on Oath or Affirmation. When the President of the United States is tried, the Chief Justice shall preside: And no Person shall be convicted without the Concurrence of two thirds of the Members present.

Judgment in Cases of Impeachment shall not extend further than to removal from Office, and disqualification to hold and enjoy any Office of

[1] The title was not part of the original document. It was added when the document was printed
[2] Amended, see Amendment 16

honor, Trust or Profit under the United States: but the Party convicted shall nevertheless be liable and subject to Indictment, Trial, Judgment and Punishment, according to Law.

Section. 4. The Times, Places and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof; but the Congress may at any time by Law make or alter such Regulations, except as to the Places of chusing Senators.

The Congress shall assemble at least once in every Year, and such Meeting shall be on the first Monday in December [Modified by Amendment XX], unless they shall by Law appoint a different Day.

Section. 5. Each House shall be the Judge of the Elections, Returns and Qualifications of its own Members, and a Majority of each shall constitute a Quorum to do Business; but a smaller Number may adjourn from day to day, and may be authorized to compel the Attendance of absent Members, in such Manner, and under such Penalties as each House may provide.

Each House may determine the Rules of its Proceedings, punish its Members for disorderly Behaviour, and, with the Concurrence of two thirds, expel a Member.

Each House shall keep a Journal of its Proceedings, and from time to time publish the same, excepting such Parts as may in their Judgment require Secrecy; and the Yeas and Nays of the Members of either House on any question shall, at the Desire of one fifth of those Present, be entered on the Journal.

Neither House, during the Session of Congress, shall, without the Consent of the other, adjourn for more than three days, nor to any other Place than that in which the two Houses shall be sitting.

Section. 6. The Senators and Representatives shall receive a Compensation for their Services, to be ascertained by Law, and paid out of the Treasury of the United States. They shall in all Cases, except Treason, Felony and Breach of the Peace, be privileged from Arrest during their Attendance at the Session of their respective Houses, and in going to and returning from the same; and for any Speech or Debate in either House, they shall not be questioned in any other Place.

No Senator or Representative shall, during the Time for which he was elected, be appointed to any civil Office under the Authority of the United States, which shall have been created, or the Emoluments whereof shall have been encreased during such time; and no Person holding any Office under the United States, shall be a Member of either House during his Continuance in Office.

Section. 7. **All Bills for raising Revenue shall originate in the House of Representatives; but the Senate may propose or concur with Amendments as on other Bills.**

Every Bill which shall have passed the House of Representatives and the Senate, shall, before it become a Law, be presented to the President of the United States; If he approve he shall sign it, but if not he shall return it, with his Objections to that House in which it shall have originated, who shall enter the Objections at large on their Journal, and proceed to reconsider it. If after such Reconsideration two thirds of that House shall agree to pass the Bill, it shall be sent, together with the Objections, to the other House, by which it shall likewise be reconsidered, and if approved by two thirds of that House, it shall become a Law. But in all such Cases the Votes of both Houses shall be determined by yeas and Nays, and the Names of the Persons voting for and against the Bill shall be entered on the Journal of each House respectively. If any Bill shall not be returned by the President within ten Days (Sundays excepted) after it shall have been presented to him, the Same shall be a Law, in like Manner as if he had signed it, unless the Congress by their Adjournment prevent its Return, in which Case it shall not be a Law.

Every Order, Resolution, or Vote to which the Concurrence of the Senate and House of Representatives may be necessary (except on a question of Adjournment) shall be presented to the President of the United States; and before the Same shall take Effect, shall be approved by him, or being disapproved by him, shall be repassed by two thirds of the Senate and House of Representatives, according to the Rules and Limitations prescribed in the Case of a Bill.

Section. 8. **The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States;**

To borrow Money on the credit of the United States;

To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes;

To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States;

To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures;

To provide for the Punishment of counterfeiting the Securities and current Coin of the United States;

To establish Post Offices and post Roads;

To promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries;

To constitute Tribunals inferior to the supreme Court;

To define and punish Piracies and Felonies committed on the high Seas, and Offences against the Law of Nations;

To declare War, grant Letters of Marque and Reprisal, and make Rules concerning Captures on Land and Water;

To raise and support Armies, but no Appropriation of Money to that Use shall be for a longer Term than two Years;

To provide and maintain a Navy;

To make Rules for the Government and Regulation of the land and naval Forces;

To provide for calling forth the Militia to execute the Laws of the Union, suppress Insurrections and repel Invasions;

To provide for organizing, arming, and disciplining, the Militia, and for governing such Part of them as may be employed in the Service of the United States, reserving to the States respectively, the Appointment of the Officers, and the Authority of training the Militia according to the discipline prescribed by Congress;

To exercise exclusive Legislation in all Cases whatsoever, over such District (not exceeding ten Miles square) as may, by Cession of particular States, and the Acceptance of Congress, become the Seat of the Government of the United States, and to exercise like Authority over all Places purchased by the Consent of the Legislature of the State in which the Same shall be, for the Erection of Forts, Magazines, Arsenals, dock-Yards, and other needful Buildings; —And

To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof.

<u>Section. 9</u>. The Migration or Importation of such Persons as any of the States now existing shall think proper to admit, shall not be prohibited by the Congress prior to the Year one thousand eight hundred and eight, but a Tax or duty may be imposed on such Importation, not exceeding ten dollars for each Person.

The Privilege of the Writ of Habeas Corpus shall not be suspended, unless when in Cases of Rebellion or Invasion the public Safety may require it.

No Bill of Attainder or ex post facto Law shall be passed.

No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.[3]

No Tax or Duty shall be laid on Articles exported from any State.

No Preference shall be given by any Regulation of Commerce or Revenue to the Ports of one State over those of another; nor shall Vessels bound to, or from, one State, be obliged to enter, clear, or pay Duties in another.

No Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law; and a regular Statement and Account of the Receipts and Expenditures of all public Money shall be published from time to time.

No Title of Nobility shall be granted by the United States: And no Person holding any Office of Profit or Trust under them, shall, without the Consent of the Congress, accept of any present, Emolument, Office, or Title, of any kind whatever, from any King, Prince, or foreign State.

[3] Modified, see Amendment 16

Section. 10. **No State shall enter into any Treaty, Alliance, or Confederation**; grant Letters of Marque and Reprisal; coin Money; emit Bills of Credit; make any Thing but gold and silver Coin a Tender in Payment of Debts; pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any Title of Nobility.

No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports, except what may be absolutely necessary for executing it's inspection Laws; and the net Produce of all Duties and Imposts, laid by any State on Imports or Exports, shall be for the Use of the Treasury of the United States; and all such Laws shall be subject to the Revision and Controul of the Congress.

No State shall, without the Consent of Congress, lay any Duty of Tonnage, keep Troops, or Ships of War in time of Peace, enter into any Agreement or Compact with another State, or with a foreign Power, or engage in War, unless actually invaded, or in such imminent Danger as will not admit of delay.

Article. II.

Section. 1. The executive Power shall be vested in a President of the United States of America. He shall hold his Office during the Term of four Years, and, together with the Vice President, chosen for the same Term, be elected, as follows:

Each State shall appoint, in such Manner as the Legislature thereof may direct, a Number of Electors, equal to the whole Number of Senators and Representatives to which the State may be entitled in the Congress: but no Senator or Representative, or Person holding an Office of Trust or Profit under the United States, shall be appointed an Elector.

The Electors shall meet in their respective States, and vote by Ballot for two Persons, of whom one at least shall not be an Inhabitant of the same State with themselves. And they shall make a List of all the Persons voted for, and of the Number of Votes for each; which List they shall sign and certify, and transmit sealed to the Seat of the Government of the United States, directed to the President of the Senate. The President of the Senate shall, in the Presence of the Senate and House of Representatives, open all the Certificates, and the Votes shall then be counted. The Person having the greatest Number of Votes shall be the President, if such Number be a Majority of the whole Number of Electors appointed; and if there be more than one who have such Majority, and have an equal Number of Votes, then the House of Representatives shall immediately chuse by Ballot one of them for President; and if no Person have a Majority, then from the five highest on the List the said House shall in like Manner chuse the President. But in chusing the President, the Votes shall be taken by States, the Representation from each State having one Vote; a quorum for this Purpose shall consist of a Member or Members from two thirds of the States, and a Majority of all the States shall be necessary to a Choice. In every Case, after the Choice of the President, the Person having the greatest Number of Votes of the Electors shall be the Vice President. But if there should remain two or more who have equal Votes, the Senate shall chuse from them by Ballot the Vice President.

The Congress may determine the Time of chusing the Electors, and the Day on which they shall give their Votes; which Day shall be the same throughout the United States.

No Person except a natural born Citizen, or a Citizen of the United States, at the time of the Adoption of this Constitution, shall be eligible to the Office of President; neither shall any Person be eligible to that Office who shall not have attained to the Age of thirty five Years, and been fourteen Years a Resident within the United States.

In Case of the Removal of the President from Office, or of his Death, Resignation, or Inability to discharge the Powers and Duties of the said Office, the Same shall devolve on the Vice President, and the Congress may by Law provide for the Case of Removal, Death, Resignation or Inability, both of the President and Vice President, declaring what Officer shall then act as President, and such Officer shall act accordingly, until the Disability be removed, or a President shall be elected.

The President shall, at stated Times, receive for his Services, a Compensation, which shall neither be increased nor diminished during the Period for which he shall have been elected, and he shall not receive within that Period any other Emolument from the United States, or any of them.

Before he enter on the Execution of his Office, he shall take the following Oath or Affirmation: — "I do solemnly swear (or affirm) that I will faithfully execute the Office of President of the United States, and will to the best of my Ability, preserve, protect and defend the Constitution of the United States."

Section. 2. The President shall be Commander in Chief of the Army and Navy of the United States, and of the Militia of the several States, when called into the actual Service of the United States; he may require the Opinion, in writing, of the principal Officer in each of the executive Departments, upon any Subject relating to the Duties of their respective Offices, and he shall have Power to grant Reprieves and Pardons for Offences against the United States, except in Cases of Impeachment.

He shall have Power, by and with the Advice and Consent of the Senate, to make Treaties, provided two thirds of the Senators present concur; and he shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.

The President shall have Power to fill up all Vacancies that may happen during the Recess of the Senate, by granting Commissions which shall expire at the End of their next Session.

Section. 3. He shall from time to time give to the Congress Information of the State of the Union, and recommend to their Consideration such Measures as he shall judge necessary and expedient; he may, on extraordinary Occasions, convene both Houses, or either of them, and in Case of Disagreement between them, with Respect to the Time of Adjournment, he may adjourn them to such Time as he shall think proper; he shall receive Ambassadors and other public Ministers; he shall take Care that the Laws be faithfully executed, and shall Commission all the Officers of the United States.

Section. 4. The President, Vice President and all civil Officers of the United States, shall be removed from Office on Impeachment for, and Conviction of, Treason, Bribery, or other high Crimes and Misdemeanors.

Article. III.

Section. 1. **The judicial Power of the United States shall be vested in one supreme Court, and in such inferior Courts as the Congress may from time to time ordain and establish. The Judges, both of the supreme and inferior Courts, shall hold their Offices during good Behaviour, and shall, at stated Times, receive for their Services a Compensation, which shall not be diminished during their Continuance in Office.**

Section. 2. **The judicial Power shall extend to all Cases, in Law and Equity, arising under this Constitution, the Laws of the United States, and Treaties made, or which shall be made, under their Authority; — to all Cases affecting Ambassadors, other public Ministers and Consuls; — to all Cases of admiralty and maritime Jurisdiction; — to Controversies to which the United States shall be a Party; — to Controversies between two or more States; — between a State and Citizens of another State; — between Citizens of different States; — between Citizens of the same State claiming Lands under Grants of different States, and between a State, or the Citizens thereof, and foreign States, Citizens or Subjects**.

In all Cases affecting Ambassadors, other public Ministers and Consuls, and those in which a State shall be Party, the supreme Court shall have original Jurisdiction. In all the other Cases before mentioned, the supreme Court shall have appellate Jurisdiction, both as to Law and Fact, with such Exceptions, and under such Regulations as the Congress shall make.

The Trial of all Crimes, except in Cases of Impeachment, shall be by Jury; and such Trial shall be held in the State where the said Crimes shall have been committed; but when not committed within any State, the Trial shall be at such Place or Places as the Congress may by Law have directed.

Section. 3. Treason against the United States shall consist only in levying War against them, or in adhering to their Enemies, giving them Aid and Comfort. No Person shall be convicted of Treason unless on the Testimony of two Witnesses to the same overt Act, or on Confession in open Court.

The Congress shall have Power to declare the Punishment of Treason, but no Attainder of Treason shall work Corruption of Blood, or Forfeiture except during the Life of the Person attainted.

Article. IV.

Section. 1. Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State. And the Congress may by general Laws prescribe the Manner in which such Acts, Records and Proceedings shall be proved, and the Effect thereof.

Section. 2. **The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States.**

A Person charged in any State with Treason, Felony, or other Crime, who shall flee from Justice, and be found in another State, shall on Demand of the executive Authority of the State from which he fled, be delivered up, to be removed to the State having Jurisdiction of the Crime.

No Person held to Service or Labour in one State, under the Laws thereof, escaping into another, shall, in Consequence of any Law or Regulation therein, be discharged from such Service or Labour, but shall be delivered up on Claim of the Party to whom such Service or Labour may be due.

Section. 3. New States may be admitted by the Congress into this Union; but no new State shall be formed or erected within the Jurisdiction of any other State; nor any State be formed by the Junction of two or more States, or Parts of States, without the Consent of the Legislatures of the States concerned as well as of the Congress.

The Congress shall have Power to dispose of and make all needful Rules and Regulations respecting the Territory or other Property belonging to the United States; and nothing in this Constitution shall be so construed as to Prejudice any Claims of the United States, or of any particular State.

Section. 4. The United States shall guarantee to every State in this Union a Republican Form of Government, and shall protect each of them against Invasion; and on Application of the Legislature, or of the Executive (when the Legislature cannot be convened), against domestic Violence.

Article. V.

The Congress, whenever two thirds of both Houses shall deem it necessary, shall propose Amendments to this Constitution, or, on the Application of the Legislatures of two thirds of the several States, shall call a Convention for proposing Amendments, which, in either Case, shall be valid to all Intents and Purposes, as Part of this Constitution, when ratified by the Legislatures of three fourths of the several States, or by Conventions in three fourths thereof, as the one or the other Mode of Ratification may be proposed by the Congress; Provided that no Amendment which may be made prior to the Year One thousand eight hundred and eight shall in any Manner affect the first and fourth Clauses in the Ninth Section of the first Article; and that no State, without its Consent, shall be deprived of its equal Suffrage in the Senate.

Article. VI.

All Debts contracted and Engagements entered into, before the Adoption of this Constitution, shall be as valid against the United States under this Constitution, as under the Confederation.

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The Senators and Representatives before mentioned, and the Members of the several State Legislatures, and all executive and judicial Officers, both of the United States and of the several States, shall be bound by Oath or Affirmation, to support this Constitution; but no religious Test shall ever be required as a Qualification to any Office or public Trust under the United States.

Article. VII.

The Ratification of the Conventions of nine States, shall be sufficient for the Establishment of this Constitution between the States so ratifying the Same.

BILL OF RIGHTS

Article the third [**Amendment I**]

Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof; or abridging the freedom of speech, or of the press; or the right of the people peaceably to assemble, and to petition the Government for a redress of grievances.

Article the fourth [**Amendment II**]

A well regulated Militia, being necessary to the security of a free State, the right of the people to keep and bear Arms, shall not be infringed.

Article the fifth [**Amendment III**]

No Soldier shall, in time of peace be quartered in any house, without the consent of the Owner, nor in time of war, but in a manner to be prescribed by law.

Article the sixth [**Amendment IV**]

The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated, and no Warrants shall issue, but upon probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized.

Article the seventh [**Amendment V**]

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Article the eighth [**Amendment VI**]

In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law, and to be informed of the nature and cause of the accusation; to be confronted with the witnesses against him; to have compulsory process for obtaining witnesses in his favor, and to have the Assistance of Counsel for his defence.

Article the ninth [**Amendment VII**]

In Suits at common law, where the value in controversy shall exceed twenty dollars, the right of trial by jury shall be preserved, and no fact tried by a jury, shall be otherwise re-examined in any Court of the United States, than according to the rules of the common law.

Article the tenth [**Amendment VIII**]

Excessive bail shall not be required, nor excessive fines imposed, nor cruel and unusual punishments inflicted.

Article the eleventh [**Amendment IX]**

The enumeration in the Constitution, of certain rights, shall not be construed to deny or disparage others retained by the people.

Article the twelfth [**Amendment X**]

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

[Additional Amendments to the Constitution]

[**Article. XI**.][Proposed 1794; Ratified 1798]

The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State.

[**Article. XII**.][Proposed 1803; Ratified 1804]

The Electors shall meet in their respective states, and vote by ballot for President and Vice-President, one of whom, at least, shall not be an inhabitant of the same state with themselves; they shall name in their ballots the person voted for as President, and in distinct ballots the person voted for as Vice-President, and they shall make distinct lists of all persons voted for as President, and of all persons voted for as Vice-President, and of the number of votes for each, which lists they shall sign and certify, and transmit sealed to the seat of the government of the United States, directed to the President of the Senate; — The President of the Senate shall, in the presence of the Senate and House of Representatives, open all the certificates and the votes shall then be counted; — The person having the greatest number of votes for President, shall be the President, if such number be a majority of the whole number of Electors appointed; and if no person have such majority, then from the persons having the highest numbers not exceeding three on the list of those voted for as President, the House of Representatives shall choose immediately, by ballot, the President. But in choosing the President, the votes shall be taken by states, the representation from each state having one vote; a quorum for this purpose shall consist of a member or members from two-thirds of the states, and a majority of all the states shall be necessary to a choice. And if the House of Representatives shall not choose a President whenever the right of choice shall devolve upon them, before the fourth day of March next following, then the Vice-President shall act as President, as in the case of the death or other constitutional disability of the President. — The person having the greatest number of votes as Vice-President, shall be the Vice-President, if such number be a majority of the whole number of Electors appointed, and if no person have a majority, then from the two highest numbers on the list, the Senate shall choose the Vice-President; a quorum for the purpose shall consist of two-thirds of the whole number of Senators, and a majority of the whole number shall be necessary to a choice. But no person constitutionally ineligible to the office of President shall be eligible to that of Vice-President of the United States.

Article. XIII. [Proposed 1865; Ratified 1865]

Section. 1. Neither slavery nor involuntary servitude, except as a punishment for crime whereof the party shall have been duly convicted, shall exist within the United States, or any place subject to their jurisdiction.

Section. 2. Congress shall have power to enforce this article by appropriate legislation.

Article. XIV. [Proposed 1866; Ratified 1868]

Section. 1. **All persons born or naturalized in the United States, and subject to the jurisdiction thereof, are citizens of the United States and of the State wherein they reside. No State shall make or enforce any law which shall abridge the privileges or immunities of citizens of the United States; nor shall any State deprive any person of life, liberty, or property, without due process of law; nor deny to any person within its jurisdiction the equal protection of the laws.**

Section. 2. Representatives shall be apportioned among the several States according to their respective numbers, counting the whole number of persons in each State, excluding Indians not taxed. But when the right to vote at any election for the choice of electors for President and Vice President of the United States, Representatives in Congress, the Executive and Judicial officers of a State, or the members of the Legislature thereof, is denied to any of the male inhabitants of such State, being twenty-one years of age, and citizens of the United States, or in any way abridged, except for participation in rebellion, or other crime, the basis of representation therein shall be reduced in the proportion which the number of such male citizens shall bear to the whole number of male citizens twenty-one years of age in such State.

Section. 3. No person shall be a Senator or Representative in Congress, or elector of President and Vice President, or hold any office, civil or military, under the United States, or under any State, who, having previously taken an oath, as a member of Congress, or as an officer of the United States, or as a member of any State legislature, or as an executive or judicial officer of any State, to support the Constitution of the United States, shall have engaged in insurrection or rebellion against the same, or given aid or comfort to the enemies thereof. But Congress may by a vote of two-thirds of each House, remove such disability.

Section. 4. The validity of the public debt of the United States, authorized by law, including debts incurred for payment of pensions and bounties for services in suppressing insurrection or rebellion, shall not be questioned. But neither the United States nor any State shall assume or pay any debt or obligation incurred in aid of insurrection or rebellion against the United States, or any claim for the loss or emancipation of any slave; but all such debts, obligations and claims shall be held illegal and void.

Section. 5. The Congress shall have power to enforce, by appropriate legislation, the provisions of this article.

Article. XV. [Proposed 1869; Ratified 1870]

Section. 1. The right of citizens of the United States to vote shall not be denied or abridged by the United States or by any State on account of race, color, or previous condition of servitude.

Section. 2. The Congress shall have power to enforce this article by appropriate legislation.

Article. XVI. [Proposed 1909; Questionably Ratified 1913]

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

[**Article. XVII**.] [Proposed 1912; Ratified 1913]

The Senate of the United States shall be composed of two Senators from each State, elected by the people thereof, for six years; and each Senator shall have one vote. The electors in each State shall have the qualifications requisite for electors of the most numerous branch of the State legislatures.

When vacancies happen in the representation of any State in the Senate, the executive authority of such State shall issue writs of election to fill such vacancies: Provided, That the legislature of any State may empower the executive thereof to make temporary appointments until the people fill the vacancies by election as the legislature may direct.

This amendment shall not be so construed as to affect the election or term of any Senator chosen before it becomes valid as part of the Constitution.

Article. [XVIII.] [Proposed 1917; Ratified 1919; Repealed 1933 (See Amendment XXI, Section 1)]

Section. 1. After one year from the ratification of this article the manufacture, sale, or transportation of intoxicating liquors within, the importation thereof into, or the exportation thereof from the United States and all territory subject to the jurisdiction thereof for beverage purposes is hereby prohibited.

Section. 2. The Congress and the several States shall have concurrent power to enforce this article by appropriate legislation.

Section. 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by the legislatures of the several States, as provided in the Constitution, within seven years from the date of the submission hereof to the States by the Congress.

Article. [XIX.] [Proposed 1919; Ratified 1920]

The right of citizens of the United States to vote shall not be denied or abridged by the United States or by any State on account of sex.

Congress shall have power to enforce this article by appropriate legislation.

Article. [XX.] [Proposed 1932; Ratified 1933]

Section. 1. The terms of the President and Vice President shall end at noon on the 20th day of January, and the terms of Senators and Representatives at noon on the 3d day of January, of the years in which such terms would have ended if this article had not been ratified; and the terms of their successors shall then begin.

Section. 2. The Congress shall assemble at least once in every year, and such meeting shall begin at noon on the 3d day of January, unless they shall by law appoint a different day.

Section. 3. If, at the time fixed for the beginning of the term of the President, the President elect shall have died, the Vice President elect shall become President. If a President shall not have been chosen before the time fixed for the beginning of his term, or if the President elect shall have failed to qualify, then the Vice President elect shall act as President until a President shall have qualified; and the Congress may by law provide for the case wherein neither a President elect nor a Vice President elect shall have qualified, declaring who shall then act as President, or the manner in which one who is to act shall be selected, and such person shall act accordingly until a President or Vice President shall have qualified.

Section. 4. The Congress may by law provide for the case of the death of any of the persons from whom the House of Representatives may choose a President whenever the right of choice shall have devolved upon them, and for the case of the death of any of the persons from whom the Senate may choose a Vice President whenever the right of choice shall have devolved upon them.

Section. 5. Sections 1 and 2 shall take effect on the 15th day of October following the ratification of this article.

Section. 6. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by the legislatures of three-fourths of the several States within seven years from the date of its submission.

Article. [XXI.] [Proposed 1933; Ratified 1933]

Section. 1. The eighteenth article of amendment to the Constitution of the United States is hereby repealed.

Section. 2. The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.

Section. 3. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by conventions in the several States, as provided in the Constitution, within seven years from the date of the submission hereof to the States by the Congress.

Article. [XXII.] [Proposed 1947; Ratified 1951]

Section. 1. No person shall be elected to the office of the President more than twice, and no person who has held the office of President, or acted as President, for more than two years of a term to which some other person was elected President shall be elected to the office of the President more than once. But this Article shall not apply to any person holding the office of President when this Article was proposed by the Congress, and shall not prevent any person who may be holding the office of President, or acting as President, during the term within which this Article becomes operative from holding the office of President or acting as President during the remainder of such term.

Section. 2. This article shall be inoperative unless it shall have been ratified as an amendment to the Constitution by the legislatures of three-fourths of the several States within seven years from the date of its submission to the States by the Congress.

Article. [XXIII.] [Proposed 1960; Ratified 1961]

Section. 1. The District constituting the seat of Government of the United States shall appoint in such manner as the Congress may direct:

A number of electors of President and Vice President equal to the whole number of Senators and Representatives in Congress to which the District would be entitled if it were a State, but in no event more than the least populous State; they shall be in addition to those appointed by the States, but they shall be considered, for the purposes of the election of President and Vice President, to be electors appointed by a State; and they shall meet in the District and perform such duties as provided by the twelfth article of amendment.

Section. 2. The Congress shall have power to enforce this article by appropriate legislation.

Article. [XXIV.] [Proposed 1962; Ratified 1964]

Section. 1. The right of citizens of the United States to vote in any primary or other election for President or Vice President, for electors for President or Vice President, or for Senator or Representative in Congress, shall not be denied or abridged by the United States or any State by reason of failure to pay any poll tax or other tax.

Section. 2. The Congress shall have power to enforce this article by appropriate legislation.

Article. [XXV.] [Proposed 1965; Ratified 1967]

Section. 1. In case of the removal of the President from office or of his death or resignation, the Vice President shall become President.

Section. 2. Whenever there is a vacancy in the office of the Vice President, the President shall nominate a Vice President who shall take office upon confirmation by a majority vote of both Houses of Congress.

Section. 3. Whenever the President transmits to the President pro tempore of the Senate and the Speaker of the House of Representatives his written declaration that he is unable to discharge the powers and duties of his office, and until he transmits to them a written declaration to the contrary, such powers and duties shall be discharged by the Vice President as Acting President.

Section. 4. Whenever the Vice President and a majority of either the principal officers of the executive departments or of such other body as Congress may by law provide, transmit to the President pro tempore of the Senate and the Speaker of the House of Representatives their written declaration that the President is unable to discharge the powers and duties of his office, the Vice President shall immediately assume the powers and duties of the office as Acting President.

Thereafter, when the President transmits to the President pro tempore of the Senate and the Speaker of the House of Representatives his written declaration that no inability exists, he shall resume the powers and duties of his office unless the Vice President and a majority of either the principal officers of the executive department or of such other body as Congress may by law provide, transmit within four days to the President pro tempore of the Senate and the Speaker of the House of Representatives their written declaration that the President is unable to discharge the powers and duties of his office. Thereupon Congress shall decide the issue, assembling within forty-eight hours for that purpose if not in session. If the Congress, within twenty-one days after receipt of the latter written declaration, or, if Congress is not in session, within twenty-one days after Congress is required to assemble, determines by two-thirds vote of both Houses that the President is unable to discharge the powers and duties of his office, the Vice President shall continue to discharge the same as Acting President; otherwise, the President shall resume the powers and duties of his office.

Article. [XXVI.] [Proposed 1971; Ratified 1971]

Section. 1. The right of citizens of the United States, who are eighteen years of age or older, to vote shall not be denied or abridged by the United States or by any State on account of age.

Section. 2. The Congress shall have power to enforce this article by appropriate legislation.

Article. [XXVII.] [Proposed 1789; Ratified 1992; Second of twelve Articles comprising the Bill of Rights]

No law, varying the compensation for the services of the Senators and Representatives, shall take effect, until an election of Representatives shall have intervened.

Supreme Court of the United States
William **MARBURY**
v.
James MADISON, Secretary of State of the United States.
Feb. 1803.

MARSHALL.

[Marbury was nominated as a federal judge by the President John Adams and was confirmed by the Senate on the last day the President was in office. But under the Judiciary Act of 1789, before he could join the bench, Marbury had to receive his commission, which had to be delivered by the Secretary of States. The new President was Thomas Jefferson, and he told the new Secretary of State, James Madison, not to deliver commissions to Marbury and other so-called midnight judges, who were appointed by Adams just before he left office. Marbury sued to have Madison deliver the commission.]

***

The constitution vests the whole judicial power of the United States in one supreme court, and such inferior courts as congress shall, from time to time, ordain and establish. This power is expressly extended to all cases arising under the laws of the United States; and consequently, in some form, may be exercised over the present ***174** case; because the right claimed is given by a law of the United States.

****24** In the distribution of this power it is declared that "the supreme court shall have original jurisdiction in all cases affecting ambassadors, other public ministers and consuls, and those in which a state shall be a party. In all other cases, the supreme court shall have appellate jurisdiction."

It has been insisted, at the bar, that as the original grant of jurisdiction, to the supreme and inferior courts, is general, and the clause, assigning original jurisdiction to the supreme court, contains no negative or restrictive words; the power remains to the legislature, to assign original jurisdiction to that court in other cases than those specified in the article which has been recited; provided those cases belong to the judicial power of the United States.

If it had been intended to leave it in the discretion of the legislature to apportion the judicial power between the supreme and inferior courts according to the will of that body, it would certainly have been useless to have proceeded further than to have defined the judicial power, and the tribunals in which it should be vested. The subsequent part of the section is mere surplusage, is entirely without meaning, if such is to be the construction. If congress remains at liberty to give this court appellate jurisdiction, where the constitution has declared their jurisdiction shall be original; and original jurisdiction where the constitution has declared it shall be appellate; the distribution of jurisdiction, made in the constitution, is form without substance.

Affirmative words are often, in their operation, negative of other objects than those affirmed; and in this case, a negative or exclusive sense must be given to them or they have no operation at all.

It cannot be presumed that any clause in the constitution is intended to be without effect; and therefore such a construction is inadmissible, unless the words require it.

***175** If the solicitude of the convention, respecting our peace with foreign powers, induced a provision that the supreme court should take original jurisdiction in cases which might be supposed to affect them; yet the clause would have proceeded no further than to provide for such cases, if no further restriction on the powers of congress had been intended. That they should have appellate jurisdiction in all other cases, with such exceptions as congress might make, is no restriction; unless the words be deemed exclusive of original jurisdiction.

When an instrument organizing fundamentally a judicial system, divides it into one supreme, and so many inferior courts as the legislature may ordain and establish; then enumerates its powers, and proceeds so far to distribute them, as to define the jurisdiction of the supreme court by declaring the cases in which it shall take original jurisdiction, and that in others it shall take appellate jurisdiction; the plain import of the words seems to be, that in one class of cases its jurisdiction is original, and not appellate; in the other it is appellate, and not original. If any other construction would render the clause inoperative, that is an additional reason for rejecting such other construction, and for adhering to their obvious meaning.

To enable this court then to issue a mandamus, it must be shewn to be an exercise of appellate jurisdiction, or to be necessary to enable them to exercise appellate jurisdiction.

****25** It has been stated at the bar that the appellate jurisdiction may be exercised in a variety of forms, and that if it be the will of the legislature that a mandamus should be used for that purpose, that will must be obeyed. This is true, yet the jurisdiction must be appellate, not original.

It is the essential criterion of appellate jurisdiction, that it revises and corrects the proceedings in a cause already instituted, and does not create that cause. Although, therefore, a mandamus may be directed to courts, yet to issue such a writ to an officer for the delivery of a paper, is in effect the same as to sustain an original action for that paper, and therefore seems not to belong to ***176** appellate, but to original jurisdiction. Neither is it necessary in such a case as this, to enable the court to exercise its appellate jurisdiction.

The authority, therefore, given to the supreme court, by the act establishing the judicial courts of the United States, to issue writs of mandamus to public officers, appears not to be warranted by the constitution; and it becomes necessary to enquire whether a jurisdiction, so conferred, can be exercised.

The question, whether an act, repugnant to the constitution, can become the law of the land, is a question deeply interesting to the United States; but, happily, not of an intricacy proportioned to its interest. It seems only necessary to recognize certain principles, supposed to have been long and well established, to decide it.

That the people have an original right to establish, for their future government, such principles as, in their opinion, shall most conduce to their own happiness, is the basis, on which the whole American fabric has been erected. The exercise of this original right is a very great exertion; nor can it, nor ought it to be frequently repeated. The principles, therefore, so established, are deemed fundamental. And as the authority, from which they proceed, is supreme, and can seldom act, they are designed to be permanent.

This original and supreme will organizes the government, and assigns, to different departments, their respective powers. It may either stop here; or establish certain limits not to be transcended by those departments.

The government of the United States is of the latter description. The powers of the legislature are defined, and limited; and that those limits may not be mistaken, or forgotten, the constitution is written. To what purpose are powers limited, and to what purpose is that limitation committed to writing, if these limits may, at any time, be passed by those intended to be restrained? The distinction, between a government with limited and unlimited powers, is abolished, if those limits do not confine the persons on whom they are imposed, and if acts prohibited***177** and acts allowed, are of equal obligation. It is a proposition too plain to be contested, that the constitution controls any legislative act repugnant to it; or, that the legislature may alter the constitution by an ordinary act.

Between these alternatives there is no middle ground. The constitution is either a superior, paramount law, unchangeable by ordinary means, or it is on a level with ordinary legislative acts, and like other acts, is alterable when the legislature shall please to alter it.

****26** If the former part of the alternative be true, then a legislative act contrary to the constitution is not law: if the latter part be true, then written constitutions are absurd attempts, on the part of the people, to limit a power, in its own nature illimitable.

Certainly all those who have framed written constitutions contemplate them as forming the fundamental and paramount law of the nation, and consequently the theory of every such government must be, that an act of the legislature, repugnant to the constitution, is void.

This theory is essentially attached to a written constitution, and is consequently to be considered, by this court, as one of the fundamental principles of our society. It is not therefore to be lost sight of in the further consideration of this subject.

If an act of the legislature, repugnant to the constitution, is void, does it, notwithstanding its invalidity, bind the courts, and oblige them to give it effect? Or, in other words, though it be not law, does it constitute a rule as operative as if it was a law? This would be to overthrow in fact what was established in theory; and would seem, at first view, an absurdity too gross to be insisted on. It shall, however, receive a more attentive consideration.

It is emphatically the province and duty of the judicial department to say what the law is. Those who apply the rule to particular cases, must of necessity expound and interpret that rule. If two laws conflict with each other, the courts must decide on the operation of each.

***178** So if a law be in opposition to the constitution; if both the law and the constitution apply to a particular case, so that the court must either decide that case conformably to the law, disregarding the constitution; or conformably to the constitution, disregarding the law; the court must determine which of these conflicting rules governs the case. This is of the very essence of judicial duty.

If then the courts are to regard the constitution; and the constitution is superior to any ordinary act of the legislature; the constitution, and not such ordinary act, must govern the case to which they both apply.

Those then who controvert the principle that the constitution is to be considered, in court, as a paramount law, are reduced to the necessity of maintaining that courts must close their eyes on the constitution, and see only the law.

This doctrine would subvert the very foundation of all written constitutions. It would declare that an act, which, according to the principles and theory of our government, is entirely void; is yet, in practice, completely obligatory. It would declare, that if the legislature shall do what is expressly forbidden, such act, notwithstanding the express prohibition, is in reality effectual. It would be giving to the legislature a practical and real omnipotence, with the same breath which professes to restrict their powers within narrow limits. It is prescribing limits, and declaring that those limits may be passed as pleasure.

That it thus reduces to nothing what we have deemed the greatest improvement on political institutions-a written constitution-would of itself be sufficient, in America, where written constitutions have been viewed with so much reverence, for rejecting the construction. But the peculiar expressions of the constitution of the United States furnish additional arguments in favour of its rejection.

****27** The judicial power of the United States is extended to all cases arising under the constitution.

***179** Could it be the intention of those who gave this power, to say that, in using it, the constitution should not be looked into? That a case arising under the constitution should be decided without examining the instrument under which it arises?

This is too extravagant to be maintained.

In some cases then, the constitution must be looked into by the judges. And if they can open it at all, what part of it are they forbidden to read, or to obey?

There are many other parts of the constitution which serve to illustrate this subject.

It is declared that “no tax or duty shall be laid on articles exported from any state.” Suppose a duty on the export of cotton, of tobacco, or of flour; and a suit instituted to recover it. Ought judgment to be rendered in such a case? ought the judges to close their eyes on the constitution, and only see the law.

The constitution declares that “no bill of attainder or *ex post facto* law shall be passed.”

If, however, such a bill should be passed and a person should be prosecuted under it; must the court condemn to death those victims whom the constitution endeavors to preserve?

“No person,” says the constitution, “shall be convicted of treason unless on the testimony of two witnesses to the same overt act, or on confession in open court.”

Here the language of the constitution is addressed especially to the courts. It prescribes, directly for them, a rule of evidence not to be departed from. If the legislature should change that rule, and declare *one* witness, or a confession *out of* court, sufficient for conviction, must the constitutional principle yield to the legislative act?

From these, and many other selections which might be made, it is apparent, that the framers of the constitution***180** contemplated that instrument, as a rule for the government of *courts,* as well as of the legislature.

Why otherwise does it direct the judges to take an oath to support it? This oath certainly applies, in an especial manner, to their conduct in their official character. How immoral to impose it on them, if they were to be used as the instruments, and the knowing instruments, for violating what they swear to support?

The oath of office, too, imposed by the legislature, is completely demonstrative of the legislative opinion on this subject. It is in these words, “I do solemnly swear that I will administer justice without respect to persons, and do equal right to the poor and to the rich; and that I will faithfully and impartially discharge all the duties incumbent on me as according to the best of my abilities and understanding, agreeably to *the constitution,* and laws of the United States.”

Why does a judge swear to discharge his duties agreeably to the constitution of the United States, if that constitution forms no rule for his government? if it is closed upon him, and cannot be inspected by him?

****28** If such be the real state of things, this is worse than solemn mockery. To prescribe, or to take this oath, becomes equally a crime.

It is also not entirely unworthy of observation, that in declaring what shall be the *supreme* law of the land, the *constitution* itself is first mentioned; and not the laws of the United States generally, but those only which shall be made in *pursuance* of the constitution, have that rank.

Thus, the particular phraseology of the constitution of the United States confirms and strengthens the principle, supposed to be essential to all written constitutions, that a law repugnant to the constitution is void; and that *courts,* as well as other departments, are bound by that instrument.

The rule must be discharged.

U.S.Dist.Col.,1803.
Marbury v. Madison
1 Cranch 137, 5 U.S. 137, 1803 WL 893 (U.S.Dist.Col.), 2 L.Ed. 60

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Supreme Court of the United States.
CHALKER et al.
v.
BIRMINGHAM & N. W. RY. CO. et al.
No. 283.

Argued March 25 and 26, 1919.
Decided April 21, 1919.

***523 **366** Messrs. C. E. Pigford, of Jackson, Tenn., and Watson E. Coleman, of Washington, D. C., for plaintiffs in error.
Mr. R. F. Spragins, of Jackson, Tenn., for defendants in error.

***525** Mr. Justice McREYNOLDS delivered the opinion of the Court.
The point for determination is the liability ****367** of J. W. Wright, Jr., a citizen and resident of Alabama with his chief office therein, who engaged in the business of constructing a railroad in Tennessee, for the tax prescribed by section 4 of 'An act to provide revenue for the state of Tennessee and the counties and municipalities thereof,' approved May 1, 1909 (Acts of Tenn. 1909, c. 479, pp. 1726, 1727, 1735), which provides:
'Sec. 4. Be it further enacted, that each vocation, occupation, and business hereinafter named in this section is hereby declared to be a privilege, and the rate of taxation on such privilege shall be as hereinafter fixed, which privilege tax shall be paid to the county court clerk as provided by law for the collection of revenue.

'Each foreign construction company, with its chief office outside of this state, operating or doing business ***526** in this state, directly or by agent, or by any subletting contract, each, per annum, in each county . . . $100.00
'Each domestic construction company and each foreign construction company, having its chief office in this state, doing business in this state, each, per annum, in each county . . . $25.00
'The above tax shall be paid by persons, firms, or corporations engaged in the business of constructing bridges, waterworks, railroads, street-paving construction work, or other structures of a public nature.'

Replying to the claim that the statute in effect discriminates against citizens of other states the Supreme Court of Tennessee, in Wright v. Jackson Const. Co., 138 Tenn. 145, 152, 153, 196 S. W. 488, 490, said:
'The determining feature in the legislation quoted is the having of one's chief office in this state. Any citizen of this state, as well as any citizen of a foreign state, who has his chief office out of the state, must pay the $100 tax; so of any domestic corporation, as well as foreign corporation, having its chief office out of the state. Any foreign corporation or citizen of another state, or firm, as well as domestic corporations, citizens of this state, and firms of this state having its or their chief office in this state, are all alike entitled to carry on a railroad construction business here on the payment of $25. There is no discrimination at all.'

With this conclusion we are unable to agree. Accepting the construction placed upon it by the Supreme Court, we think the quoted section does discriminate between citizens of Tennessee and those of other states by imposing a higher charge on the latter than it does on the former, contrary to section 2, art. 4, of the federal Constitution:
'The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.'

The power of a state to make reasonable and natural classifications for purposes of taxation is clear and not questioned; but neither under form of classification nor ***527** otherwise can any state enforce taxing laws which in their practical operation materially abridge or impair the equality of commercial privileges secured by the federal Constitution to citizens of the several states.
'Excise taxes, it is everywhere conceded, may be imposed by the states, if not in any sense discriminating; but it should not be forgotten that the people of the several states live under one common Constitution, which was ordained to establish justice, and which, with the laws of Congress, and the treaties

made by the proper authority, is the supreme law of the land; and that that supreme law requires equality of burden, and forbids discrimination in state taxation when the power is applied to the citizens of the other states. Inequality of burden, as well as the want of uniformity in commercial regulations, was one of the grievances of the citizens under the Confederation; and the new Constitution was adopted, among other things, to remedy those defects in the prior system.' Ward v. Maryland, 12 Wall. 418, 431 (20 L. Ed. 449); Guy v. Baltimore, 100 U. S. 434, 439, 25 L. Ed. 743; Blake v. McClung, 172 U. S. 239, 254, 19 Sup. Ct. 165, 43 L. Ed. 432; Darnell & Son v. Memphis, 208 U. S. 113, 121, 28 Sup. Ct. 247, 52 L. Ed. 413.

As the chief office of an individual is commonly in the state of which he is a citizen, Tennessee citizens engaged in constructing railroads in that state will ordinarily have their chief offices therein, while citizens of other states so engaged will not. Practically, therefore, the statute under consideration would produce discrimination against citizens of other states by imposing higher charges against them than citizens of Tennessee are required to pay. We can find no adequate basis for taxing individuals according to the location of their chief offices-the classification, we think, is arbitrary and unreasonable. Under the federal Constitution a citizen of one state is guaranteed the right to enjoy in all other states equality of commercial privileges with their citizens; but he cannot have his chief office in every one of them.

***528** It is insisted that no tender of any sum for license tax was made in time, and therefore plaintiff in error cannot question the validity of the enactment because of discrimination. But the Supreme Court expressly declared that the statute fixed the liability of Wright at $100. A tender of less would have availed nothing and it was therefore unnecessary.

The judgment of the court below is reversed and the cause remanded for further proceedings not inconsistent with this opinion.

Reversed and remanded.

U.S. 1919
Chalker v. Birmingham & N. W. Ry. Co.
249 U.S. 522, 39 S.Ct. 366, 63 L.Ed. 748

END OF DOCUMENT

QUEEN v. INLAND REVENUE COMMISSIONERS, *EX PARTE* COMMERZBANK AG

1993 E.C.R. 4017

13 July 1993

Case C-330/91

The High Court of Justice of England and Wales referred to the ECJ the question of whether its national law violated the freedom of establishment under (now) Article 43 EC or the prohibition on nationality-based discrimination under (now) Article 12 EC when it denied interest on tax refunds to non-resident taxpayers in cases where resident taxpayers would be entitled to interest.

Commerzbank was a company resident in Germany that operated in the United Kingdom as a non-resident taxpayer through a branch. Commerzbank appealed to the High Court the decision by the British tax administration to deny interest on a refund of a tax overpayment on the grounds that Commerzbank was not a British resident.

The ECJ held that although the contested law did not make specific reference to nationality, using the criterion of residence to grant benefits under British tax law would generally work to the disadvantage of nationals of other Member States and was therefore discriminatory (paragraphs 15 and 19).

The United Kingdom sought to justify the discrimination by noting that under the substantive law, it taxed residents more heavily than non-residents. In fact, Commerzbank's overpayment in this case stemmed from an exemption granted non-residents under a double tax treaty with Germany (paragraph 16). The ECJ ruled that it was irrelevant that Commerzbank's refund was dependent on its status as a non-resident. Unequal treatment of non-residents and residents in the refund context discriminated against nationals of other Member States and violated Articles 43 and 48 EC.[10]

The question of discrimination under (now) Article 12 was subsumed by the finding of a restriction of the freedoms of Articles 43 and 48 EC.

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[10] *See* Advocate General Darmon's argument that the appropriate comparison was not between a British resident not entitled to a refund and a non-resident entitled to a refund only because it was a non-resident, but rather between a British resident entitled to a refund with interest and a resident of another Member State entitled to refund but denied interest. Opinion of Advocate General Darmon, 17 March 1993, para. 11.

Summary

Articles 52 and 58 of the Treaty prevent the legislation of a Member State from granting repayment supplement on overpaid tax to companies which are resident for tax purposes in that State whilst refusing the supplement to companies resident for tax purposes in another Member State. The fact that the latter would not have been exempt from tax if they had been resident in that State is of no relevance in that regard.

Although it applies independently of a company' s seat and therefore of the factor connecting it with the legal system of a particular State, the use of the criterion of fiscal residence within national territory for the purpose of granting repayment supplement on overpaid tax is liable to work more particularly to the disadvantage of companies having their seat in other Member States since it is most often those companies which are resident for tax purposes outside the territory of the Member State in question.

Parties

In Case C-330/91,

REFERENCE to the Court under Article 177 of the EEC Treaty by the Queen' s Bench Division of the High Court of Justice of England and Wales for a preliminary ruling in the proceedings pending before that court between

The Queen

and

Inland Revenue Commissioners

ex parte: Commerzbank AG

on the interpretation of Articles 5, 7, 52 and 58 of the EEC Treaty,

THE COURT,

composed of: G.C. Rodríguez Iglesias, President of Chamber, acting for the President, M. Zuleeg, J.L. Murray (Presidents of Chambers), G.F. Mancini, R. Joliet, F.A. Schockweiler, J.C. Moitinho de Almeida, F. Grévisse and D.A.O. Edward, Judges,

Advocate General: M. Darmon,

Registrar: H.A. Ruehl, Principal Administrator,

after considering the written observations submitted on behalf of:

° Commerzbank, by Gerald Barling QC and David Anderson, Barrister,

° the United Kingdom Government, by John Collins, Assistant Treasury Solicitor, assisted by Alan Moses QC and Derrick Wyatt, Barrister,

° the Commission of the European Communities, by Thomas Cusack, Legal Adviser, acting as Agent,

having regard to the Report for the Hearing,

after hearing the oral observations of Commerzbank AG, the United Kingdom Government and the Commission at the hearing on 20 January 1993,

after hearing the Opinion of the Advocate General at the sitting on 17 March 1993,

gives the following

Judgment

Grounds

1 By order of 12 April 1991, received at the Court on 18 December 1991, the Queen' s Bench Division of the High Court of Justice of England and Wales referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty a question relating to the interpretation of the provisions of the Treaty concerning right of establishment and prohibition of discrimination on grounds of nationality.

2 Those questions were raised in connection with a dispute between Commerzbank AG, a company incorporated under German law whose registered office is in Germany, and the Inland Revenue Commissioners (hereinafter "the tax authorities") concerning the conditions governing liability to tax under the Income and Corporation Taxes Act 1988.

3 The facts as set out in the order for reference are as follows.

4 Commerzbank has a branch in the United Kingdom through the intermediary of which it granted loans to

a number of United States companies between 1973 and 1976. Commerzbank paid tax in the United Kingdom of 4 222 234 on the interest received from those companies.

5 Subsequently Commerzbank sought repayment of that sum from the tax authorities on the ground that the interest was exempt in the United Kingdom by virtue of Article 15 of the Convention of 2 August 1946 between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (S.R. & O. 1946, No 1327), as amended by a Protocol of 20 September 1966 (S.I. 1966 No 1188). That article provides in substance that interest paid by a United States company is taxable in the United Kingdom only when it is paid to a United Kingdom company or a company resident for tax purposes in the United Kingdom. Since Commerzbank was not resident for tax purposes in the United Kingdom, it received a refund of the overpaid tax.

6 Commerzbank then made a claim in connection with that refund under Article 825 of the Income and Corporation Taxes Act 1988. That article provides:

"(1) This section applies to the following payments made to a company in connection with any accounting period for which the company was resident in the United Kingdom ... :

(a) a repayment of corporation tax paid by the company for that accounting period ... .

(2) Subject to the following provisions of this section, where a payment of not less than 100 to which this section applies is made by the Board or an inspector after the end of the 12 months beginning with the material date, the payment shall be increased under this section by an amount (' a repayment supplement') equal to interest on the amount paid at the rate of 8.25 per cent per annum ...".

7 Commerzbank claimed repayment supplement from the tax authorities, calculating the amount payable as 5 199 258.

8 The tax authorities rejected Commerzbank' s claim on the ground that the company was not resident in the United Kingdom. Commerzbank therefore applied to the High Court for judicial review of that decision, claiming that the refusal to grant repayment supplement to non-residents constituted a restriction of the right of establishment and indirect discrimination on grounds of nationality, since the companies affected were for the most part foreign.

9 The High Court considered it necessary to refer to the Court a question concerning the interpretation of Articles 5, 7, 52 and 58 of the Treaty.

10 That question is worded as follows:

"Where:

(i) a company which is formed in accordance with the law of, and has its principal place of business in, one Member State carries on business through a branch in a second Member State;

(ii) the company is subject to a demand for payment of tax in the second Member State on certain profits generated by the branch, and pays the tax;

(iii) the said tax is not in fact due if the company is entitled to benefit from an exemption under a double taxation agreement between the second Member State and a third country to companies which are neither nationals of, nor resident for tax purposes in, the second Member State;

(iv) the company successfully claims the benefit of the exemption and secures recovery of the tax paid but not due;

(v) the law of the second Member State provides for statutory compensation in the nature of interest (known as 'repayment supplement') where the company recovering the tax paid but not due was resident in that Member State at the material time;

(vi) the company claims the repayment supplement notwithstanding that it was not resident in that Member State at the material time;

(vii) the second Member State refuses on that ground to pay repayment supplement to the company;

is the refusal of the second Member State to pay the company any repayment supplement on the ground of its non-residence inconsistent with Community law and in particular Articles 5, 7 and 52 to 58 of the EEC Treaty, and in answering that question is it relevant that the company would not have been exempt from the tax (so that no question of recovery of the tax and therefore of repayment supplement would arise) if the company had been resident in that Member State?"

11 Reference is made to the Report for the Hearing for a fuller account of the facts of the case, the relevant rules and the written observations submitted to the Court, which are mentioned or discussed hereinafter only in so far as is necessary for the reasoning of the Court.

12 The file shows that the national court' s question is designed to ascertain, first, whether Articles 52 and 58 and Articles 5 and 7 of the Treaty prevent the legislation of a Member State from granting repayment supplement on overpaid tax to companies resident for tax purposes in that State whilst refusing that supplement to companies which are resident for tax purposes in another Member State and, secondly, whether such a rule is still discriminatory where the exemption from tax which gave rise to the refund applies only to companies which are not resident for tax purposes in that Member State.

The right of establishment

13 As the Court held in its judgment in Case C-270/83 Commission v France [1986] ECR 273, at paragraph 18, the freedom of establishment which Article 52 grants to nationals of a Member State, and which entails the right for them to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected, includes, pursuant to Article 58 of the EEC Treaty, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member State concerned through a branch or agency. With regard to companies, it should be noted in this context that it is their seat in the abovementioned sense that serves as the connecting factor within the legal system of a particular State, like nationality in the case of natural persons. In the same judgment the Court held that acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it different treatment solely by reason of the fact that its seat is situated in another Member State would deprive the provision of all meaning.

14 Moreover, it follows from the Court' s judgment in Case 152/73 Sotgiu v Deutsche Bundespost [1974] ECR 153 (at paragraph 11) that the rules regarding equality of treatment forbid not only overt discrimination by reason of nationality or, in the case of a company, its seat, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.

15 Although it applies independently of a company' s seat, the use of the criterion of fiscal residence within national territory for the purpose of granting repayment supplement on overpaid tax is liable to work more particularly to the disadvantage of companies having their seat in other Member States. Indeed, it is most often those companies which are resident for tax purposes outside the territory of the Member State in question.

16 In order to justify the national provision at issue in the main proceedings, the United Kingdom Government argues that, far from suffering discrimination under the United Kingdom tax rules, non-resident companies which are in Commerzbank' s situation enjoy privileged treatment. They are exempt from tax normally payable by resident companies. In those circumstances, there is no discrimination with respect to repayment supplement: resident companies and non-resident companies are treated differently because, for the purposes of corporation tax, they are in different situations.

17 That argument cannot be upheld.

18 A national provision such as the one in question entails unequal treatment. Where a non-resident company is deprived of the right to repayment supplement on overpaid tax to which resident companies are always entitled, it is placed at a disadvantage by comparison with the latter.

19 The fact that the exemption from tax which gave rise to the refund was available only to non-resident companies cannot justify a rule of a general nature withholding the benefit. That rule is therefore discriminatory.

20 It follows from those considerations that the reply to be given to the national court is that Articles 52 and 58 of the Treaty prevent the legislation of a Member State from granting repayment supplement on overpaid tax to companies which are resident for tax purposes in that State whilst refusing the supplement to companies which are resident for tax purposes in another Member State. The fact that the latter would not have been exempt from tax if they had been resident in that State is of no relevance in that regard.

21 Since legislation such as that at issue in the main proceedings is contrary to Articles 52 and 58 of the

Treaty, it is unnecessary to consider its compatibility with Articles 5 and 7.

Decision on costs

Costs

22 The costs incurred by the United Kingdom and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

Operative part

On those grounds,

THE COURT,

in answer to the question referred to it by the Queen' s Bench Division of the High Court of Justice of England and Wales, by order of 12 April 1991, hereby rules:

Articles 52 and 58 of the Treaty prevent the legislation of a Member State from granting repayment supplement on overpaid tax to companies which are resident for tax purposes in that State whilst refusing the supplement to companies resident for tax purposes in another Member State. The fact that the latter would not have been exempt from tax if they had been resident in that State is of no relevance in that regard.

Supreme Court of the United States
SHAFFER
v.
CARTER, State Auditor, et al. (two cases).
Nos. 531, 580.

Argued December 11 and 12, 1919.
Decided March 1, 1920.

****222 *43** Mr. Malcolm E. Rosser, of Muskogee, Okl., for appellant.
Messrs. C. W. King and S. P. Freeling, both of Oklahoma City, Okl., for appellees.

Mr. Justice PITNEY delivered the **opinion** of the Court.

[Procedural history deleted.]
***

The [Oklahoma] act in question is chapter 164 of the Laws of 1915. Its first section reads as follows:****223** 'Each and every person in this state, shall be liable to an annual tax upon the entire net income of such person arising or accruing from all sources during the preceding calendar year, and a like tax shall be levied, assessed, collected and paid annually upon the entire net income from all property owned, and of every business, trade or profession carried on in this ***45** state by persons residing elsewhere.'

Subsequent sections define what the term 'income' shall include; prescribe how net income shall be computed; provide for certain deductions; prescribe varying rates of tax for all taxable incomes in excess of $3,000, this amount being deducted (by way of exemption) from the income of each individual, and for one living with spouse an additional $1,000, with further deductions where there are children or dependents, exemptions being the same for residents and nonresidents; require (section 2) a return on or before March 1st from each person liable for an income tax under the provisions of the act for the preceding calendar year;…

***

Plaintiff, a nonresident of Oklahoma, being a citizen of Illinois and a resident of Chicago, in that state, was at the time of the commencement of the suit and for several years theretofore (including the years 1915 and 1916) engaged in the oil business in Oklahoma, having purchased, owned, developed and operated a number of oil and gas mining leases, and being the owner in fee of certain oil-producing land, in that state. From properties thus owned and operated during the year 1916 he received a net income exceeding $1,500,000, and of this he made, under protest, a return which showed that, ***46** at the rates fixed by the act, there was due to the state an income tax in excess of $76,000. The then state auditor overruled the protest and assessed a tax in accordance with the return; the present auditor has put it in due course of collection; and plaintiff resists its enforcement upon the ground that the act, in so far as it subjects the incomes of nonresidents to the payment of such a tax, takes their property without due process of law and denies to them the equal protection of the laws, in contravention of section 1 of the Fourteenth Amendment, burdens interstate commerce, in contravention of the commerce clause of section 8 of article 1 of the Constitution, and discriminates against nonresidents in favor of residents, and thus deprives plaintiff and other nonresidents of the privileges and immunities of citizens and residents of the state of Oklahoma, in violation of section 2 of article 4. He also insists that the lien attempted to be imposed upon his property pursuant to section 11 for taxes assessed upon income not arising out of the same property would deprive him of property without due process of law.

[Procedural details deleted]

***

This brings us to the merits.

Under the 'due process of law' provision appellant makes two contentions: First, that the state is without jurisdiction to levy a tax upon the income of nonresidents; and, secondly, that the lien is invalid because imposed upon all his property real and personal, without regard to its relation to the production of his income.

***

[Discussion of Oklahoma's ability to tax non-residents on income earned in Oklahoma under the Due Process Clause deleted]

***

Appellant contends that there is a denial to noncitizens of the privileges and immunities to which they are entitled, and also a denial of the equal protection of the laws, in that the act permits residents to deduct from their gross income not only losses incurred within the state of Oklahoma but also those sustained outside of that state, while nonresidents may deduct only those incurred within the ***57** state. The difference, however, is only such as arises naturally from the extent of the jurisdiction of the state in the two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination. As to residents it may, and does, exert its taxing power over their income from all sources, whether within or without the state, and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to nonresidents, the jurisdiction extends only to their property owned within the state and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no obligation to accord to them a deduction by reason of losses elsewhere incurred. It may be remarked, in passing, that there is no showing that appellant has sustained such losses, and so he is not entitled to raise this question.

It is urged that, regarding the tax as imposed upon the business conducted within the state, it amounts in the case of appellant's business to a burden upon interstate commerce, because the products of his oil operations are shipped out of the state. Assuming that it fairly appears that his method of business constitutes interstate commerce, it is sufficient to say that the tax is imposed not upon the gross receipts, as in Crew Levick Co. v. Pennsylvania, 245 U. S. 292, 38 Sup. Ct. 126, 62 L. Ed. 295; but only upon the net proceeds, and is plainly sustainable, even if it includes net gains from interstate commerce. U. S. Glue C. v. Oak Creek, 247 U. S. 321, 38 Sup. Ct. 499, 62 L. Ed. 1135, Ann. Cas. 1918E, 748. Compare Peck & Co. v. Lowe, 247 U. S. 165, 38 Sup. Ct. 432, 62 L. Ed. 1049.

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[ad valorem tax and Due Process discussions deleted]

No. 531: Appeal dismissed.

No. 580: Decree affirmed.

Mr. Justice McREYNOLDS dissents.

FN1 [deleted]

U.S.Okl. 1920
Shaffer v. Carter
252 U.S. 37, 40 S.Ct. 221, 4 A.F.T.R. 4727, 64 L.Ed. 445

END OF DOCUMENT

ARNOUD GERRITSE v. FINANZAMT NEUKÖLLN-NORD

2003 E.C.R. 5933

12 June 2003

Case C-234/01

The District Tax Court of Berlin referred to the ECJ for preliminary ruling a question on the interpretation of (now) Article 43 EC.

Under German law at the time, non-residents were taxed as “partially taxable persons” only on income received in Germany. A tax of 25% was levied on such amounts, and no deduction was permitted for related business expenses, unless such expenses were more than half of the income received (paragraph 4). Non-residents could elect to be treated as fully-taxable persons, entitled to full deduction for business expenses, but only if either: (1) at least 90% of their income was subject to German income tax during the calendar year, or (2) the income not subject to German income tax did not exceed DEM 12,000 (paragraph 7).[124]

Mr. Gerritse earned about DEM 6,000 in 1996 for performing as a drummer in Berlin. His associated expenses were about DEM 1,000. In the same year, he earned about DEM 55,000 in the Netherlands, his State of residence. Gerritse sought to be treated as fully taxable in Germany, but his request was denied because he did not satisfy the conditions for election (paragraph 12).

Offsetting Business Expenses

The referring court noted that Germany’s failure to take offsetting business expenses into account when assessing the flat 25% tax on non-residents could lead to inequitable results when a non-resident incurred significant expenses related to the production of income in Germany, even though the rule might result in lower taxes for non-residents without significant business expenses (paragraphs 18-20).

The ECJ first noted that since Gerritse was a drummer, the relevant Treaty provision was the freedom to provide services, not the freedom of establishment (paragraph 23). The Court held that denying non-residents an opportunity to offset their German-source income by related expenses indirectly discriminated on grounds of nationality because non-residents who

[124] At the time of the conversion to the euro, DEM 12,000 was about €6,100.

were similarly situated to residents were assessed higher taxes and were therefore discouraged from offering services in Germany (paragraph 28). Therefore, denying business deductions to non-residents when such deductions were allowed for residents was contrary to the EC Treaty (paragraph 29).

Tax-free Allowance

The Court then considered Gerritse's argument that he was entitled to the tax-free allowance provided to German residents of DEM 12,095, such that no tax was due on his income from drumming. The German tax office and the Finnish government argued that under the Court's rulings in *Schumacker*,[125] *Gschwind,*[126] and *Asscher*,[127] the obligation to take into account the taxpayer's personal situation is the responsibility of the residence State, except where the income in the residence State is insufficient to allow the State to offset the resident's expenses (paragraph 35). They argued that the tax-free allowance was designed to protect a minimum amount of income from taxation for the benefit of low income taxpayers, and such minimum income protection is a responsibility of the State of residence, where the taxpayer generally receives most of his income (paragraph 36).[128] The Commission agreed that it is for the State of residence to take into account social policies such as the tax-free allowance and argued that Gerritse should not be entitled to the tax-free allowance. Instead, progressive rates should be applied to his net income without the application of the allowance (paragraphs 38-40).[129]

The ECJ considered whether the objective differences between resident and non-resident taxpayers could justify a national tax system in which non-residents were taxed at a uniform rate, whereas residents were entitled to progressive taxation, including a tax-free allowance. The ECJ held that where a non-resident receives most of his income in Germany, as demonstrated by his ability to fulfill the conditions necessary to elect to be treated as wholly taxable, then he must be taxed in precisely the same was a resident, including progressivity and the tax-free allowance (paragraph 49). However, Gerritse did not fulfill those conditions. The ECJ noted that he might benefit from a tax-free allowance provided by the Netherlands, which as his residence State is

[125] Case C-279/93, Finanzamt Köln-Altstadt v. Schumacker, 1995 E.C.R. 225.
[126] Case C-391/97, Gschwind v. Finanzamt Aachen-Außenstadt, 1997 E.C.R. 5451.
[127] Case C-107/94, Asscher v. Staatssecretaris van Financiën, 1996 E.C.R. 3089.
[128] The District Court said that to grant the tax-free allowance against only Gerritse's German-source income would put him in a better position than that of other Germans, whose worldwide income was taken into account when applying the progressive rates, rather than just their German-source income (paragraph 14).
[129] In essence, the Commission argued that Gerritse should provisionally be considered to have earned his net income plus an amount equal to the tax-free amount in order to determine the proper amount of tax (paragraph 39).

primarily responsible for taking his family and personal circumstances into account (paragraph 51).

While the tax-free allowance is a social policy to be applied by the State of residence, residents and non-residents are otherwise similarly situated with respect to progressivity, and to the extent that the flat 25% rate leads to higher tax for non-residents than residents, it is contrary to EC law. The ECJ said that it was for the referring court to determine whether the flat 25% tax was higher than the progressive tax would have been in this case.

FÖRSÄKRINGSAKTIEBOLAGET SKANDIA (PUBL), OLA RAMSTEDT v. RIKSSKATTEVERKET

2003 E.C.R. 6817

26 June 2003

Case C-422/01

The Supreme Administrative Court of Sweden referred to the ECJ for preliminary ruling a question on the interpretation of Article 49 EC.

Under Swedish domestic law, employers paying premiums on insurance policies for their employees were able to deduct the premiums when paid if Sweden considered the policy to be pension insurance rather than endowment insurance. To be considered pension insurance, as a general rule, a policy had to be written by an insurer established in Sweden (paragraph 5). For employer-paid endowment insurance, the deduction could only be taken when the pension benefits were actually paid to the pensioner, and the amount of the pension could be deducted by the employer (paragraph 10).

Skandia, a Swedish company, and its employee, a Swedish citizen and resident named Mr. Ramstedt, applied for an advance ruling from the Swedish Council (Skatterättsnämnden) on whether Skandia could deduct insurance premiums paid on behalf of Ramstedt to insurers established in other Member States (paragraphs 11-12). The taxpayers appealed the Skatterättsnämnden's advance ruling that Skandia could not deduct the premiums when paid to foreign insurers to the Swedish Supreme Administrative Court. The Supreme Administrative Court referred to the ECJ the question of whether conditioning a tax benefit on the obligation to buy insurance from a domestic insurer

JUDGMENT OF THE COURT (Fifth Chamber)

12 June 2003 (1)

(Income tax - Non-residents - Article 59 of the EC Treaty (now, after amendment, Article 49 EC) and Article 60 of the EC Treaty (now Article 50 EC) - Non-taxable threshold amount - Deduction of business expenses

In Case C-234/01,

REFERENCE to the Court under Article 234 EC by the Finanzgericht Berlin (Germany) for a preliminary ruling in the proceedings pending before that court between

Arnoud Gerritse

and

Finanzamt Neukölln-Nord,

on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC),

THE COURT (Fifth Chamber),

composed of: M. Wathelet (Rapporteur), President of the Chamber, C.W.A. Timmermans, D.A.O. Edward, P. Jann and A. Rosas, Judges,

Advocate General: P. Léger,

Registrar: M.-F. Contet, Principal Administrator,

after considering the written observations submitted on behalf of:

- Mr Gerritse, by H. Grams, Rechtsanwalt, and D. Molenaar, belastingadviseur,

- the Finanzamt Neukölln-Nord, by W. Czarnetzki and S. Wolff, acting as Agents,

- the Finnish Government, by T. Pynnä, acting as Agent,

- the Commission of the European Communities, by R. Lyal and W. Mölls, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Mr Gerritse and the Commission at the hearing on 9 January 2003,

after hearing the Opinion of the Advocate General at the sitting on 13 March 2003,

gives the following

Judgment

1.
By order of 28 May 2001, received at the Court on 19 June 2001, the Finanzgericht Berlin (District Tax Court, Berlin) referred to the Court for a preliminary ruling under Article 234 EC a question on the interpretation of Article 52 of the EC Treaty (now, after amendment, Article 43 EC).

2.
That question was raised in proceedings between Mr Gerritse and the Finanzamt Neukölln-Nord (the Finanzamt) concerning the taxation of income received in Germany as a non-resident.

National legal background

3.
Paragraph 50a of the Einkommensteuergesetz (Law on Income Tax) in its 1996 version (the EStG 1996) concerns the taxation of partially taxable persons; that is to say those having neither their permanent residence nor ordinary abode in Germany, and who are taxed there only on the income received in that State. Under Paragraph 50a(4) of that Law:

In the case of partially taxable persons, income tax shall be deducted at source:

1. In respect of income from artistic, sporting or similar performances in national territory or from the exploitation of such performances in national territory, including income derived from other acts of performance connected with the above, irrespective of the person who receives the income ...

...

The deduction at source shall be 25% of the income received ...

4.

In accordance with Paragraph 50(5), fourth sentence, of the EStG in its 1997 version, applicable with retrospective effect to remuneration received in 1996, no deduction for business expenses is in principle authorised, unless those costs represent more than half of the income received.

5.
In principle, retention at source constitutes a definitive charge, as is shown by Paragraph 50(5) of the EStG 1996:

In the case of partially taxable persons, income tax on income which ... is subject to deduction at source under Paragraph 50a is to be regarded as finally paid by that deduction.

6.
Under Paragraph 1(3) of the EStG 1996, certain persons falling within the scope of Paragraph 50a of that law may nevertheless ask to be treated like persons wholly subject to income tax, their tax treatment being thereafter on the same basis as that of a wholly taxable person for the purposes of assessing the tax due in the light of the tax return.

7.
However, partially taxable persons may use that option only if one of the following conditions is fulfilled: either at least 90% of the income must have been subject to German income tax during the calendar year, or the income not subject to German income tax during the calendar year must be equal to or less than DEM 12 000.

8.
In the clearance procedure for income tax, generally applicable to wholly taxable persons, the basis of assessment, as regards income from a self-employed activity, is the net profit after deducting business expenses (see Paragraph 50(1) and (2) of the EStG). In addition, the progressive table laid down by Paragraph 32a of the EStG 1996, which includes a non-taxable threshold amount limited for 1996 to DEM 12 095, must be applied.

The dispute in the main proceedings and the question referred

9.
Mr Gerritse, a Netherlands national resident in the Netherlands, received the sum of DEM 6 007.55 in 1996 for performing as a drummer at a radio station in Berlin. The documents before the Court show that the business expenses occasioned by that performance amounted to DEM 968.

10.
In the same year, Mr Gerritse also received gross income totalling around DEM 55 000 in his State of residence and in Belgium.

11.
In accordance with the Convention concluded on 16 June 1959 between the Kingdom of the Netherlands and the Federal Republic of Germany for the avoidance of double taxation in the area of income, capital and various other taxes, and for regulating other tax matters (BGBl. 1960 II, p. 1782; the bilateral convention) and with Article 50a(4) of the EStG 1996, the fee of DEM 6 007.55 was subjected to tax on a notional assessment of income, at the rate of 25% (namely DEM 1 501.89), which was deducted at source.

12.
In September 1998, Mr Gerritse lodged with the German tax authorities, under Paragraph 1(3) of the EStG 1996, a declaration of income with a view to be being treated as a wholly taxable person. The Finanzamt refused to carry out income tax clearance, however, on the ground that the other income declared exceeded the ceiling of DEM 12 000. Mr Gerritse's administrative complaint was likewise rejected.

13.
Mr Gerritse brought an action against that rejection before the Finanzgericht Berlin, relying on the principle of non-discrimination guaranteed by Community law. He argued that a wholly taxable resident in a situation comparable to his own would not be required to pay tax by reason of the non-taxable threshold amount limited to DEM 12 095.

14.
The Finanzamt argued that, by applying the basic table, the applicant would escape the progressivity of German income tax, even though the level of his income, having regard to his worldwide income, required the application of a higher rate. In that way, he would be favoured in comparison with wholly taxable residents, in respect of whom, in accordance with Paragraph 32b(1), point 3, of the EStG 1996, worldwide income is taken into account when determining the rate of taxation.

15.

The referring court inquires as to the compatibility with Community law of the definitive taxation at the rate of 25% laid down by Paragraph 50a(4), first sentence, point 1, and second sentence, of the EStG 1996.

16.
It notes that the possibility, by virtue of the bilateral convention, of the State of residence taking the income received in the State of activity into account for the purposes of taxing the balance of worldwide income might lead to an extra charge for the taxpayer in that a possible leap in the rate of income tax would not be entirely compensated for by deduction of the tax in the State of residence, such deduction being calculated in a purely abstract way by reference to the relation between the income received in Germany and the taxpayer's worldwide income.

17.
According to the referring court, the definitive taxation of Mr Gerritse's income at a rate of 25% cannot be justified by the principle of tax consistency, since there was not, as the case-law of the Court of Justice on the matter requires, a direct link between the tax advantage - in this case the tax-free allowance - and the definitive taxation.

18.
The referring court also finds that, in certain cases, application of a uniform rate of 25% risks leading to blatant discrimination against a partially taxable person by comparison with a tax resident. For example, in 1996, a single taxpayer with his permanent residence in the Netherlands and receiving there the equivalent of DEM 12 001 by way of net income, as well as gross income in Germany derived from a self-employed artistic activity amounting to DEM 100 000 gross and DEM 50 001 net, was subject to a definitive charge of DEM 25 000 by way of income tax, in addition to the proportionate solidarity surcharge. According to the referring court, that corresponds - when applied to the net income received in Germany - to an average rate of tax of 49.99%, which is generally applicable only to persons with very high incomes (the maximum tax rate in 1996 amounted to 53% for single taxpayers with taxable income over DEM 120 042).

19.
If the taxpayer's permanent residence had been in Germany, and he had obtained a net worldwide income there of DEM 62 002, he would have had to pay, according to the basic table, a tax on income of only DEM 15 123. In that case, the average rate of taxation would have corresponded to only 24.4%, half the rate mentioned in the previous paragraph.

20.
The referring court recognises, however, that, in a large number of cases, particularly where national income is very high and business expenses negligible, the provisions at issue in the main proceedings lead, in relation to the rate of tax to be applied, to more favourable treatment of a partially taxable person subject to the deduction of tax, compared with a taxpayer established in Germany or with a partially taxable person assessed to tax in accordance with Article 50 of the EStG 1996. Mr Gerritse, however, was not one of those favoured persons, given that the tax assessment in respect of income received in German territory would have been nil in the event of full liability to tax.

21.
The referring court adds that the dispute in the main proceedings might be resolved by allowing Mr Gerritse the possibility of being assessed to tax on the basis of the basic income tax table, but without taking account of the tax-free allowance, which would lead to income tax slightly lower than has been demanded. The question would then arise whether negligible differences in the matter of taxation constitute an effective obstacle to the exercise of an economic activity in another Member State.

22.
In those circumstances, the Finanzgericht Berlin decided to suspend the proceedings and refer the following question to the Court of Justice for a preliminary ruling:

Is there an infringement of Article 52 of the EC Treaty ... where, under Paragraph 50a(4), first sentence, point 1 and second sentence, of [the EStG 1996], a Netherlands national who earns in Germany taxable net income of approximately DEM 5 000 from self-employed activity in the calendar year is subject to deduction of tax at source by the person liable to pay his fees at the rate of 25% of his (gross) revenue of approximately DEM 6 000 plus solidarity surcharge, where it is not possible, by means of an application for a refund or an application for a tax assessment, for him to recover, in whole or in part, the taxes paid?

The question referred

23.

It should be noted at the outset that Mr Gerritse, who lives in the Netherlands, performed temporary services in Germany, for which he received income the taxation of which is disputed before the referring court. In those circumstances, as Mr Gerritse and the Commission have observed, the question referred should be understood as concerning the freedom to provide services rather than the freedom of establishment.

24.
The Court considers, therefore, that the referring court is essentially enquiring whether Article 59 of the EC Treaty (now, after amendment, Article 49 EC) and Article 60 of the EC Treaty (now Article 50 EC) preclude a national provision such as that at issue in the main proceedings which, as a general rule, on the one hand, takes gross income into account when taxing non-residents, without deduction of business expenses, whereas residents are taxed on their net income after deduction of their business expenses, and, on the other, makes the income of non-residents liable to a definitive tax at the uniform rate of 25%, deducted at source, whereas the income of residents is taxed in accordance with a progressive table which includes a tax-free allowance.

The deductibility of business expenses

25.
Mr Gerritse and the Commission argue that, in the case of self-employed persons who are wholly taxable, only the profit is subject to income tax, business expenses being generally excluded from the basis of assessment, whereas, in the case of partially taxable persons, the tax of 25% is levied on receipts, business expenses being non-deductible (save where they are higher than half of the receipts, in which case tax is repaid in so far as it exceeds 50% of the difference between the receipts and the business expenses).

26.
Mr Gerritse argues, in particular, that there are serious consequences for non-resident artists on tour in Germany, whose business expenses are generally very high.

27.
It is to be noted at this stage that the business expenses in question are directly linked to the activity that generated the taxable income in Germany, so that residents and non-residents are placed in a comparable situation in that respect.

28.
In those circumstances, a national provision which, in matters of taxation, refuses to allow non-residents to deduct business expenses, whereas residents are allowed to do so, risks operating mainly to the detriment of nationals of other Member States and therefore constitutes indirect discrimination on grounds of nationality, contrary in principle to Articles 59 and 60 of the Treaty.

29.
Since no precise argument has been put before the Court to justify such a difference in treatment, Articles 59 and 60 must be held to preclude a national provision such as that at issue in the main proceedings in so far as it excludes the possibility for partially taxable persons to deduct business expenses from their taxable income, whereas such a possibility is granted to wholly taxable persons.

The deduction at source of 25%

Observations submitted to the Court

30.
Mr Gerritse argues that the effect of exacting income tax by way of deduction at source and the fact that non-residents are thereby excluded from any form of repayment of overpaid amounts are incompatible with the third paragraph of Article 60 of the Treaty. In particular, he maintains that the failure to take account of the tax-free allowance leads to discrimination contrary to Community law, since its effect is to impose a minimum rate of tax, ruled unlawful by the Court in its judgment in Case C-107/94 Asscher [1996] ECR I-3089, paragraph 49.

31.
There is, he submits, no objective reason capable of justifying that difference in treatment by comparison with residents. In particular, the argument of tax consistency cannot be validly relied on, since there is here no advantage to compensate for the tax disadvantage, as required by the Court's case-law on the subject.

32.
The Finanzamt and the Finnish Government argue, by contrast, that the tax regime at issue in the main proceedings complies with Community law.

33.
First, according to the Finanzamt, deduction at source constitutes a legitimate and appropriate method for

the tax treatment of a partially taxable person, established abroad.

34.
In addition, if the basic tax table were to be applied without restriction, which in this case would result in no German income tax being levied, Mr Gerritse would escape the progressive element of that tax, even though his worldwide income required the application of a higher rate. In that way, a partially taxable taxpayer would be favoured in comparison with wholly taxable persons, for whom worldwide income is taken into account when determining the tax rate.

35.
The Finanzamt and the Finnish Government add that, according to the case-law of the Court (judgments in Case C-279/93 Schumacker [1995] ECR I-225, paragraphs 31 to 33; Case C-391/97 Gschwind [1999] ECR I-5451, paragraph 22; and Asscher, paragraph 44), the obligation to take account of a taxpayer's personal situation is, in principle, a matter for the competence of the State of residence, and not that of the State where the income originates, unless, on account of the lack of sufficient income for taxation in the first State, the latter were unable to fulfil that obligation, so that, from the economic point of view, neither of the two States under consideration would in the end take account of the personal situation of the taxpayer for the purposes of tax assessment.

36.
However, a tax-free allowance is designed to protect the essential minimum income of taxpayers with low incomes, which is in principle a matter falling within the responsibility of the State of residence, where, as a general rule, the taxpayer receives the greater part of his income. The German tax authorities take account of the essential minimum in the case of a partially taxable person, in so far as that person is subject to assessment in the ordinary way, where the income received abroad is less than DEM 12 000.

37.
Finally, according to the Finnish Government, the rate of 25% often corresponds to the actual rate of tax to which the person is subject in his State of residence, so that the deduction at source at issue does not constitute an unforeseeable obstacle to the free movement of persons.

38.
The Commission makes a similar argument. It considers that, bearing in mind the circumstances of the case at issue in the main proceedings, account should not be taken of the tax-free allowance, so that the rate corresponding to taxation above that amount should be applied.

39.
It thus proposes that the net income (A) be added to the tax-free allowance (B) to obtain a total (C). The amount of tax (D) laid down by the relevant table for that total (C) could be regarded as a fair tax on the net income. The average rate of taxation, which could serve as a reference for non-discriminatory treatment, would then arise from the relationship between the amount of the tax (D) in accordance with the table and net income (A).

40.
According to the Commission, the calculation in Mr Gerritse's case would be as follows: the total (C) would be composed of net income (A) amounting to DEM 5 039.55 plus the tax-free allowance (B) of DEM 12 095, and would thus amount to DEM 17 134.55. For that income, the relevant tax table gives a tax (D) of DEM 1 337. Having regard to net income (A), that sum would correspond to an average rate of taxation of 26.5%, close to the rate of 25% actually applied to Mr Gerritse.

41.
The Commission argues that, at that rate, there is no discrimination. There is therefore no cause in this case to challenge the German authorities' application of the uniform rate of 25% to partially taxable persons.

42.
It also shares the views of the Finanzamt and the Finnish Government as to the benefit of the tax-free allowance. It is in principle for the State of residence, which carries out the global taxation of the person concerned taking his worldwide net income into account, to integrate into its system of progressive taxation the considerations of a social nature that justify the existence of such an allowance.

The answer of the Court

43.
As the Court has already held, in relation to direct taxes, the situations of residents and of non-residents are generally not comparable, because the income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence, and because a non-resident's personal

ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is easier to assess at the place where his personal and financial interests are centred, which in general is the place where he has his usual abode (Schumacker, paragraphs 31 and 32; Gschwind, paragraph 22; Case C-87/99 Zurstrassen [2000] ECR I-3337, paragraph 21).

44.
Also, the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory having regard to the objective differences between the situations of residents and of non-residents, from the point of view both of the source of their income and of their personal ability to pay tax or their personal and family circumstances (Schumacker, paragraph 34; Gschwind, paragraph 23).

45.
Moreover, for tax purposes, residence is the connecting factor on which international tax law, in particular the Model Convention of the Organisation for Economic Cooperation and Development (OECD) (Model Convention on Double Taxation concerning Income and Capital, Report of the Tax Affairs Committee of the OECD, 1977, version of 29 April 2000) is as a rule founded for the purpose of allocating powers of taxation between States in situations involving extraneous elements.

46.
In this case, the documents before the Court show that Mr Gerritse, who lives in the Netherlands, received only a minimal part of his overall income in German territory.

47.
The question therefore arises whether the objective difference in situation between such a non-resident and a resident allows one to disregard the discriminatory character of a national provision such as that at issue in the main proceedings which makes the income of non-residents subject to a definitive tax at the uniform rate of 25% deducted at source, whereas the income of residents is taxed according to a progressive table including a tax-free allowance.

48.
Concerning, first, the tax-free allowance, since, as the Finanzgericht Berlin, the Finnish Government and the Commission have argued, it has a social purpose, allowing the taxpayer to be granted an essential minimum exempt from all income tax, it is legitimate to reserve the grant of that advantage to persons who have received the greater part of their taxable income in the State of taxation, that is to say, as a general rule, residents.

49.
It should be noted that, where it is nevertheless established that a partially taxable person has received the greater part of his income in Germany, by fulfilling one of the two conditions mentioned in paragraph 7 of this judgment, the national provision at issue in the main proceedings assesses him to tax in precisely the same way as a wholly taxable person, by applying to the income of the taxpayer concerned a progressive table including a tax-free allowance.

50.
That is not, however, the case with Mr Gerritse.

51.
In that regard, the Netherlands Government has stated, in reply to a question by the Court, that, in a case such as that at issue in the main proceedings, the taxpayer may benefit in the Netherlands, the State of residence, from the tax-free allowance which is deducted from overall income. In other words, an advantage comparable to that claimed by Mr Gerritse in Germany is granted in the State of his residence, which must, in principle, take into account the personal and family situation of the person concerned.

52.
Moreover, as regards the application to non-residents of a flat rate of tax of 25% while residents are subject to a progressive table, as the Commission has pointed out, the Netherlands as State of residence, pursuant to the bilateral convention, integrates the income in respect of which the right to tax belongs to Germany into the basis of assessment, in accordance with the progressivity rule. It does, however, take account of the tax levied in Germany, by deducting from the Netherlands tax a fraction which corresponds to the relation between the income taxed in Germany and worldwide income.

53.
That means that, with regard to the progressivity rule, non-residents and residents are in a comparable situation, so that application to the former of a higher rate of income tax than that applicable to the latter and to taxpayers who are assimilated to them would constitute indirect discrimination prohibited by Community law, in particular by Article 60 of the Treaty (see, by analogy, Asscher, paragraph 49).

54.

It is for the referring court to verify, in this case, whether the 25% tax rate applied to Mr Gerritse's income is higher than that which would follow from application of the progressive table. In order to compare comparable situations, it is necessary in that respect, as the Commission has rightly pointed out, to add to the net income received by the person concerned in Germany an amount corresponding to the tax-free allowance. According to the Commission, which carried out that calculation, application of the progressive table, in a case such as that at issue in the main proceedings, would lead to a rate of tax of 26.5%, which is higher than that actually applied.

55.
In view of the whole of the above considerations, the answer to the Finanzgericht Berlin must be:

- Articles 59 and 60 of the Treaty preclude a national provision such as that at issue in the main proceedings which, as a general rule, takes into account gross income when taxing non-residents, without deducting business expenses, whereas residents are taxed on their net income, after deduction of those expenses;

- However, those articles of the Treaty do not preclude that same provision in so far as, as a general rule, it subjects the income of non-residents to a definitive tax at the uniform rate of 25%, deducted at source, whilst the income of residents is taxed according to a progressive table including a tax-free allowance, provided that the rate of 25% is not higher than that which would actually be applied to the person concerned, in accordance with the progressive table, in respect of net income increased by an amount corresponding to the tax-free allowance.

Costs

56.
The costs incurred by the Finnish Government and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the question referred to it by the Finanzgericht Berlin by order of 28 May 2001, hereby rules:

1. Article 59 of the EC Treaty (now, after amendment, Article 49 EC) and Article 60 of the EC Treaty (now Article 50 EC) preclude a national provision such as that at issue in the main proceedings which, as a general rule, takes into account gross income when taxing non-residents, without deducting business expenses, whereas residents are taxed on their net income, after deduction of those expenses.

2. However, those articles of the Treaty do not preclude that same provision in so far as, as a general rule, it subjects the income of non-residents to a definitive tax at the uniform rate of 25%, deducted at source, whilst the income of residents is taxed according to a progressive table including a tax-free allowance, provided that the rate of 25% is not higher than that which would actually be applied to the person concerned, in accordance with the progressive table, in respect of net income increased by an amount corresponding to the tax-free allowance.

Wathelet

Timmermans
Edward

Jann

Rosas

Delivered in open court in Luxembourg on 12 June 2003.

R. Grass

M. Wathelet
Registrar

President of the Fifth Chamber

1: Language of the case: German.

Supreme Court of the United States
TRAVIS, Comptroller of State of New York,
v.
YALE & TOWNE MFG. CO.
No. 548.

Argued Dec. 15 and 16, 1919.
Decided March 1, 1920.

****229 *61** Messrs. James S. Y. Ivins, of Albany, N. Y., and Jerome L. Cheney, First Deputy Atty. Gen., for appellant.
***66** Messrs. Louis H. Porter and Archibald Cox, both of New York City, for appellee.

***72** Mr. Justice PITNEY delivered the **opinion** of the Court.
This was a suit in equity, brought in the District Court by appellee against appellant as comptroller of the state of New York to obtain an injunction restraining the enforcement of the Income Tax Law of that state (chapter 627, Laws 1919) as against complainant, upon the ground of its repugnance to the Constitution of the United States because violating the interstate commerce clause, impairing the obligation of contracts, depriving citizens of the states of Connecticut and New Jersey employed by complainant of the privileges and immunities enjoyed by citizens of the state of New York, depriving complainant and its nonresident employés of their ***73** property without due process of law, and denying to such employés the equal protection of the laws.

[procedural history deleted]

The act (section 351) imposes an annual tax upon every resident of the state with respect to his net income as defined in the act, at specified rates, and provides also:
‘A like tax is hereby imposed and shall be levied, collected and paid annually, at the rates specified in this section, upon and with respect to the entire net income as herein defined, except as hereinafter provided, from all property owned and from every business, trade, profession or occupation carried on in this state by natural persons not residents of the state.'

Section 359 defines gross income, and contains this paragraph:
‘3. In the case of taxpayers other than residents, gross income includes only the gross income from sources within the state, but shall not include annuities, interest on bank deposits, interest on bonds, notes or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession, or occupation carried on in this state subject to taxation under this article.'

In section 360 provision is made for deducting in the computation of net income ****230** expenses, taxes, losses, depreciation charges, etc.; but, by paragraph 11 of the same section:
‘In the case of a taxpayer other than a resident of the state the deductions allowed in this section shall be allowed only if, and to the extent that, they are connected with income arising from sources within the state. * * *'

By ***74** section 362, certain exemptions are allowed to any resident individual taxpayer, viz. in the case of a single person a personal exemption of $1,000, in the case of the head of a family or a married person living with husband or wife, $2,000, and $200 additional for each dependent person under 18 years of age or mentally or physically defective. The next section reads as follows:
‘Sec. 363. *Credit for Taxes in Case of Taxpayers Other Than Residents of the State*.-Whenever a taxpayer other than a resident of the state has become liable to income tax to the state or country where he resides upon his net income for the taxable year, derived from sources within this state and subject to taxation under this article, the comptroller shall credit the amount of income tax payable by him under this article with such proportion of the tax so payable by him to the state or country where he resides as his income subject to taxation under this article bears to his entire income upon which the tax so payable to such other state or country was imposed; provided that such credit shall be allowed only if the laws of said state or country grant a substantially similar credit to residents of this state subject to income tax under such laws.'

Section 366 in terms requires that every 'withholding agent' (including employers) shall deduct and withhold 2 per centum from all salaries, wages, etc., payable to nonresidents, where the amount paid to any individual equals or exceeds $1,000 in the year, and shall pay the tax to the comptroller. This applies to a resident employé, also, unless he files a certificate showing his residence address within the state.

Complainant, a Connecticut corporation doing business in New York and elsewhere, has employés who are residents, some of Connecticut, others of New Jersey, but are occupied in whole or in part in complainant's business in New York. Many of them have annual salaries or fixed compensation exceeding $1,000 per year, and the ***75** amount required by the act to be withheld by complainant from the salaries of such nonresident employés is in excess of $3,000 per year. Most of these persons are engaged under term contracts calling for stipulated wages or salaries for a specified period.

*** [discussion of appropriateness of employer bringing the action as withholding agent deleted]

That the state of New York has jurisdiction to impose a tax of this kind upon the incomes of nonresidents arising from any business, trade, profession, or occupation carried on within its borders, enforcing payment so far as it can by the exercise of a just control over persons and property within the state, as by garnishment of credits (of which the withholding provision of the New York law is the practical equivalent), and that such a tax, so enforced, does not violate the due process of law provision of the Fourteenth Amendment, is settled by our decision in Shaffer v. Carter, State Auditor, 252 U. S. 37, 40 Sup. Ct. 221. 64 L. Ed. --, this day announced, involving the Income Tax Law of the state of Oklahoma. That there is no unconstitutional discrimination against citizens of other states in confining the deduction of expenses, losses, etc., in the case of nonresident taxpayers, to such as are ***76** connected with income arising from sources within the taxing state, likewise is settled by that decision.

It is not here asserted that the tax is a burden upon interstate commerce; the point having been abandoned in this court.

*** [deleted discussion of and Court's conclusion that New York's requirement that a Connecticut company doing business in New York serve as a withholding agent for its employees did not in itself violate the Commerce Clause]

The District Court, not passing upon the above questions, held that the act, in granting to residents exemptions denied to nonresidents, violated the provision of section 2 of article 4 of the federal Constitution:
'The citizens of each state shall be entitled to all privileges and immunities of citizens in the several states.'

And, notwithstanding ***78** the elaborate and ingenious argument submitted by appellant to the contrary, we are constrained to affirm the ruling.

The purpose of the provision came under consideration in Paul v. Virginia, 8 Wall. 168, 180 (19 L. Ed. 357), where the court, speaking by Mr. Justice Field, said:
'It was undoubtedly the object of the clause in question to place the citizens of each state upon the same footing with citizens of other states, so far as the advantages resulting from citizenship in those states are concerned. It relieves them from the disabilities of alienage in other states; it inhibits discriminating legislation against them by other states; it gives them the right of free ingress into other states, and egress from them; it insures to them in other states the same freedom possessed by the citizens of those states in the acquisition and enjoyment of property and in the pursuit of happiness; and it secures to them in other states the equal protection of their laws. It has been justly said that no provision in the Constitution has tended so strongly to constitute the citizens of the United States one people as this.'

And in Ward v. Maryland, 12 Wall. 418, 430 (20 L. Ed. 449), holding a discriminatory state tax upon nonresident traders to be void, the court, by Mr. Justice Clifford, said:
'Beyond doubt those words [privileges and immunities] are words of very comprehensive meaning, but it will be sufficient to say that the clause plainly and unmistakably secures and protects the right of a citizen of one state to pass into any other state of the Union for the purpose of engaging in lawful commerce, trade, or business without molestation; to acquire personal property; to take and hold real estate; to maintain actions in the courts of

the state; and to be exempt from any higher taxes or excises than are imposed by the state upon its own citizens.'

Of course the terms 'resident' and 'citizen' are not synonymous, and in some cases the distinction is important ***79** (La Tourette v. McMaster, 248 U. S. 465, 470, 39 Sup. Ct. 160, 63 L. Ed. 362); but a general taxing scheme such as the one under consideration, if it discriminates against all nonresidents, has the necessary effect of including in the discrimination those who are citizens of other states; and, if there be no reasonable ground for the diversity of treatment, it abridges the privileges and immunities to which such citizens are entitled. In Blake v. McClung, 172 U. S. 239, 247, 19 Sup. Ct. 165, 43 L. Ed. 432, and 176 U. S. 59, 67, 20 Sup. Ct. 307, 44 L. Ed. 371, the court held that a statute of Tennessee, declaring the terms upon which a foreign corporation might carry on business and hold property in that state, which gave to its creditors residing in Tennessee priority over all creditors residing elsewhere, without special reference to whether they were citizens or not, must ****232** be regarded as contravening the 'privileges and immunities' clause.

The nature and effect of the crucial discrimination in the present case are manifest. Section 362, in the case of residents, exempts from taxation $1,000 of the income of a single person, $2,000 in the case of a married person, and $200 additional for each dependent. A nonresident taxpayer has no similar exemption; but by section 363, if liable to an income tax in his own state, including income derived from sources within New York and subject to taxation under this act, he is entitled to a credit upon the income tax otherwise payable to the state of New York by the same proportion of the tax payable to the state of his residence as his income subject to taxation by the New York act bears to his entire income taxed in his own state:
'Provided, that such credit shall be allowed only if the laws of said state * * * grant a substantially similar credit to residents of this state subject to income tax under such laws.'

***80** In the concrete, the particular incidence of the discrimination is upon citizens of Connecticut and New Jersey, neither of which states has an income tax law. A considerable number of complainant's employés, residents and citizens of one or the other of those states, spend their working time at its office in the city of New York, and earn their salaries there. The case is typical; it being a matter of common knowledge that from necessity, due to the geographical situation of that city, in close proximity to the neighboring states, many thousands of men and women, residents and citizens of those states, go daily from their homes to the city and earn their livelihood there. They pursue their several occupations side by side with residents of the state of New York-in effect competing with them as to wages, salaries, and other terms of employment. Whether they must pay a tax upon the first $1,000 or $2,000 of income, while their associates and competitors who reside in New York do not, makes a substantial difference. Under the circumstances as disclosed, we are unable to find adequate ground for the discrimination, and are constrained to hold that it is an unwarranted denial to the citizens of Connecticut and New Jersey of the privileges and immunities enjoyed by citizens of New York. This is not a case of occasional or accidental inequality due to circumstances personal to the taxpayer (see ***81**Amoskeag Savings Rank v. Purdy, 231 U. S. 373, 393-394, 34 Sup. Ct. 114, 58 L. Ed. 274; Maxwell v. Bugbee, 250 U. S. 525, 543, 40 Sup. Ct. 2, 63 L. Ed. 1124); but a general rule, operating to the disadvantage of all nonresidents including those who are citizens of the neighboring states, and favoring all residents including those who are citizens of the taxing state.

It cannot be deemed to be counterbalanced by the provision of paragraph 3 of section 359, which excludes from the income of nonresident taxpayers--
'annuities, interest on bank deposits, interest on bonds, notes, or other interest-bearing obligations or dividends from corporations, except to the extent to which the same shall be a part of income from any business, trade, profession or occupation carried on in this state subject to taxation under this article.'

This provision is not so conditioned as probably to benefit nonresidents to a degree corresponding to the discrimination against them; it seems to have been designed rather (as is avowed in appellant's brief) to preserve the pre-eminence of New York City as a financial center.

Nor can the discrimination be upheld, as is attempted to be done, upon the theory that nonresidents have untaxed income derived from sources in their home states or elsewhere outside of the state of New York, corresponding to the amount upon which residents of that state are exempt from taxation under this act.

The discrimination is not conditioned upon the existence of such untaxed income; and it would be rash to assume that nonresidents taxable in New York under this law, as a class, are receiving additional income from outside sources equivalent to the amount of the exemptions that are accorded to citizens of New York and denied to them.

In the brief submitted by the Attorney General of New York in behalf of appellant, it is said that the framers of the act, in embodying in it the provision for unequal treatment of the residents of other states with ***82** respect to the exemptions, looked forward to the speedy adoption of an income tax by the adjoining states, in which event injustice to their citizens on the part of New York could be avoided by providing similar exemptions similarly conditioned. This, however, is wholly speculative; New York has no authority to legislate for the adjoining states; and we must pass upon its ****233** statute with respect to its effect and operation in the existing situation. But besides, in view of the provisions of the Constitution of the United States, a discrimination by the state of New York against the citizens of adjoining states would not be cured were those states to establish like discriminations against citizens of the state of New York. A state may not barter away the right, conferred upon its citizens by the Constitution of the United States, to enjoy the privileges and immunities of citizens when they go into other states. Nor can discrimination be corrected by retaliation; to prevent this was one of the chief ends sought to be accomplished by the adoption of the Constitution.

Decree affirmed.

Mr. Justice McREYNOLDS concurs in the result.

[FN1 deleted]

U.S. 1920
Travis v. Yale & Towne Mfg. Co.
252 U.S. 60, 40 S.Ct. 228, 3 A.F.T.R. 3036, 64 L.Ed. 460

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would not have suffered had it operated a Dutch company (paragraph 19). Therefore, there was indirect nationality discrimination in violation of Article 43 (paragraph 20).

The ECJ also rejected the Netherlands' argument that the provision was necessary because the Netherlands could not determine whether legal entities established in other Member States were equivalent to the Dutch legal entities that were entitled to the exemption. The ECJ stated that the Netherlands could obtain that information from other Member States by using the Mutual Assistance Directive (paragraph 22).

FINANZAMT KÖLN-ALTSTADT v. ROLAND SCHUMACKER

1995 E.C.R. 225

14 February 1995

Case C-279/93

The German Bundesfinanzhof referred to the ECJ questions arising from a suit against the tax office of Cologne by Mr. Schumacker, a Belgian national residing in Belgium and working exclusively in Germany. Under the Belgian-German double tax convention, whereas Belgium had the right to tax Schumacher on his worldwide income, Germany could only tax him on his German-source income. Schumacker's German-source income was his only income.

The German tax system denied non-resident taxpayers the following tax preferences: (a) the "income splitting" method of relieving the burden of progressive tax rates for married couples (paragraph 7), (b) annual adjustment and refund of over-withheld taxes (paragraph 8), and (c) deduction of certain personal and family expenses (paragraph 10). Even though Schumacker's German wage was his sole source of income, as a non-resident taxpayer, he was denied those benefits. Since he did not have any income in his residence State (Belgium), and Belgium exempted his German income, Schumacker could not effectively deduct his personal and family expenses, such as medical costs, anywhere.

The Bundesfinanzhof, to which the case was appealed, submitted the following questions to the ECJ: (1) Does (now) Article 39 EC restrict Germany's ability to tax another Member State's national? (2) May Germany impose a higher level of tax on a Belgian national and resident than on a comparable German resident? (3) For Question 2, does it matter if the Belgian resident derives almost all (over 90%) of his income in Germany and owes taxes only in Germany on that income? (4) May Germany exclude natural persons who are residents of other Member States from annual adjustment procedures that might result in refunds?

First Question

The ECJ held that although direct taxation does not expressly fall within the purview of the Treaty, but is instead reserved to the Member States, all reserved powers must be exercised consistently with Community law. Therefore, Article 39 limits a Member State's power to levy a direct tax against a national of another Member State, because no Member State may treat a national of another Member State exercising his freedom of movement less favorably than one of its own similarly situated nationals (paragraph 24).

Second and Third Questions

The ECJ noted that the laws at issue in this case applied irrespective of nationality, but stated that where laws draw on the distinction between residence and non-residence, they may operate primarily to the detriment of nationals of other Member States because non-residents tend to be non-nationals (paragraphs 25-29).

In principle, the ECJ noted that Article 39 does not preclude a Member State from taxing a non-resident more heavily than a resident on his income (paragraph 35). This is because in general, residents and non-residents are not in comparable situations, since residents usually earn all their income in the residence Member State, whereas non-residents generally also earn income in their home State (paragraph 31). Therefore, generally, the non-residence State does not have to take into account personal expenses because the State of residence takes them into account.[11] To require the non-residence State to allow personal expenses to offset income sourced in that State might result in a double-deduction of personal expenses, which would violate the cohesion of the tax system (paragraph 41). Since personal and family expenses are usually incurred in the State of residence, it also makes sense administratively for the residence State to take those expenses into account (paragraph 32).

[11] In paragraph 32 of its opinion, the ECJ cited the OECD Model Double Taxation Treaty, which it interpreted to provide that personal and family expenses will generally be taken into account by the residence state.

However, the ECJ concluded that this analysis changes where the non-resident earns almost all his income in the host State, because there may be insufficient income in the residence State to grant the taxpayer the full benefit of his personal and family expenses (paragraph 36). In that case, resident and non-resident taxpayers are comparably situated vis-à-vis personal expenses. A host Member State cannot deny such a non-resident the benefit of deductions of personal expenses that are granted to residents.

Furthermore, the ECJ held that the need to ensure the cohesion of the tax system did not justify treating comparably situated residents and non-residents differently in this case. In cases where almost all the income is earned in the non-residence State, there would not be a double benefit caused by deducting the personal expenses twice (once in the source State and once in the residence State), because there would be insufficient income in the residence State to confer the full benefit of the deduction (paragraph 41).

The difference could also not be justified by the administrative difficulty of ascertaining the amount of income earned by the worker in his State of residence, since the State of employment can avail itself of Council Directive 77/799/EEC of 19 December 1977 on Mutual Assistance (paragraphs 43-45).

Fourth question

The ECJ held that non-residents are also entitled under Article 39 to avail themselves of adjustment procedures that may result in a refund (paragraph 59).

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Judgment of the Court of 14 February 1995. - **Finanzamt Köln-Altstadt v Roland Schumacker. -** Reference for a preliminary ruling: Bundesfinanzhof - Germany. - Article 48 of the EEC Treaty - Obligation of equal treatment - Taxation of non-residents' income. - Case C-279/93.

European Court reports 1995 Page I-00225

(EEC Treaty, Art. 48)

Summary

1. Although direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law.

Accordingly, Article 48 of the Treaty must be interpreted as being capable of limiting the right of a Member State to lay down conditions concerning the liability to taxation of a national of another Member State and the manner in which tax is to be levied on the income received by him within its territory, since that article does not allow a Member State, as regards the collection of direct taxes, to treat a national of another Member State employed in the territory of the first State in the exercise of his right of freedom of movement less favourably than one of its own nationals in the same situation.

2. Although Article 48 of the Treaty does not in principle preclude the application of rules of a Member State under which a non-resident working as an employed person in that Member State is taxed more heavily on his income than a resident in the same employment, the position is different in a case where the non-resident receives no significant income in the State of his residence and obtains the major part of his taxable income from an activity performed in the State of employment, with the result that the State of his residence is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances. There is no objective difference between the situations of such a non-resident and a resident engaged in comparable employment such as to justify different treatment as regards the taking into account for taxation purposes of the taxpayer' s personal and family circumstances.

It follows that Article 48 of the Treaty must be interpreted as precluding the application of rules of a Member State under which a worker who is a national of, and resides in, another Member State and is employed in the first State is taxed more heavily than a worker who resides in the first State and performs the same work there when the national of the second State obtains his income entirely or almost exclusively from the work performed in the first State and does not receive in the second State sufficient income to be subject to taxation there in a manner enabling his personal and family circumstances to be taken into account.

3. Article 48 of the Treaty must be interpreted as precluding legislation of a Member State on direct taxation under which the benefit of procedures such as annual adjustment of deductions at source in respect of wages tax and the assessment by the administration of the tax payable on remuneration from employment is available only to residents, thereby excluding natural persons who have no permanent residence or usual abode on its territory but receive income there from employment.

Parties

In Case C-279/93,

REFERENCE to the Court under Article 177 of the EEC Treaty by the Bundesfinanzhof (Federal Finance Court) for a preliminary ruling in the proceedings pending before that court between

Finanzamt Koeln-Altstadt

and

Roland Schumacker

on the interpretation of Article 48 of the EEC Treaty,

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, F.A. Schockweiler (Rapporteur), P.J.G. Kapteyn and C. Gulmann (Presidents of Chambers), G.F. Mancini, C.N, Kakouris, J.C. Moitinho de Almeida, J.L. Murray, D.A.O. Edward, J.-P. Puissochet and G. Hirsch, Judges,

Advocate General: P. Léger,

Registrar: H.A. Ruehl, Principal Administrator, after considering the written observations submitted on behalf of:

° Finanzamt Koeln-Altstadt, by D. Deutgen, its Leitender Regierungsdirektor;

° Roland Schumacker, by W. Kaefer, Rechtsanwalt, Aachen, and G. Sass, Avocat and Tax Adviser, Tervuren;

° the German Government, by E. Roeder, Ministerialrat in the Federal Ministry of the Economy and C.D. Quassowski, Regierungsdirektor in the same ministry, acting as Agents;

° the Greek Government, by D. Raptis, State Legal Adviser, and I. Chalkias, Assistant State Legal Adviser in the State Legal Service, acting as Agents;

° the French Government, by C. de Salins, Assistant Director in the Legal Directorate in the Ministry of Foreign Affairs, and J.-L. Falconi, Secretary for Foreign Affairs in the Legal Directorate in the same Ministry, acting as Agents;

° the Netherlands Government, by A. Bos, Legal Adviser in the Ministry of Foreign Affairs, acting as Agent;

° the United Kingdom, by J.E. Collins, Assistant Treasury Solicitor, acting as Agent, and A. Moses QC;

° the Commission, by J. Grunwald and E. Traversa, of its Legal Service, acting as Agents, assisted by B. Knobbe-Keuk, Professor at the University of Bonn,

having regard to the Report for the Hearing,

after hearing the oral observations of the Finanzamt Koeln-Altstadt, represented by D. Deutgen and by V. Nickel, Regierungsdirektor, Oberfinanzdirektion Koeln, acting as Agents, Roland Schumacker, represented by W. Kaefer and G. Sass, the Danish Government, represented by P. Biering, Legal Adviser, Ministry of Foreign Affairs, acting as Agent, the German Government, represented J. Sedemund, Rechtsanwalt, Cologne, the Greek Government, represented by P. Kamarineas, State Legal Adviser, acting as Agent, the French Government, represented by J.-L. Falconi, the Netherlands Government, represented by J. W. de Zwaan, Assistant Legal Adviser in the Ministry of Foreign Affairs, acting as Agent, the United Kingdom, represented by J.E. Collins and A. Moses QC, and the Commission, represented by J. Grunwald and E. Traversa, assisted by Professor B. Knobbe-Keuk, at the hearing on 18 October 1994,

after hearing the Opinion of the Advocate General at the sitting on 22 November 1994,

gives the following

Judgment

Grounds

1 By order of 14 April 1993, received at the Court Registry on 14 May 1993, the Bundesfinanzhof referred to the Court for a preliminary ruling under Article 177 of the EEC Treaty several questions on the interpretation of Article 48 of the EEC Treaty in order to enable it to assess the compatibility with Community law of certain provisions of the legislation of the Federal Republic of Germany on income tax under which taxpayers are treated differently depending on whether or not they reside within national territory.

2 Those questions were raised in proceedings between the Finanzamt Koeln-Altstadt (Tax Office, Cologne Alstadt) and Roland Schumacker, a Belgian national, concerning the way in which the latter' s earnings as an employee were taxed in Germany.

3 In Germany, the Einkommensteuergesetz (Law on income tax, hereinafter "the EStG") applies different tax regimes to employed persons according to their residence.

4 Under Paragraph 1(1) of the EStG, natural persons who have their permanent residence or usual abode in Germany are subject there to tax on all their income ("unlimited taxation").

5 However, under Paragraph 1(4) natural persons with no permanent residence or usual abode in Germany are subject to tax only on the part of their income arising in Germany ("limited taxation"). Under Paragraph 49(1)(4), such income of German origin includes in particular income from employment in Germany.

6 In Germany, in general, tax on income from employment is deducted at source by the employer from workers' wages and is then paid to the tax administration.

7 For this deduction at source to be carried out, employed persons subject to unlimited taxation are divided into several taxation categories (Paragraph 38b of the EStG). Unmarried persons come within category I (general tax tariff). Married employed persons who are not permanently separated come within category III (the "splitting" tariff, Paragraph 26b of the EStG), provided that both spouses are resident in Germany and are subject to unlimited taxation. The German "splitting" regime was introduced to mitigate the progressive nature of the income tax rates. Under the "splitting" regime, the spouses' total income is aggregated, notionally attributed to each spouse as to 50% and then taxed accordingly. If the income of one spouse is high and that of the other low, "splitting" makes their taxable amounts the same and palliates the progressive nature of the income tax rates.

8 Employed persons subject to unlimited taxation also benefit from the procedure of annual adjustment of wages tax (Paragraph 42b of the EStG). Under that procedure, the employer is required to refund to the employee part of the wages tax which he has levied where the aggregate of the sums deducted each month exceeds the amount indicated by the tax scale for the year, for example, if the amount of wages has varied from month to month.

9 Moreover, employed persons subject to unlimited taxation qualified, until 1990, for annual wages tax adjustment by the tax administration and, since then, have qualified for the procedure whereby the tax is assessed by the administration (Paragraph 46 of the EStG). That procedure makes it possible to set off against income from employment losses suffered in respect of income of another kind (for example, dividends).

10 Finally, in the case of persons subject to unlimited taxation, tax is assessed according to overall ability to pay, that is to say having regard to all the other income received by such taxpayers and to their personal and family circumstances (family expenses, welfare expenses and other outgoings which in general give rise to tax reliefs and rebates).

11 Some of the above benefits are withheld from those employed persons who are subject only to limited taxation. The German Gesetz zur einkommensteuerlichen Entlastung von Grenzpendlern und anderen beschraenkt steuerpflichtigen natuerlichen Personen und zur AEnderung anderer gesetzlicher Vorschriften ° Grenzpendlergesetz (Law reducing taxation of the income of cross-frontier workers and other natural persons subject to limited taxation and amending other legislative provisions) of 24 June 1994, which is intended to remedy this situation at national level, is not relevant in the present case since it had not come into force at the material time.

12 Under the legislation in force at the material time, persons subject to limited taxation came within category I (general tariff) regardless of their family circumstances (Paragraph 39d of the EStG). Consequently, they did not qualify for the tax benefit of "splitting" and married employed persons were treated in the same way as unmarried persons.

13 A simplified tax procedure was applied to persons subject to limited taxation. Their liability to income tax was deemed to be definitively discharged by the monthly deduction at source made by the employer. They were excluded both from the annual wages tax adjustment made by the employer (Paragraph 50(5) of the EStG) and from the annual income tax assessment by the administration. Without such annual wages tax adjustment, they could not qualify for reimbursement of any overpaid tax at the end of the year.

14 Finally, by contrast with employed persons subject to unlimited taxation, persons subject to limited taxation were not entitled to deduct their social expenses (premiums in respect of old-age, sickness or invalidity insurance) where they exceeded the flat rates laid down in the taxation scale.

15 According to the case-file, Mr Schumacker has always lived in Belgium with his wife and their children. After first working in Belgium, he was employed in Germany from 15 May 1988 until 31 December 1989, although he continued to live in Belgium. Mrs Schumacker, who was not employed, drew unemployment benefit in Belgium only during 1988. Since 1989, Mr Schumacker' s wages have been the household' s sole income.

16 Pursuant to Article 15(1) of the Double Taxation Treaty concluded between Belgium and Germany on 11 April 1967, the right to tax Mr Schumacker' s wages was, as from 15 May 1988, vested in the Federal Republic of Germany, as the State where he worked. Mr Schumacker' s wages were thus subject in Germany to a deduction at source by his employer, calculated by reference to taxation category I, pursuant to Paragraphs 1(4) and 39d of the EStG.

17 On 6 March 1989, Mr Schumacker asked the Finanzamt to calculate his tax on an equitable basis (Paragraph 163 of the Abgabenordnung ° the German

Tax Code), by reference to tax category III (normally applicable to married employed persons residing in Germany, giving them the right to "splitting") and requested that the difference between the deduction from his wages each month, on the basis of tax category I, and what would be payable by him on the basis of tax category III, be refunded to him.

18 The Finanzamt rejected his request by decision of 22 June 1989, whereupon Mr Schumacker instituted proceedings before the Finanzgericht, Cologne. That court upheld Mr Schumacker' s claims in respect of 1988 and 1989 and ordered the Finanzamt to take a decision on an equitable basis pursuant to Article 163 of the German tax code. The Finanzamt then brought an appeal on a point of law before the Bundesfinanzhof against the judgment of the Finanzgericht.

19 The Bundesfinanzhof is uncertain whether Article 48 of the EEC Treaty may have a bearing on the decision to be given in the case before it. It has therefore stayed the proceedings pending a ruling from the Court of Justice on the following questions:

"1. Does Article 48 of the EEC Treaty restrict the right of the Federal Republic of Germany to levy income tax on a national of another EC Member State?

If so:

2. Does Article 48 of the EEC Treaty allow the Federal Republic of Germany to impose a higher level of income tax on a natural person of Belgian nationality, whose sole permanent residence and usual abode is in Belgium and who has acquired his professional qualifications and experience there, than on an otherwise comparable person resident in the Federal Republic of Germany, if the former commences employment in the Federal Republic of Germany without transferring his permanent residence to the Federal Republic of Germany?

3. Does it make any difference if the person of Belgian nationality referred to in Question 2 derives almost all (that is over 90%) of his income from the Federal Republic of Germany and the said income is also only taxable in the Federal Republic of Germany, in accordance with the Double Taxation Agreement between the Federal Republic of Germany and the Kingdom of Belgium?

4. Is it contrary to Article 48 of the EEC Treaty for the Federal Republic of Germany to exclude natural persons who have no permanent residence or usual abode in the Federal Republic of Germany and in that country derive income from employment from the annual wages tax adjustment and also to deny them the possibility of being assessed for income tax with account being taken of earnings from employment?"

The first question

20 By its first question, the national court asks essentially whether Article 48 of the Treaty must be interpreted as being capable of limiting the right of a Member State to lay down the conditions concerning the liability to taxation of a national of another Member State and the manner in which tax is to be levied on the income received by him within its territory.

21 Although, as Community law stands at present, direct taxation does not as such fall within the purview of the Community, the powers retained by the Member States must nevertheless be exercised consistently with Community law (see the judgment in Case C-246/89 Commission v United Kingdom [1991] ECR I-4585, paragraph 12).

22 With regard more particularly to the free movement of persons within the Community, Article 48(2) of the Treaty requires the abolition of any discrimination based on nationality between workers of the Member States as regards, inter alia, remuneration.

23 In that connection, the Court held in Case C-175/88 Biehl v Administration des Contributions [1990] ECR I-1779, paragraph 12) that the principle of equal treatment with regard to remuneration would be rendered ineffective if it could be undermined by discriminatory national provisions on income tax. That is why the Council laid down the requirement in Article 7 of Regulation (EEC) No 1612/68 of 15 October 1968 on the free movement of workers within the Community (OJ, English Special Edition 1968 (II) p. 475) that workers who are nationals of a Member State are to enjoy, in the territory of another Member State, the same tax benefits as nationals working there.

24 In view of the foregoing, the answer to be given to the first question is that Article 48 of the Treaty must be interpreted as being capable of limiting the right of a Member State to lay down conditions concerning the liability to taxation of a national of another Member State and the manner in which tax is to be levied on the income received by him within its territory, since that article does not allow a Member State, as regards the collection of direct taxes, to treat

a national of another Member State employed in the territory of the first State in the exercise of his right of freedom of movement less favourably than one of its own nationals in the same situation.

The second and third questions

25 By its second and third questions, which it is appropriate to consider together, the national court seeks essentially to ascertain whether Article 48 of the Treaty must be interpreted as precluding the application of rules of a Member State under which a worker who is a national of, and resides in, another Member State and is employed in the first State is taxed more heavily than a worker who resides in the first State and performs the same work there. The national court also asks whether the answer to that question is affected by the fact that the national of the second Member State derives his income entirely or almost exclusively from his work in the first Member State and does not receive, in the second State, sufficient income to be subject to taxation there in a manner enabling his personal and family circumstances to be taken into account.

26 The Court has consistently held that the rules regarding equal treatment forbid not only overt discrimination by reason of nationality but also all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result (Case 153/73 Sotgiu v Deutsche Bundespost [1974] ECR 153, paragraph 11).

27 It is true that the rules at issue in the main proceedings apply irrespective of the nationality of the taxpayer concerned.

28 However, national rules of that kind, under which a distinction is drawn on the basis of residence in that non-residents are denied certain benefits which are, conversely, granted to persons residing within national territory, are liable to operate mainly to the detriment of nationals of other Member States. Non-residents are in the majority of cases foreigners.

29 In those circumstances, tax benefits granted only to residents of a Member State may constitute indirect discrimination by reason of nationality.

30 It is also settled law that discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations.

31 In relation to direct taxes, the situations of residents and of non-residents are not, as a rule, comparable.

32 Income received in the territory of a Member State by a non-resident is in most cases only a part of his total income, which is concentrated at his place of residence. Moreover, a non-resident' s personal ability to pay tax, determined by reference to his aggregate income and his personal and family circumstances, is more easy to assess at the place where his personal and financial interests are centred. In general, that is the place where he has his usual abode. Accordingly, international tax law, and in particular the Model Double Taxation Treaty of the Organization for Economic Cooperation and Development (OECD), recognizes that in principle the overall taxation of taxpayers, taking account of their personal and family circumstances, is a matter for the State of residence.

33 The situation of a resident is different in so far as the major part of his income is normally concentrated in the State of residence. Moreover, that State generally has available all the information needed to assess the taxpayer' s overall ability to pay, taking account of his personal and family circumstances.

34 Consequently, the fact that a Member State does not grant to a non-resident certain tax benefits which it grants to a resident is not, as a rule, discriminatory since those two categories of taxpayer are not in a comparable situation.

35 Accordingly, Article 48 of the Treaty does not in principle preclude the application of rules of a Member State under which a non-resident working as an employed person in that Member State is taxed more heavily on his income than a resident in the same employment.

36 The position is different, however, in a case such as this one where the non-resident receives no significant income in the State of his residence and obtains the major part of his taxable income from an activity performed in the State of employment, with the result that the State of his residence is not in a position to grant him the benefits resulting from the taking into account of his personal and family circumstances.

37 There is no objective difference between the situations of such a non-resident and a resident engaged in comparable employment, such as to justify different treatment as regards the taking into

account for taxation purposes of the taxpayer' s personal and family circumstances.

38 In the case of a non-resident who receives the major part of his income and almost all his family income in a Member State other than that of his residence, discrimination arises from the fact that his personal and family circumstances are taken into account neither in the State of residence nor in the State of employment.

39 The further question arises whether there is any justification for such discrimination.

40 The view has been advanced, by those Member States which have submitted observations, that discriminatory treatment ° regarding the taking into account of personal and family circumstances and the availability of "splitting" ° was justified by the need for consistent application of tax regimes to non-residents. That justification, based on the need for cohesion of the tax system, was upheld by the Court in Case C-204/90 Bachmann v Belgium [1992] ECR I-249, paragraph 28). According to those Member States, there is a link between the taking into account of personal and family circumstances and the right to tax worldwide income. Since the taking into account of those circumstances is a matter for the Member State of residence, which is alone entitled to tax worldwide income, they contend that the State on whose territory the non-resident works does not have to take account of his personal and family circumstances since otherwise the personal and family circumstances of the non-resident would be taken into account twice and he would enjoy the corresponding tax benefits in both States.

41 That argument cannot be upheld. In a situation such as that in the main proceedings, the State of residence cannot take account of the taxpayer' s personal and family circumstances because the tax payable there is insufficient to enable it to do so. Where that is the case, the Community principle of equal treatment requires that, in the State of employment, the personal and family circumstances of a foreign non-resident be taken into account in the same way as those of resident nationals and that the same tax benefits should be granted to him.

42 The distinction at issue in the main proceedings is thus in no way justified by the need to ensure the cohesion of the applicable tax system.

43 At the hearing, the Finanzamt argued that administrative difficulties prevent the State of employment from ascertaining the income which non-residents working in its territory receive in their State of residence.

44 That argument likewise cannot be upheld.

45 Council Directive 77/799/EEC of 19 December 1977 concerning mutual assistance by the competent authorities of the Member States in the field of direct taxation (OJ 1977 L 336, p. 15) provides for ways of obtaining information comparable to those existing between tax authorities at national level. There is thus no administrative obstacle to account being taken in the State of employment of a non-resident' s personal and family circumstances.

46 More particularly, it must be pointed out that the Federal Republic of Germany grants frontier workers resident in the Netherlands and working in Germany the tax benefits resulting from the taking into account of their personal and family circumstances, including the "splitting tariff". Provided that they receive at least 90% of their income in Germany, those Community nationals are treated in the same way as German nationals under the German Law of 21 October 1980 implementing the additional protocol of 13 March 1980 to the Double Taxation Treaty between the Federal Republic of Germany and the Kingdom of the Netherlands of 16 June 1959.

47 The answer to be given to the second and third questions is therefore that Article 48 of the Treaty must be interpreted as precluding the application of rules of a Member State under which a worker who is a national of, and resides in, another Member State and is employed in the first State is taxed more heavily than a worker who resides in the first State and performs the same work there when, as in the main action, the national of the second State obtains his income entirely or almost exclusively from the work performed in the first State and does not receive in the second State sufficient income to be subject to taxation there in a manner enabling his personal and family circumstances to be taken into account.

The fourth question

48 By its fourth question, the national court essentially asks whether Article 48 of the Treaty must be interpreted as precluding a provision in the legislation of a Member State on direct taxation under which the benefit of procedures such as annual adjustment of deductions at source in respect of wages tax and the assessment by the administration of the tax payable on remuneration from employment is available only to residents, thereby excluding natural persons who have no permanent residence or

usual abode on its territory but receive income there from employment.

49 The answers to the second and third questions have disclosed discrimination of a substantive nature between non-resident Community nationals and nationals resident in Germany. It is necessary to consider whether such discrimination also exists at procedural level in so far as the application of the abovementioned adjustment procedures is available only to resident nationals and is withheld from non-resident Community nationals. If such discrimination is found to exist, it will be necessary to decide whether there is any justification for it.

50 It should be noted at the outset that in Germany the wages tax deducted at source is deemed to discharge all liability to income tax on remuneration from employment.

51 According to the order from the national court, by virtue of the discharge from liability arising from the deduction at source, non-residents are first of all deprived, for reasons of administrative simplification, of the possibility of relying, in the procedure for the annual adjustment of deductions at source or in connection with the assessment by the administration of tax on remuneration from employment, on certain items forming part of the basis of assessment (for example, occupational expenses, special expenditure or so-called extraordinary costs) which might give rise to a partial refund of the tax deducted at source.

52 Non-residents may thereby be placed in a less advantageous position than residents, the latter being taxed, by virtue of Paragraphs 42, 42a and 46 of the EStG, in principle in such a way that all items forming part of the basis of assessment are taken into account.

53 In its observations, the German Government emphasized that German law provides for a procedure under which non-resident taxpayers may ask the tax administration to supply them with a tax certificate indicating certain reliefs to which they are entitled and which the tax administration must retrospectively apportion equally over the calendar year (Paragraph 39d of the EStG). The employer is then entitled, under that paragraph in conjunction with Paragraph 41c of the EStG, to reimburse, with the next payment of wages, the wages tax collected up to that time if the employee provides the employer with a certificate having retroactive effect. If the employer does not exercise that right, the adjustment may be made by the tax administration after the end of the calendar year.

54 However, it must be noted that those provisions are not binding and that neither the Finanzamt Koeln-Altstadt nor the German Government has referred to any provision imposing an obligation on the tax administration to remedy in all cases the discriminatory consequences of application of the provisions of the EStG at issue.

55 Secondly, since they do not have the benefit of the abovementioned procedures, non-residents who in the course of the year have left employment in a Member State in order to take up another post in another Member State, or who have been unemployed for part of the year, cannot obtain reimbursement of any overpaid tax from their employer or from the tax administration.

56 It is apparent from the order from the national court that an equitable procedure exists under German law pursuant to which a non-resident may ask the tax administration to review his situation and recalculate the taxable amount. That procedure is provided for by Paragraph 163 of the German tax code.

57 However, it does not suffice to meet the requirements of Article 48 of the Treaty for a foreign worker to have to rely on equitable measures adopted by the tax administration on a case-by-case basis. Moreover, in its judgment in Biehl, cited above, the Court rejected the arguments to that effect advanced by the Luxembourg tax administration.

58 It follows that Article 48 of the Treaty requires equal treatment at procedural level for non-resident Community nationals and resident nationals. Refusal to grant non-resident Community nationals the benefit of annual adjustment procedures which are available to resident nationals constitutes unjustified discrimination.

59 The answer to be given to the national court is therefore that Article 48 of the Treaty must be interpreted as precluding a provision in the legislation of a Member State on direct taxation under which the benefit of procedures such as annual adjustment of deductions at source in respect of wages tax and the assessment by the administration of the tax payable on remuneration from employment is available only to residents, thereby excluding natural persons who have no permanent residence or usual abode on its territory but receive income there from employment.

Decision on costs

Costs

60 The costs incurred by the Danish, German, Greek, French, Netherlands and United Kingdom Governments and the Commission of the European Communities, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court.

Operative part

On those grounds,

THE COURT,

in answer to the questions referred to it by the Bundesfinanzhof by order of 14 April 1993, hereby rules:

1. Article 48 of the EEC Treaty must be interpreted as being capable of limiting the right of a Member State to lay down conditions concerning the liability to taxation of a national of another Member State and the manner in which tax is to be levied on the income received by him within its territory, since that article does not allow a Member State, as regards the collection of direct taxes, to treat a national of another Member State employed in the territory of the first State in the exercise of his right of freedom of movement less favourably than one of its own nationals in the same situation.

2. Article 48 of the Treaty must be interpreted as precluding the application of rules of a Member State under which a worker who is a national of, and resides in, another Member State and is employed in the first State is taxed more heavily than a worker who resides in the first State and performs the same work there when, as in the main action, the national of the second State obtains his income entirely or almost exclusively from the work performed in the first State and does not receive in the second State sufficient income to be subject to taxation there in a manner enabling his personal and family circumstances to be taken into account.

3. Article 48 of the Treaty must be interpreted as precluding a provision in the legislation of a Member State on direct taxation under which the benefit of procedures such as annual adjustment of deductions at source in respect of wages tax and the assessment by the administration of the tax payable on remuneration from employment is available only to residents, thereby excluding natural persons who have no permanent residence or usual abode on its territory but receive income there from employment.

Supreme Court of the United States
Christopher H. LUNDING, et ux., Petitioners,
v.
NEW YORK TAX APPEALS TRIBUNAL, et al.
No. 96-1462.

Argued Nov. 5, 1997.
Decided Jan. 21, 1998.

Justice Ginsburg filed dissenting opinion in which Chief Justice Rehnquist and Justice Kennedy joined.

*****768 Syllabus*** [*]

287** New York Tax Law § 631(b)(6) effectively denies only nonresident taxpayers a state income tax deduction for alimony paid. Petitioners-a Connecticut couple required to pay higher taxes on their New York income when that State denied their attempted deduction of a pro rata portion of the alimony petitioner husband paid a previous spouse-exhausted their administrative remedies and commenced this action, asserting, among other things, that § 631(b)(6) discriminates against New York nonresidents in violation of the Privileges and Immunities Clause, U.S. Const., Art. IV, § 2. The Appellate Division of the New York Supreme Court agreed and held § 631(b)(6) to be unconstitutional, but the New York Court of Appeals reversed, holding that § 631(b)(6) was adequately justified because New York residents who are subject to taxation on all of their income regardless of source should be entitled to the benefit of full deduction of expenses, while personal expenses of a nonresident taxpayer are more appropriately allocated to the State of residence. The court also noted that § 631(b)(6)'s practical effect did not deny nonresidents all benefit of the alimony deduction, because they could claim the full amount of such payments in computing*769** their hypothetical tax liability "as if" a resident, one of the steps involved in computing nonresident tax under New York law.

Held: In the absence of a substantial reason for the difference in treatment of New York nonresidents, § 631(b)(6) violates the Privileges and Immunities Clause by denying only nonresidents an income tax deduction for alimony payments. Pp. 773-782.

(a) While States have considerable discretion in formulating their income tax laws, that power must be exercised within the limits of the Federal Constitution. When confronted with a challenge under the Privileges and Immunities Clause to a law distinguishing between residents and nonresidents, a State may defend its position 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." *Supreme Court of N.H. v. Piper,* 470 U.S. 274, 284, 105 S.Ct. 1272, 1278, 84 L.Ed.2d 205. Thus, New York must defend § 631(b)(6) with a substantial justification for its different treatment of nonresidents, including an explanation of how the discrimination relates ***288** to the State's justification. *E.g., Shaffer v. Carter,* 252 U.S. 37, 55, 40 S.Ct. 221, 226-227, 64 L.Ed. 445. Pp. 773-775.

(b) This Court's precedent respecting Privileges and Immunities Clause challenges to nonresident income tax provisions informs the review of the State's justification for § 631(b)(6). *Travis v. Yale & Towne Mfg. Co.,* 252 U.S. 60, 80-82, 40 S.Ct. 228, 232-233, 64 L.Ed. 460, and *Austin v. New Hampshire,* 420 U.S. 656, 665, 95 S.Ct. 1191, 1197, 43 L.Ed.2d 530, make clear that the Clause prohibits a State from denying nonresidents a general tax exemption provided to residents, and *Shaffer, supra,* at 57, 40 S.Ct., at 227, and *Travis, supra,* at 75-76, 40 S.Ct. at 230-231, establish that States may limit nonresidents' deductions of business expenses and nonbusiness deductions based on the relationship between those expenses and in-state property or income. While the latter decisions provide States considerable leeway in aligning nonresidents' tax burden to their in-state activities, neither those decisions nor *Austin* can be fairly read to hold that the Clause permits States to categorically deny personal deductions to a nonresident taxpayer without a substantial justification for the difference in treatment. Pp. 775-

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

776.

(c) Respondents' attempt to justify § 631(b)(6)'s limitation on nonresidents' deduction of alimony payments by asserting that the State only has jurisdiction over their in-state activities is rejected. The State's contention that, under *Shaffer* and *Travis,* it should not be required to consider expenses “wholly linked to personal activities outside New York” does not suffice. Pp. 776-782.

(i) The New York Court of Appeals' decision upholding § 631(b)(6) does not contain any reasonable explanation or substantial justification for the discriminatory provision. The case on which that decision was based, *Goodwin v. State Tax Commission*, 286 App.Div. 694, 146 N.Y.S.2d 172, aff'd, 1 N.Y.2d 680, 150 N.Y.S.2d 203, 133 N.E.2d 711, appeal dism'd, 352 U.S. 805, 77 S.Ct. 47, 1 L.Ed.2d 38, is of questionable relevance here, since it involved a state tax provision that is not analogous to § 631(b)(6), was rendered before New York adopted its present system of nonresident taxation, and was called into doubt in a subsequent decision. Unlike the New York Court of Appeals, this Court takes little comfort in the fact that inclusion of the alimony deduction in a nonresident's federal adjusted gross income reduces the nonresident's “as if” tax liability, because New York effectively takes the alimony deduction back in the “apportionment percentage” used to determine the actual tax owed. In summarizing its holding in the present case, the New York Court of Appeals explained that, because there could be no serious argument that petitioners' alimony deductions were legitimate business expenses, the approximate equality of tax treatment required by the Constitution was satisfied. This Court's precedent, however, should not be read to suggest that tax schemes allowing nonresidents to deduct only their business expenses are *per se* constitutional.***289** Accordingly, further inquiry into the State's justification for § 631(b)(6) in light of its practical effect is required. Pp. 777-778.

****770** (ii) Respondents' arguments to this Court do not supply adequate justification for § 631(b)(6). The State's suggestion that the Court's summary dismissals in *Goodwin* and other cases should be dispositive here is rejected, because such dismissals do not have the same precedential value as do opinions of the Court after briefing and oral argument. Moreover, none of those cases involved the unique problem of the complete denial of deductions for nonresidents' alimony payments. Also unavailing is the State's reliance on a statement by one of its former Tax Commissioners that, because it cannot legally recognize the existence of non-New York source income, the State cannot recognize deductions of a personal nature unconnected with the production of income in New York. There is good reason to question whether that statement actually is a rationale for § 631(b)(6), given evidence that the State currently permits nonresidents what amounts to a pro rata deduction for personal expenses other than alimony and that, before 1987, it allowed them to deduct a pro rata share of alimony payments. Moreover, this Court is not satisfied by the State's argument that it need not consider the impact of disallowing nonresidents a deduction for alimony paid merely because alimony expenses are personal in nature, particularly in light of the inequities that could result when a nonresident with alimony obligations derives nearly all of her income from New York, a scenario that may be “typical,” see *Travis, supra*, at 80, 40 S.Ct., at 232. By requiring nonresidents to pay more tax than similarly situated residents solely on the basis of whether or not the nonresidents are liable for alimony payments, § 631(b)(6) violates the “rule of substantial equality of treatment” required by *Austin, supra*, at 665, 95 S.Ct., at 1197. Pp. 778-781.

(iii) The Court also rejects respondents' claim that § 631(b)(6) is justified by the State's adoption of an “income splitting” regime that creates parity in the tax treatment of the spouses in a dissolved marital relationship by allowing the alimony payer to exclude the payment from income and requiring the recipient to report a corresponding increase in income. Section 631(b)(6) disallows nonresidents' entire alimony expenses without consideration as to whether New York income tax will be paid by the alimony recipients. Respondents' analysis begs the question whether there is a substantial reason for this difference in treatment, and is therefore not appreciably distinct from the State's assertion that no justification is required because § 631(b)(6) does not concern business expenses. Pp. 781-782.

(iv) There is no basis in the record for the assertions of several respondents' state *amici* that § 631(b)(6) would have only a *de minimis* effect on the run-of-the-mill taxpayer or on comity among the States ***290** because States typically give their residents a deduction or credit for income taxes paid to other States, so that the taxpayer would pay roughly the same overall tax. Further, the constitutionality of one State's statutes affecting nonresidents cannot depend upon the statutes of other States. *E.g., Austin, supra,* at 668, 95 S.Ct., at 1198-99. P. 782.

89 N.Y.2d 283, 653 N.Y.S.2d 62, 675 N.E.2d 816 (1996), reversed and remanded.

[OPINION]

O'CONNOR, J., delivered the opinion of the Court, in which STEVENS, SCALIA, SOUTER, THOMAS, and BREYER, JJ., joined. GINSBURG, J., filed a dissenting opinion, in which REHNQUIST, C.J., and KENNEDY, J., joined, *post*, p. 782.

Christopher H. Lunding, New York City, pro se.
Andrew D. Bing, Albany, NY, for respondents.For U.S. Supreme Court briefs, see:1997 WL 367050 (Pet.Brief)1997 WL 441293 (Resp.Brief)1997 WL 531307 (Reply.Brief)
Justice O'CONNOR delivered the opinion of the Court.
The Privileges and Immunities Clause, U.S. Const., Art. IV, § 2, provides that "[t]he Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." In this case, we consider whether a provision of New York law that effectively denies only nonresident taxpayers ****771** an income tax deduction for alimony paid is consistent with that constitutional command. We conclude that because New York has not adequately justified the discriminatory ***291** treatment of nonresidents effected by N.Y. Tax Law § 631(b)(6), the challenged provision violates the Privileges and Immunities Clause.

I

A

New York law requires nonresident individuals to pay tax on net income from New York real property or tangible personalty and net income from employment or business, trade, or professional operations in New York. See N.Y. Tax Law § 631(a), (b) (McKinney 1987). Under provisions enacted by the New York Legislature in 1987, the tax on such income is determined according to a method that takes into consideration the relationship between a nonresident taxpayer's New York source income and the taxpayer's total income, as reported to the Federal Government. § 601(e)(1).

[discussion of NY apportionment formula deleted]

Section 631(b)(6) was enacted as part of New York's Tax Reform and Reduction Act of 1987. Until then, nonresidents were allowed to claim a pro rata deduction for alimony expenses, pursuant to a New York Court of Appeals decision holding that New York tax law then "reflected a policy decision that nonresidents be allowed the same non-business deductions as residents, but that such deductions be allowed to nonresidents in the proportion of their New York income to income from all sources." *Friedsam v. State Tax Comm'n,* 64 N.Y.2d 76, 81, 484 N.Y.S.2d 807, 810, 473 N.E.2d 1181, 1184 (1984) (internal quotation marks omitted); see also Memorandum of Governor, L.1961, ch. 68, N.Y. State Legis. Ann., 1961, p. 398 (describing former N.Y. Tax Law § 635(c)(1), which permitted nonresidents to deduct a pro rata portion of their itemized deductions, then including alimony, as "represent[ing] the fairest and most equitable solution to the problem of many years' standing" respecting ****772** the taxation of nonresidents working in New York). Although there is no legislative history explaining the rationale for its enactment, ***293** § 631(b)(6) clearly overruled *Friedsam* 's requirement that New York permit nonresidents a pro rata deduction for alimony payments.

B

In 1990, petitioners Christopher Lunding and his wife, Barbara, were residents of Connecticut. During that year, Christopher Lunding earned substantial income from the practice of law in New York. That year, he also incurred alimony expenses relating to the dissolution of a previous marriage. In accordance with New York law, petitioners filed a New York Nonresident Income Tax Return to report the New York earnings. Petitioners did not comply with the limitation in § 631(b)(6), however, instead deducting a pro rata portion of alimony paid in computing their New York income based on their determination that approximately 48% of Christopher's business income was attributable to New York.

The Audit Division of the New York Department of Taxation and Finance denied that deduction and recomputed petitioners' tax liability. After recalculation without the pro rata alimony deduction, petitioners owed an additional $3,724 in New York income taxes, plus interest. Petitioners appealed the additional assessment to the New York Division of Tax Appeals, asserting that § 631(b)(6) discriminates against New York nonresidents in violation of the Privileges and Immunities, Equal Protection, and Commerce Clauses of the Federal Constitution. After unsuccessful administrative appeals, in which their constitutional arguments were not addressed, petitioners commenced an action before the Appellate Division of the New York Supreme Court, pursuant to N.Y. Tax Law § 2016 (McKinney 1987).

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Respondents appealed to the New York Court of Appeals, which reversed the lower court's ruling and upheld the constitutionality of § 631(b)(6). 89 N.Y.2d 283, 653 N.Y.S.2d 62, 675 N.E.2d 816 (1996). In its decision, the New York Court of Appeals found that *Shaffer v. Carter*, 252 U.S. 37, 40 S.Ct. 221, 64 L.Ed. 445 (1920), and *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 40 S.Ct. 228, 64 L.Ed. 460 (1920), "established that limiting taxation of nonresidents to their in-State income [is] a sufficient justification for similarly limiting their deductions to expenses derived from sources producing that in-State income," and that the constitutionality of a tax law should be determined based on its " 'practical effect.' " 89 N.Y.2d, at 288, 653 N.Y.S.2d, at 65, 675 N.E.2d, at 819. The court noted that "the Privileges and Immunities Clause does not mandate absolute equality in tax treatment," and quoted from *Supreme Court of N.H. v. Piper*, 470 U.S. 274, 284, 105 S.Ct. 1272, 1278, 84 L.Ed.2d 205 (1985), in explaining that the Clause is not violated where " '(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.' " 89 N.Y.2d, at 289, 653 N.Y.S.2d, at 66, 675 N.E.2d, at 820.

Applying those principles to § 631(b)(6), the court determined that the constitutionality of not allowing nonresidents to deduct ****773** personal expenses had been settled by ***295***Goodwin v. State Tax Comm'n*, 286 App.Div. 694, 146 N.Y.S.2d 172 (1955), aff'd, 1 N.Y.2d 680, 150 N.Y.S.2d 203, 133 N.E.2d 711, appeal dism'd, 352 U.S. 805, 77 S.Ct. 47, 1 L.Ed.2d 38 (1956), in which a New Jersey resident unsuccessfully challenged New York's denial of tax deductions respecting New Jersey real estate taxes, interest payments, medical expenses, and life insurance premiums. The *Lunding* court adopted two rationales from *Goodwin* in concluding that § 631(b)(6) was adequately justified. First, the court reasoned that because New York residents are subject to the burden of taxation on all of their income regardless of source, they should be entitled to the benefit of full deduction of expenses. Second, the court concluded that where deductions represent personal expenses of a nonresident taxpayer, they are more appropriately allocated to the State of residence. 89 N.Y.2d, at 289-290, 653 N.Y.S.2d, at 66, 675 N.E.2d, at 820.

***

Recognizing that the ruling of the New York Court of Appeals in this case creates a clear conflict with the Oregon Supreme Court's decision in *Wood v. Department of Revenue*, 305 Or. 23, 749 P.2d 1169 (1988), and is in tension with the South Carolina Supreme Court's ruling in *Spencer v. South Carolina Tax Comm'n*, 281 S.C. 492, 316 S.E.2d 386 (1984), aff'd by an equally divided Court, 471 U.S. 82, 105 S.Ct. 1859, 85 L.Ed.2d 62 (1985), we granted certiorari. 520 U.S. 1277, 117 S.Ct. 1817, 137 L.Ed.2d 1026 (1997). We conclude that, in the absence of a substantial reason for the difference in treatment of nonresidents, § 631(b)(6) violates the Privileges and Immunities Clause by denying only nonresidents an income tax deduction for alimony payments.

II

A

[1][2] The object of the Privileges and Immunities Clause is to "strongly ... constitute the citizens of the United States one people," by "plac[ing] the citizens of each State upon the same footing with citizens of other States, so far as the advantages resulting from citizenship in those States are concerned." *Paul v. Virginia*, 8 Wall. 168, 180, 19 L.Ed. 357 (1868). One right thereby secured is the right of a citizen of any State to "remove to and carry on business in another without being subjected in property or person to taxes more onerous than the citizens of the latter State are subjected to." *Shaffer*, *supra*, at 56, 40 S.Ct., at 227; see also *Toomer v. Witsell*, 334 U.S. 385, 396, 68 S.Ct. 1156, 1162, 92 L.Ed. 1460 (1948); ****774***Ward v. Maryland*, 12 Wall. 418, 430, 20 L.Ed. 449 (1871).

[3][4] Of course, nonresidents may "be required to make a ratable contribution in taxes for the support of the government."***297** *Shaffer*, 252 U.S., at 53, 40 S.Ct., at 225. That duty is one "to pay taxes not more onerous in effect than those imposed under like circumstances upon citizens of the ... State." *Ibid.;* see also *Ward v. Maryland, supra*, 430, 20 L.Ed. 449 (nonresidents should not be "subjected to any higher tax or excise than that exacted by law of ... permanent residents"). Nonetheless, as a practical matter, the Privileges and Immunities Clause affords no assurance of precise equality in taxation between residents and nonresidents of a particular State. Some differences may be inherent in any taxing scheme, given that, "[l]ike many other constitutional provisions, the privileges and immunities clause is not an absolute," *Toomer, supra*, at 396, 68 S.Ct., at 1162, and that "[a]bsolute equality is impracticable in taxation," *Maxwell v. Bugbee*, 250 U.S. 525, 543, 40 S.Ct. 2, 7, 63 L.Ed. 1124 (1919).

[5][6] Because state legislatures must draw some distinctions in light of "local needs," they have considerable discretion in formulating tax policy. *Madden v. Kentucky*, 309 U.S. 83, 88, 60 S.Ct. 406, 408, 84 L.Ed. 590 (1940). Thus, "where the question is whether a state taxing law contravenes rights secured by [the Federal Constitution], the decision must depend not upon any mere question of form, construction, or definition, but upon the practical operation and effect of the tax imposed." *Shaffer, supra*, at 55, 40 S.Ct., at 226; see also *St. Louis Southwestern R. Co. v. Arkansas*, 235 U.S. 350, 362, 35 S.Ct. 99, 102, 59 L.Ed. 265 (1914) ("[W]hen the question is whether a tax imposed by a State deprives a party of rights secured by the Federal Constitution, ... [w]e must regard the substance, rather than the form, and the controlling test is to be found in the operation and effect of the law as applied and enforced by the State"). In short, as this Court has noted in the equal protection context, "inequalities that result not from hostile discrimination, but occasionally and incidentally in the application of a [tax] system that is not arbitrary in its classification, are not sufficient to defeat the law." *Maxwell, supra*, at 543, 40 S.Ct., at 7.

[7][8] We have described this balance as "a rule of substantial equality of treatment" for resident and nonresident taxpayers.***298** *Austin v. New Hampshire*, 420 U.S. 656, 665, 95 S.Ct. 1191, 1197, 43 L.Ed.2d 530 (1975). Where nonresidents are subject to different treatment, there must be "reasonable ground for ... diversity of treatment." *Travis*, 252 U.S., at 79, 40 S.Ct., at 231; see also *Travellers' Ins. Co. v. Connecticut*, 185 U.S. 364, 371, 22 S.Ct. 673, 676, 46 L.Ed. 949 (1902) ("It is enough that the State has secured a reasonably fair distribution of burdens"). As explained in *Toomer*, the Privileges and Immunities Clause bars "discrimination against citizens of other States where there is no substantial reason for the discrimination beyond the mere fact that they are citizens of other States. But it does not preclude disparity of treatment in the many situations where there are perfectly valid independent reasons for it. Thus the inquiry in each case must be concerned with whether such reasons do exist and whether the degree of discrimination bears a close relationship to them. The inquiry must also, of course, be conducted with due regard for the principle that the States should have considerable leeway in analyzing local evils and in prescribing appropriate cures." 334 U.S., at 396, 68 S.Ct., at 1162.

[9] Thus, when confronted with a challenge under the Privileges and Immunities Clause to a law distinguishing between residents and nonresidents, a State may defend its position 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." *Piper*, 470 U.S., at 284, 105 S.Ct., at 1278.

[10] Our concern for the integrity of the Privileges and Immunities Clause is reflected through a "standard of review substantially more rigorous than that applied to state tax distinctions, among, say, forms of business ****775** organizations or different trades and professions." *Austin, supra*, at 663, 95 S.Ct., at 1196. Thus, as both the New York Court of Appeals, 89 N.Y.2d, at 290, 653 N.Y.S.2d at 66, 675 N.E.2d, at 820, and the State, Brief for Respondent ***299** Commissioner of Taxation and Finance 10-11, appropriately acknowledge, the State must defend § 631(b)(6) with a substantial justification for its different treatment of nonresidents, including an explanation of how the discrimination relates to the State's justification.

B

Our review of the State's justification for § 631(b)(6) is informed by this Court's precedent respecting Privileges and Immunities Clause challenges to nonresident income tax provisions. In *Shaffer v. Carter,* the Court upheld Oklahoma's denial of deductions for out-of-state losses to nonresidents who were subject to Oklahoma's tax on in-state income. The Court explained:

"The difference ... is only such as arises naturally from the extent of the jurisdiction of the State in the two classes of cases, and cannot be regarded as an unfriendly or unreasonable discrimination. As to residents, it may, and does, exert its taxing power over their income from all sources, whether within or without the State, and it accords to them a corresponding privilege of deducting their losses, wherever these accrue. As to nonresidents, the jurisdiction extends only to their property owned within the State and their business, trade, or profession carried on therein, and the tax is only on such income as is derived from those sources. Hence there is no obligation to accord to them a deduction by reason of losses elsewhere incurred." 252 U.S., at 57, 40 S.Ct., at 227.

In so holding, the Court emphasized the practical effect of the provision, concluding that "the nonresident was not treated more onerously than the resident in any particular, and in fact was called upon to make no more than his ratable contribution to the support of the state government." *Austin, supra,* at 664, 95 S.Ct., at 1196

Shaffer involved a challenge to the State's denial of business-related deductions. The record in *Shaffer* discloses***300** that, while Oklahoma law specified that nonresidents were liable for Oklahoma income tax on "the entire net income from all property owned, and of every business, trade or profession carried on in [Oklahoma]," there was no express statutory bar preventing nonresidents from claiming the same nonbusiness exemptions and deductions as were available to resident taxpayers. See Tr. of Record in *Shaffer v. Carter,* O.T.1919, No. 531, pp. 15-18 (Ch. 164, Okla. House Bill No. 599 (1910), § § 1, 5, 6, 8); see also Brief on Behalf of Appellant in *Shaffer v. Carter,* O.T.1919, No. 531, p. 91 ("In the trial court, ... the [Oklahoma] Attorney General asserted that the appellant has the same personal exemptions as a resident of Oklahoma").

In *Travis v. Yale & Towne Mfg. Co.,* a Connecticut corporation doing business in New York sought to enjoin enforcement of New York's nonresident income tax laws on behalf of its employees, who were residents of Connecticut and New Jersey. In an opinion issued on the same day as *Shaffer,* the Court affirmed *Shaffer* 's holding that a State may limit the deductions of nonresidents to those related to the production of in-state income. See *Travis,* 252 U.S., at 75-76, 40 S.Ct., at 230 (describing *Shaffer* as settling that "there is no unconstitutional discrimination against citizens of other States in confining the deduction of expenses, losses, etc., in the case of non-resident taxpayers, to such as are connected with income arising from sources within the taxing State"). The record in *Travis* clarifies that many of the expenses and losses of nonresidents that New York law so limited were business related, such as ordinary and necessary business expenses, depreciation on business assets, and depletion of natural resources, such as oil, gas, and timber. At the time that *Travis* was decided, New York law also allowed nonresidents a pro rata deduction for various nonbusiness expenses, such as interest paid (based on the proportion of New York source income to total income), a deduction for taxes paid (other than income taxes) to the extent those taxes were connected with New York ***301** income, and a deduction for uncompensated losses sustained in New York resulting ****776** from limited circumstances, namely, nonbusiness transactions entered into for profit and casualty losses. Both residents and nonresidents were entitled to the same deduction for contributions to charitable organizations organized under the laws of New York. Tr. of Record in *Travis v. Yale & Towne Mfg. Co.,* O.T.1919, No. 548 (State of New York, The A, B, C of the Personal Income Tax Law, pp. 11-12, 14, ¶ ¶ 42, 44 (1919)). Thus, the statutory provisions disallowing nonresidents' tax deductions at issue in *Travis* essentially mirrored those at issue in *Shaffer* because they tied nonresidents' deductions to their in-state activities.

Another provision of New York's nonresident tax law challenged in *Travis* did not survive scrutiny under the Privileges and Immunities Clause, however. Evincing the same concern with practical effect that animated the *Shaffer* decision, the *Travis* Court struck down a provision that denied only nonresidents an exemption from tax on a certain threshold of income, even though New York law allowed nonresidents a corresponding credit against New York taxes in the event that they paid resident income taxes in some other State providing a similar credit to New York residents. The Court rejected the argument that the rule was "a case of occasional or accidental inequality due to circumstances personal to the taxpayer." 252 U.S., at 80, 40 S.Ct., at 232.

Nor was denial of the exemption salvaged "upon the theory that non-residents have untaxed income derived from sources in their home States or elsewhere outside of the State of New York, corresponding to the amount upon which residents of that State are exempt from taxation [by New York] under this act," because "[t]he discrimination is not conditioned upon the existence of such untaxed income; and it would be rash to assume that non-residents taxable in New York under this law, as a class, are receiving additional income from outside sources equivalent to the amount of the exemptions that are accorded to citizens of New York and denied to them." ***302***Id.,* at 81, 40 S.Ct., at 232. Finally, the Court rejected as speculative and constitutionally unsound the argument that States adjoining New York could adopt an income tax, "in which event, injustice to their citizens on the part of New York could be avoided by providing similar exemptions similarly conditioned." *Id.,* at 82, 40 S.Ct., at 232.

In *Austin,* a more recent decision reviewing a State's taxation of nonresidents, we considered a commuter tax imposed by New Hampshire, the effect of which was to tax only nonresidents working in that State. The Court described its previous decisions, including *Shaffer* and *Travis,* as "establishing a rule of substantial equality of treatment for the citizens of the taxing State and nonresident taxpayers," under which New Hampshire's one-sided tax failed. 420 U.S., at 665, 95 S.Ct., at 1197.

[11] *Travis* and *Austin* make clear that the Privileges and Immunities Clause prohibits a State from denying nonresidents a general tax exemption provided to residents, while *Shaffer* and *Travis* establish that States may limit nonresidents' deductions of business expenses and nonbusiness deductions based on the relationship between those expenses and in-state property or income. While the latter decisions provide States a considerable amount of leeway in aligning the tax burden of nonresidents to in-state activities, neither they nor *Austin* can be fairly read as holding that the Privileges and Immunities Clause permits States to categorically deny personal deductions to a nonresident taxpayer, without a substantial justification for the difference in treatment.

III

[12] In this case, New York acknowledges the right of nonresidents to pursue their livelihood on terms of substantial equality with residents. There is no question that the issue presented in this case is likely to affect many individuals, given the fact that it is common for nonresidents to enter ***303** New York City to pursue their livelihood, "it being a matter of common knowledge that from necessity, due to the geographical situation of [New York City], in close proximity to the neighboring States, many thousands of men and women, residents and citizens of those States, go daily from their homes to the city and earn their livelihood there." ****777***Travis,* 252 U.S., at 80, 40 S.Ct., at 232. In attempting to justify the discrimination against nonresidents effected by § 631(b)(6), respondents assert that because the State only has jurisdiction over nonresidents' in-state activities, its limitation on nonresidents' deduction of alimony payments is valid. Invoking *Shaffer* and *Travis,* the State maintains that it should not be required to consider expenses "wholly linked to personal activities outside New York." Brief for Respondent Commissioner of Taxation and Finance 24. We must consider whether that assertion suffices to substantially justify the challenged statute.

A

Looking first at the rationale the New York Court of Appeals adopted in upholding § 631(b)(6), we do not find in the court's decision any reasonable explanation or substantial justification for the discriminatory provision. Although the court purported to apply the two-part inquiry derived from *Toomer* and *Piper,* in the end, the justification for § 631(b)(6) was based on rationales borrowed from another case, *Goodwin v. State Tax Comm'n,* 286 App.Div. 694, 146 N.Y.S.2d 172, aff'd, 1 N.Y.2d 680, 150 N.Y.S.2d 203, 133 N.E.2d 711 (1955), appeal dism'd, 352 U.S. 805, 77 S.Ct. 47, 1 L.Ed.2d 38 (1956). There, a New Jersey resident challenged New York's denial of deductions for real estate taxes and mortgage interest on his New Jersey home, and his medical expenses and life insurance premiums. The challenge in that case, however, was to a provision of New York tax law substantially similar to that considered in *Travis,* under which nonresident taxpayers were allowed deductions " 'only if and to the extent that, they are connected ***304** with [taxable] income arising from sources within the state.' " 286 App.Div., at 695, 146 N.Y.S.2d, at 175 (quoting then N.Y. Tax Law § 360(11)).

There is no analogous provision in § 631(b)(6), which plainly limits nonresidents' deduction of alimony payments, irrespective of whether those payments might somehow relate to New York-source income. Although the *Goodwin* court's rationale concerning New York's disallowance of nonresidents' deduction of life insurance premiums and medical expenses assumed that such expenses, "made by [the taxpayer] in the course of his personal activities, ... must be regarded as having taken place in ... the state of his residence," *id.*, at 701, 146 N.Y.S.2d, at 180, the court also found that those expenses "embodie[d] a governmental policy designed to serve a legitimate social end," *ibid.*, namely, "to encourage [New York] citizens to obtain life insurance protection and ... to help [New York] citizens bear the burden of an extraordinary illness or accident," *id.*, at 700, 146 N.Y.S.2d, at 179.

In this case, the New York Court of Appeals similarly described petitioners' alimony expenses as "wholly linked to personal activities outside the State," but did not articulate any policy basis for § 631(b)(6), save a reference in its discussion of petitioners' Equal Protection Clause claim to the State's "policy of taxing only those gains realized and losses incurred by a nonresident in New York, while taxing residents on all income." 89 N.Y.2d, at 291, 653 N.Y.S.2d, at 67, 675 N.E.2d, at 821. Quite possibly, no other policy basis for § 631(b)(6) exists, given that, at the time *Goodwin* was decided, New York appears to have allowed nonresidents a deduction for alimony paid as long as the recipient was a New York resident required to include the alimony in income. See N.Y. Tax Law § 360(17) (1944). And for several years preceding § 631(b)(6)'s enactment, New York law permitted nonresidents to claim a pro rata deduction of alimony paid regardless of the recipient's residence. See ***305***Friedsam*, 64 N.Y.2d, at 81-82, 484 N.Y.S.2d, at 810, 473 N.E.2d, at 1184 (interpreting N.Y. Tax Law § 635(c)(1) (1961)).

In its reliance on *Goodwin*, the New York Court of Appeals also failed to account for the fact that, through its broad 1987 tax reforms, New York adopted a new system of nonresident taxation that ties the income tax liability of nonresidents to the tax that they would have paid if they were residents. Indeed, a nonresident's "as if" tax liability, which determines both the tax rate and total tax owed, is based on federal adjusted gross income from *all* sources, not just New York sources. In computing their "as if" resident tax liability, nonresidents of New York are ****778** permitted to consider every deduction that New York residents are entitled to, both business and personal. It is only in the computation of the apportionment percentage that New York has chosen to isolate a specific deduction of nonresidents, alimony paid, as entirely nondeductible under any circumstances. Further, after *Goodwin* but before this case, the New York Court of Appeals acknowledged, in *Friedsam, supra*, that the State's policy and statutes favored parity, on a pro rata basis, in the allowance of personal deductions to residents and nonresidents. Accordingly, in light of the questionable relevance of *Goodwin* to New York's current system of taxing nonresidents, we do not agree with the New York Court of Appeals that "substantial reasons for the disparity in tax treatment are apparent on the face of [§ 631(b)(6)]," 89 N.Y.2d, at 291, 653 N.Y.S.2d, at 67, 675 N.E.2d, at 821.

[Discussion of effect on non-residents of computation of income "as if" a New York resident deleted]

In summarizing its holding, the New York Court of Appeals explained that, because "there can be no serious argument that petitioners' alimony deductions are legitimate business expenses[,] ... the approximate equality of tax treatment required by the Constitution is satisfied, and greater fine-tuning in this tax scheme is not constitutionally mandated." 89 N.Y.2d, at 291, 653 N.Y.S.2d, at 67, 675 N.E.2d, at 821. This Court's precedent, however, should not be read to suggest that tax schemes allowing nonresidents to deduct only their business expenses are *per se* constitutional, and we must accordingly inquire further into the State's justification for § 631(b)(6) in light of its practical effect.

B

***

As a practical matter, the Court's interpretation of the Privileges and Immunities Clause in *Travis* and *Shaffer* implies that States may effectively limit nonresidents' deduction of certain personal expenses based on a reason as simple as the fact that those expenses are clearly related to residence in another State. But here, § 631(b)(6) does not incorporate such analysis on its face or, according to the New York Court of Appeals, through legislative history, see ***310**89 N.Y.2d, at 290-291, 653 N.Y.S.2d at 67, 675 N.E.2d, at 821. Moreover, there are situations in which § 631(b)(6) could operate to require nonresidents to pay significantly more tax than identically situated residents. For example, if a nonresident's earnings were derived primarily from New York sources, the effect of § 631(b)(6) could be to raise the tax apportionment percentage above 100%, thereby requiring that individual to pay *more* tax than an identically situated resident, solely because of the disallowed alimony deduction. Under certain circumstances, the taxpayer could even be liable for New York taxes approaching or even exceeding net income.

There is no doubt that similar circumstances could arise respecting the apportionment for tax purposes of income or expenses based on in-state activities without a violation of the Privileges and Immunities Clause. Such was the case in *Shaffer,* despite the petitioner's attempt to argue that he should be allowed to offset net business income taxed by Oklahoma with business losses incurred in other States. See 252 U.S., at 57, 40 S.Ct., at 227. It is one thing, however, for an anomalous situation to arise because an individual has greater profits from business activities or property owned in one particular State than in another. An entirely different situation is presented by a facially inequitable and essentially unsubstantiated taxing scheme that denies only nonresidents a tax deduction for alimony payments, which while surely a personal matter, see *United States v. Gilmore,* 372 U.S. 39, 44, 83 S.Ct. 623, 626-627, 9 L.Ed.2d 570 (1963), arguably bear some relationship to a taxpayer's overall earnings. Alimony payments also differ from other types of personal deductions, such as mortgage interest and property tax payments, whose situs can be determined based on the location of the underlying property. Thus, unlike the expenses discussed in *Shaffer,* alimony payments cannot be so easily characterized as "losses elsewhere incurred." 252 U.S., at 57, 40 S.Ct., at 227. Rather, alimony payments reflect an obligation of some duration that is determined in large measure by an individual's income generally, wherever it is earned. The ***311** alimony obligation may be of a "personal" nature, but it cannot be viewed as geographically fixed in the manner that other expenses, such as business losses, mortgage interest payments, or real estate taxes, might be.

Accordingly, contrary to the dissent's suggestion, *post,* at 785, 788, we do not propose that States are required to allow nonresidents a deduction for all manner of personal expenses, such as taxes paid to other States or mortgage interest relating to an out-of-state residence. Nor do we imply that States invariably must provide to nonresidents the same manner of tax credits available to residents. Our precedent allows States to adopt justified and reasonable distinctions between residents and nonresidents in the provision of tax benefits, whether in the form of tax deductions or tax credits. In ****781** this case, however, we are not satisfied by the State's argument that it need not consider the impact of disallowing nonresidents a deduction for alimony paid merely because alimony expenses are personal in nature, particularly in light of the inequities that could result when a nonresident with alimony obligations derives nearly all of her income from New York, a scenario that may be "typical," see *Travis, supra,* at 80, 40 S.Ct., at 232. By requiring nonresidents to pay more tax than similarly situated residents solely on the basis of whether or not the nonresidents are liable for alimony payments, § 631(b)(6) violates the "rule of substantial equality of treatment" this Court described in *Austin,* 420 U.S., at 665, 95 S.Ct., at 1197.

C

[The Court's discussion and rejection of New York's argument concerning its consistent treatment of "taxation of the family" deleted]

D

[14] Finally, several States, as *amici* for respondents, assert that § 631(b)(6) could not "have any more than a *de minimis* effect on the run-of-the-mill taxpayer or comity among the States," because States imposing an income tax typically provide a deduction or credit to their residents for income taxes paid to other States. Brief for State of Ohio et al. 8. Accordingly, their argument runs, "[a]ll things being equal ... the taxpayer would pay roughly the same total tax in the two States, the only difference being that [the taxpayer's resident State] would get more and New York less of the revenue." *Ibid.* There is no basis for such an assertion in ***314** the record before us. In fact, in the year in question, Connecticut imposed no income tax on petitioners' earned income. Reply Brief for Petitioners 4, n. 1. "Nor, we may add, can the constitutionality of one State's statutes affecting nonresidents depend upon the present configuration of the statutes of another State." *Austin,* 420 U.S., at 668, 95 S.Ct., at 1198; see also *Travis,* 252 U.S., at 81-82, 40 S.Ct., at 232-233.

IV

[15][16] In sum, we find that the State's inability to tax a nonresident's entire income is not sufficient, in and of itself, to justify the discrimination imposed by § 631(b)(6). While States have considerable discretion in formulating their income tax laws, that power must be exercised within the limits of the Federal Constitution. Tax provisions imposing discriminatory treatment on nonresident individuals must be reasonable in effect and based on a substantial justification other than the fact of nonresidence.

[17] Although the Privileges and Immunities Clause does not prevent States from requiring nonresidents to allocate income and deductions based on their in-state activities in the manner described in *Shaffer* and *Travis,* those opinions do not automatically guarantee that a State may disallow nonresident taxpayers every manner of nonbusiness deduction on the assumption that such amounts are inevitably allocable to the State in which the taxpayer resides. Alimony obligations are unlike other expenses that can be related to activities conducted in a particular State or property held there. And as a personal obligation that generally correlates with a taxpayer's total income or wealth, alimony bears some relationship to earnings regardless of their source. Further, the manner in which New York taxes nonresidents, based on an allocation of an "as if" resident tax liability, not only imposes upon nonresidents' income the effect of New York's graduated tax rates but also imports a corresponding element of fairness in allowing nonresidents a pro rata deduction***315** of other types of personal expenses. It would seem more consistent with that taxing scheme and with notions of fairness for the State to allow nonresidents a pro rata deduction for alimony paid, as well.

Under the circumstances, we find that respondents have not presented a substantial justification for the categorical denial of alimony deductions to nonresidents. The State's failure to provide more than a cursory justification for § 631(b)(6) smacks of an effort to "penaliz[e] the citizens of other States by subjecting them to heavier taxation merely because they are such citizens," *Toomer*, 334 U.S., at 408, 68 S.Ct., at 1168 (Frankfurter, J., concurring). We thus hold that § 631(b)(6) is an unwarranted denial to the citizens of other States of the privileges and immunities enjoyed by the citizens of New York.

Accordingly, the decision of the New York Court of Appeals is reversed, and the case is remanded for proceedings not inconsistent with this opinion.

It is so ordered.

Justice GINSBURG, with whom The Chief Justice and Justice KENNEDY join, dissenting.
New York and other States follow the Federal Government's lead in according an ****783** income tax deduction for alimony to resident taxpayers only. That tax practice, I ***316** conclude, does not offend the nondiscrimination principle embodied in the Privileges and Immunities Clause of Article IV, § 2. I therefore dissent from the Court's opinion.

[Footnotes deleted]

I

To put this case in proper perspective, it is helpful to recognize not only that alimony payments are "surely a personal matter," *ante,* at 780; in addition, alimony payments are "unlike other....personal obligation[s]," *ante,* at 782. Under federal tax law, mirrored in state tax regimes, alimony is included in the recipient's gross income, 26 U.S.C. § 71(a), and the payer is allowed a corresponding deduction, § § 215(a), 62(a)(10), for payments taxable to the recipient. This scheme "can best be seen as a determination with respect to choice of taxable person rather than as rules relating to the definition of income or expense. In effect, the [alimony payer] is treated as a conduit for gross income that legally belongs to the [alimony recipient] under the divorce decree." M. Chirelstein, Federal Income Taxation ¶ 9.05, p. 230 (8th ed.1997) (hereinafter Chirelstein); see also B. Bittker & M. McMahon, Federal Income Taxation of Individuals ¶ 36.7, p. 36-18 (2d ed. 1995) ("Unlike most other personal deductions, [the deduction for alimony payments] is best viewed as a method of designating the proper taxpayer for a given amount of income, rather than a tax allowance for particular expenditures. In combination, § 71 [allowing a deduction to the alimony payer] and § 215 [requiring the alimony recipient to include the payment in gross income] treat part of the [payer]'s income as though it were received subject to an offsetting duty to pay it to the payee."). New York applies this scheme to resident alimony payers. But N.Y. Tax Law § 631(b)(6) (McKinney 1987) declares that, in the case of a nonresident with New York source income, the alimony deduction for which federal law provides "shall not constitute a deduction derived from New York sources."

***317** Thus, if petitioner Christopher Lunding and his former spouse were New York residents, his alimony payments would be included in his former spouse's gross income for state as well as federal income tax purposes, and he would receive a deduction for the payments. In other words, New York would tax the income once, but not twice. In fact, however, though Lunding derives a substantial part of his gross income from New York sources, he and his former spouse reside in Connecticut. That means, he urges, that New York may not tax the alimony payments at all. Compared to New York divorced spouses, in short, Lunding seeks a windfall, not an escape from double taxation, but a total exemption from New York's tax for the income in question. This beneficence to nonresidents earning income in New York, he insists, is what the Privileges and Immunities Clause of Article IV, § 2, of the United States Constitution demands.

Explaining why New York must so favor Connecticut residents over New York residents, Lunding invites comparisons with other broken marriages-cases in which one of the former spouses resides in New York and the other resides elsewhere. First, had Lunding's former spouse moved from Connecticut to New York, New York would count the alimony payments as income to her, but would nonetheless deny him, because of his out-of-state residence, any deduction. In such a case, New York would effectively tax the same income twice, first to the payer by ****784** giving him no deduction, then to the recipient, by taxing the payments as gross income to her. Of course, that is not Lunding's situation, and one may question his standing to demand that New York take nothing from him in order to offset the State's arguably excessive taxation of others.

More engagingly, Lunding compares his situation to that of a New York resident who pays alimony to a former spouse living in another State. In such a case, New York would permit the New Yorker to deduct the alimony payments, ***318** even though the recipient pays no tax to New York on the income transferred to her. New York's choice, according to Lunding, is to deny the alimony deduction to the New Yorker whose former spouse resides out of state, or else extend the deduction to him. The Court apparently agrees. At least, the Court holds, New York "has not adequately justified" the line it has drawn. *Ante,* at 771.

The Court's condemnation of New York's law seems to me unwarranted. As applied to a universe of former marital partners who, like Lunding and his former spouse, reside in the same State, New York's attribution of income to *someone* (either payer or recipient) is hardly unfair. True, an occasional New York resident will be afforded a deduction though his former spouse, because she resides elsewhere, will not be chased by New York's tax collector. And an occasional New York alimony recipient will be taxed despite the nonresidence of her former spouse. But New York could legitimately assume that in most cases, as in the Lundings' case, payer and recipient will reside in the same State. Moreover, in cases in which the State's system is overly generous (New York payer, nonresident recipient) or insufficiently generous (nonresident payer, New York recipient), there is no systematic discrimination discretely against nonresidents, for the pairs of former spouses in both cases include a resident and a nonresident.

In reviewing state tax classifications, we have previously held it sufficient under the Privileges and Immunities Clause that "the State has secured a reasonably fair distribution of burdens, and that no intentional discrimination has been made against non-residents." *Travellers' Ins. Co. v. Connecticut,* 185 U.S. 364, 371, 22 S.Ct. 673, 676, 46 L.Ed. 949 (1902).

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I would affirm the judgment of the New York Court of Appeals as consistent with the Court's precedent, and would not cast doubt, as today's decision does, on state tax provisions long considered secure.

II

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B

Shaffer and *Travis* plainly establish that States need not allow nonresidents to deduct out-of-state *business* expenses. The application of those cases to deductions for *personal* expenses, however, is less clear. On the one hand, *Travis* ' broad language could be read to suggest that in-state business expenses are the only deductions States must extend to nonresidents. On the other hand, neither *Shaffer* nor *Travis* upheld a scheme denying nonresidents deductions for personal expenses. A leading commentator has concluded that "nothing in either the *Shaffer* or ****787** *Travis* opinions indicates whether the Court was addressing itself to personal as well as business deductions." Hellerstein 1347, n. 165.

FN5. ***

***324** With rare exception, however, lower courts have applied *Shaffer* and *Travis* with equal force to both personal and business deductions. The New York court's decision in *Goodwin v. State Tax Comm'n*, 286 App.Div. 694, 702, 146 N.Y.S.2d 172, 180 (3d Dept.1955), aff'd mem., 1 N.Y.2d 680, 150 N.Y.S.2d 203, 133 N.E.2d 711, appeal dism'd for want of a substantial federal question, 352 U.S. 805, 77 S.Ct. 47, 1 L.Ed.2d 38 (1956), exemplifies this approach. *Goodwin* concerned a lawyer who resided in New Jersey and practiced law in New York City. In his New York income tax return, he claimed and was allowed deductions for bar association dues, subscriptions to legal periodicals, entertainment and car expenses, and certain charitable contributions. But he was disallowed deductions for real estate taxes and mortgage interest on his New Jersey home, medical expenses, and life insurance premiums. *Goodwin*, 286 App.Div., at 695, 146 N.Y.S.2d, at 174. Upholding the disallowances, the appeals court explained that the non-income-producing personal expenses at issue were of a kind properly referred to the law and policy of the State of the taxpayer's residence. That State, if it had an income tax, might well have allowed the deductions, but the New York court did not think judgment in the matter should be shouldered by a sister State. *Id.*, at 701, 146 N.Y.S.2d, at 180.

Goodwin further reasoned that a State may accord certain deductions "[i]n the exercise of its general governmental power to advance the welfare of its residents." *Ibid.* But it does not inevitably follow that the State must "extend similar aid or encouragement to the residents of other states." *Ibid.* A State need not, in short, underwrite the social policy of the Nation. Cf. *Martinez v. Bynum*, 461 U.S. 321, 328, 103 S.Ct. 1838, 1842, 75 L.Ed.2d 879 (1983) (State may provide free primary and secondary education to residents without extending the same benefit to nonresidents).

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C

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***326** Alimony payments (if properly treated as an expense at all) are a personal expense, as the Court acknowledges, see *ante*, at 780. They "ste[m] entirely from the marital relationship," *United States v. Gilmore*, 372 U.S. 39, 51, 83 S.Ct. 623, 631, 9 L.Ed.2d 570 (1963), and, like other incidents of marital and family life, are principally connected to the State of residence. Unlike donations to New York-based charities or mortgage and tax payments for second homes in the State, Lunding's alimony payments cannot be said to take place in New York, nor do they inure to New York's benefit. They are payments particularly personal in character, made by one Connecticut resident to another Connecticut resident pursuant to a decree issued by a Connecticut state court. Those payments "must be deemed to take place in" Connecticut, "the state of [Lunding's] residence, the state in which his life is centered." *Goodwin*, 286 App.Div., at 701, 146 N.Y.S.2d, at 180. New York is not constitutionally compelled to subsidize them.

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III

Although Lunding's alimony payments to a Connecticut resident surely do not facilitate his production of income in New York or contribute to New York's riches, the Court relies on this connection: "[A]s a personal obligation that generally correlates with a taxpayer's total income or wealth, alimonybears ***327** some relationship to earnings regardless of their source." *Ante*, at 782; see also *ante*, at 780 (alimony payments "arguably bear some relationship to a taxpayer's overall earnings," and are "determined in large measure by an individual's income generally, wherever it is earned"). But all manner of spending similarly relates to an individual's income from all sources. Income generated anywhere will determine, for example, the quality of home one can afford and the character of medical care one can purchase. Under a "correlat[ion] with a taxpayer's total income" approach, *ante*, at 782, it appears, the nonresident must be allowed to deduct his medical expenses and home state real estate taxes, even school district taxes, plus mortgage interest payments, if the State allows residents to deduct such expenses. And as total income also determines eligibility for tax relief aimed at low-income taxpayers, notably earned income tax credits, a State would be required to make such credits available to nonresidents if it grants them to residents.

FN6. ***

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U.S.,1998.
Lunding v. New York Tax Appeals Tribunal
522 U.S. 287, 118 S.Ct. 766, 66 USLW 4080, 98 Daily Journal D.A.R. 681, 11 Fla. L. Weekly Fed. S 478, 139 L.Ed.2d 717, 98 Cal. Daily Op. Serv. 509, 98 CJ C.A.R. 367

JUDGMENT OF THE COURT (Grand Chamber)

12 July 2005 (*)

In Case C‑403/03,

REFERENCE under Article 234 EC for a preliminary ruling from the Bundesfinanzhof (Germany), made by decision of 22 July 2003, received at the Court on 29 September 2003, in the proceedings

Egon Schempp

v

Finanzamt München V,

THE COURT (Grand Chamber),

composed of V. Skouris, President, P. Jann, C.W.A. Timmermans and A. Rosas, Presidents of Chambers, C. Gulmann, J.‑P. Puissochet, A. La Pergola, R. Schintgen, N. Colneric, J. Klučka, U. Lõhmus, E. Levits and A. Ó Caoimh (Rapporteur), Judges,

Advocate General: L.A. Geelhoed,

Registrar: R. Grass,

having regard to the written procedure,

after considering the observations submitted on behalf of:

– Mr Schempp, by J. Seest, Rechtsanwalt,

– the German Government, by W.‑D. Plessing and A. Tiemann, acting as Agents,

– the Netherlands Government, by H.G. Sevenster and C.A.H.M. ten Dam, acting as Agents,

– the Commission of the European Communities, by K. Gross and R. Lyal, acting as Agents,

after hearing the Opinion of the Advocate General at the sitting on 27 January 2005,

gives the following

Judgment

1 This reference for a preliminary ruling concerns the interpretation of Articles 12 EC and 18 EC.

2 The reference was made in the course of proceedings between Mr Schempp and the Finanzamt München V (Munich V Tax Office, 'the Finanzamt'), concerning the latter's refusal to regard the maintenance paid by Mr Schempp to his former spouse resident in Austria as special expenditure deductible in respect of income tax.

Law

3 Under Paragraph 10(1)(1) of the Einkommensteuergesetz (Law on Income Tax, 'the EStG'), the following expenditure constitutes 'special expenditure' if it is neither operating expenditure nor advertising costs:

'Maintenance payments to a divorced or separated spouse who is subject to unlimited income tax liability, if the debtor applies for this with the consent of the recipient, up to DEM 27 000 per calendar year. An application may be made only for one calendar year at a time and may not be withdrawn …'

4 Under Paragraph 22(1a) of the EStG, the amounts which are deductible by the maintenance debtor form part of the taxable income of the recipient, under the principle of 'correspondence'. The deduction which the debtor is entitled to make is not conditional on the recipient actually paying tax on those amounts. However, if the recipient has to pay tax on the maintenance payments received, it is the maintenance debtor who is, under civil law, liable to pay that tax.

5 Under Paragraph 1a(1)(1) of the EStG:

'Maintenance payments to a divorced or separated spouse (Paragraph 10(1)(1)) are also deductible as special expenditure if the recipient is not subject to unlimited income tax liability. It is a condition that the recipient has his principal or habitual residence in the territory of another Member State of the European Union or of a State to which the Agreement on the European Economic area applies. It is a further condition that the taxation of the maintenance payments in the hands of the recipient is proved by a certificate of the competent foreign tax authorities …'

6 Pursuant to Paragraph 52(2) of the EStG, Paragraph 1a(1)(1) applies to the Republic of Austria from the 1994 tax year, since that State acceded to the Agreement on the European Economic Area on 1 January 1994.

The main proceedings and the questions referred for a preliminary ruling

7 Following his divorce, Mr Schempp, a German national resident in Germany, pays maintenance to his former spouse resident in Austria.

8 In his tax declarations for the tax years 1994 to 1997, Mr Schempp sought to deduct the maintenance payments, in accordance with the first and second sentences of Paragraph 1a(1)(1) of the EStG. However, in his income tax assessments for 1994 to 1997, the Finanzamt refused him the deduction on the ground that it had not received a certificate from the Austrian tax authorities to show that his former spouse had been taxed in Austria on the maintenance payments, as prescribed by the third sentence of Paragraph 1a(1)(1).

9 Mr Schempp was unable to produce such a certificate, as Austrian tax law excludes, in principle, taxation of maintenance payments and does not allow them to be deducted. The documents in the case show, however, that Mr Schempp would have been able to deduct the total amount of the maintenance payments to his former spouse if she had been resident in Germany. In that case, she for her part would not have paid any tax on the maintenance, as her income is less than the taxable minimum in Germany.

10 Since he considered that the German legislation in question was incompatible with Articles 12 EC and 18 EC, Mr Schempp lodged objections against the Finanzamt's assessments. The Finanzamt rejected the objections by decision of 27 July 1999.

11 After his action brought against that decision was dismissed by the Finanzgericht München (Finance Court, Munich), Mr Schempp appealed on a point of law to the Bundesfinanzhof (Federal Finance Court). That court, taking the view that the proceedings raised questions of interpretation of Community law, decided to stay the proceedings and refer the following two questions to the Court for a preliminary ruling:

'1. Is Article 12 EC to be interpreted as meaning that Paragraph 1a(1)(1) and Paragraph 10(1)(1) of the EStG, to the effect that a taxpayer resident in Germany is not entitled to deduct maintenance payments to his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are incompatible therewith?

2. If Question 1 is answered in the negative: is Article 18(1) EC to be interpreted as meaning that Paragraph 1a(1)(1) and Paragraph 10(1)(1) of the EStG, to the effect that a taxpayer resident in Germany is not entitled to deduct maintenance payments for his divorced spouse resident in Austria whereas he would be entitled to do so were she still resident in Germany, are incompatible therewith?'

The questions referred for a preliminary ruling

12 By its questions the referring court asks essentially whether the first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as precluding a taxpayer resident in Germany from being unable, under the national legislation at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in Austria, where he would have been entitled to do so if she were still resident in Germany.

13 The first point to examine is whether the situation at issue in the main proceedings falls within the scope of Community law.

14 It should be recalled that the first paragraph of Article 12 EC prohibits, within the scope of application of the Treaty, and without prejudice to any special provisions contained therein, any discrimination on grounds of nationality.

15 To assess the scope of application of the Treaty within the meaning of Article 12 EC, that article must be read in conjunction with the provisions of the Treaty on citizenship of the Union. Citizenship of the Union is destined to be the fundamental status of nationals of the Member States, enabling those who find themselves in the same situation to receive the same treatment in law irrespective of their nationality, subject to such exceptions as are expressly provided for (Case C‑184/99 Grzelczyk [2001] ECR I‑6193, paragraphs 30 and 31, Case C‑148/02 Garcia Avello [2003] ECR I‑11613, paragraphs 22 and 23, and Case C‑209/03 Bidar [2005] ECR I‑0000, paragraph 31).

16 Under Article 17(1) EC, every person holding the nationality of a Member State is a citizen of the Union. Mr Schempp, as a German national, thus has such citizenship.

17 As the Court has already held, Article 17(2) EC attaches to the status of citizen of the Union the rights and duties laid down by the Treaty, including the

right to rely on Article 12 EC in all situations falling within the material scope of Community law (see Case C‑85/96 Martínez Sala [1998] ECR I‑2691, paragraph 62).

18 Those situations include those involving the exercise of the fundamental freedoms guaranteed by the Treaty and those involving the exercise of the right to move and reside within the territory of the Member States, as conferred by Article 18 EC (Bidar, paragraph 33).

19 While in the present state of Community law direct taxation falls within the competence of the Member States, the latter must none the less exercise that competence in accordance with Community law, in particular the provisions of the Treaty concerning the right of every citizen of the Union to move and reside freely within the territory of the Member States, and therefore avoid any overt or covert discrimination on the basis of nationality (see, to that effect, Case C‑279/93 Schumacker [1995] ECR I‑225, paragraphs 21 and 26, and Case C‑385/00 De Groot [2002] ECR I‑11819, paragraph 75).

20 However, it also follows from the case-law that citizenship of the Union, established by Article 17 EC, is not intended to extend the material scope of the Treaty to internal situations which have no link with Community law (Joined Cases C‑64/96 and C‑65/96 Uecker and Jacquet [1997] ECR I‑3171, paragraph 23, and Garcia Avello, paragraph 26).

21 According to the German and Netherlands Governments, the main proceedings relate to such a situation. The person relying on Article 12 EC, in the present case Mr Schempp, did not make use of his right of free movement laid down by Article 18 EC. His former spouse did indeed exercise such a right. The present case, however, does not concern her taxation but that of Mr Schempp. The German Government therefore observes that in the present case the only factor external to the Federal Republic of Germany is the fact that Mr Schempp is paying maintenance to a person resident in another Member State. Since maintenance payments have no effect on intra-Community trade in goods and services, however, the situation does not fall within Article 12 EC.

22 On this point, it must be observed that, contrary to the submissions of the German and Netherlands Governments, the situation of a national of a Member State who, like Mr Schempp, has not made use of the right to freedom of movement cannot, for that reason alone, be assimilated to a purely internal situation (see, to that effect, Case C‑200/02 Zhu and Chen [2004] ECR I‑0000, paragraph 19).

23 While it is correct that Mr Schempp has not exercised such a right, it is nevertheless common ground that his former spouse, by establishing her residence in Austria, exercised the right granted by Article 18 EC to every citizen of the Union to move and reside freely in the territory of another Member State.

24 As the Advocate General observed, in substance, in point 19 of his Opinion, since, for the purposes of determining the deductibility of maintenance paid by a taxpayer resident in Germany to a recipient resident in another Member State, the national legislation at issue in the main proceedings takes account of the fiscal treatment of those payments in the State of residence of the recipient, it necessarily follows that the exercise in the present case by Mr Schempp's former spouse of her right to move and reside freely in another Member State under Article 18 EC was such as to influence her former husband's capacity to deduct the maintenance payments made to her from his taxable income in Germany.

25 It follows from all the foregoing that, since the exercise by Mr Schempp's former spouse of a right conferred by the Community legal order had an effect on his right to deduct in his Member State of residence, such a situation cannot be regarded as an internal situation with no connection with Community law.

26 The Court must therefore examine whether Articles 12 EC and 18 EC preclude the German tax authorities from refusing deduction of the maintenance paid by Mr Schempp to his former spouse resident in Austria.

Application of Article 12 EC

27 It is common ground that if Mr Schempp's former spouse had been resident in Germany he would have been entitled to deduct the maintenance payments made to her. Since, however, she was resident in Austria, the German tax authorities refused him that deduction.

28 It is settled case-law that the principle of non-discrimination requires that comparable situations must not be treated differently unless such treatment is objectively justified (see Case C‑354/95 National

Farmers' Union and Others [1997] ECR I‑4559, paragraph 61).

29 It must therefore be examined whether the situation of Mr Schempp, who pays maintenance to his former spouse resident in Austria without being able to deduct those payments in his income tax declaration, can be compared to that of a person who makes such payments to a former spouse resident in Germany and enjoys that tax advantage.

30 Under the third sentence of Paragraph 1a(1)(1) of the EStG, the deductibility in Germany of maintenance payments by a taxpayer resident in that Member State to a recipient resident in another Member State is conditional on their being taxed in that other Member State.

31 It follows that since, in the main proceedings, the maintenance payments were not taxed in the Member State of residence of Mr Schempp's former spouse, he was not allowed to deduct those payments from his income in Germany.

32 In those circumstances, it is apparent that the unfavourable treatment of which Mr Schempp complains in fact derives from the circumstance that the tax system applicable to maintenance payments in his former spouse's Member State of residence differs from that applied in his own Member State of residence.

33 As the Netherlands Government points out, if his former spouse had chosen to reside in a Member State, such as the Netherlands, in which – contrary to the situation in Austria – maintenance payments are taxed, Mr Schempp would have been entitled under the national legislation at issue in the present case to deduct the maintenance payments made to her.

34 It is settled case-law that Article 12 EC is not concerned with any disparities in treatment, for persons and undertakings subject to the jurisdiction of the Community, which may result from divergences existing between the various Member States, so long as they affect all persons subject to them in accordance with objective criteria and without regard to their nationality (see, to that effect, Case C‑137/00 Milk Marque and National Farmers' Union [2003] ECR I‑7975, paragraph 124 and the case-law cited there).

35 It follows that, contrary to Mr Schempp's claims, the payment of maintenance to a recipient resident in Germany cannot be compared to the payment of maintenance to a recipient resident in Austria. The recipient is subject in each of those two cases, as regards taxation of the maintenance payments, to a different tax system.

36 Consequently, the fact that a taxpayer resident in Germany is not able, under Paragraph 1a(1)(1) of the EStG, to deduct maintenance paid to his former spouse resident in Austria does not constitute discrimination within the meaning of Article 12 EC.

37 According to Mr Schempp, the unequal treatment of which he is the subject in the present case derives, however, from the fact that, while deductibility of maintenance paid to a person resident in Germany is not conditional on that person actually paying tax, actual payment of tax is required for deductibility of maintenance paid to a person resident in the territory of another Member State.

38 However, it must be recalled that in the present proceedings the national court solely asks the Court whether Community law precludes a taxpayer resident in Germany from being unable to deduct the maintenance paid to his former spouse resident in Austria. Consequently, for the purpose of providing the national court with an interpretation which will be of use to it in giving its decision in the main proceedings, it must be concluded that the point raised by Mr Schempp, in that it concerns the payment of maintenance to a recipient resident in another Member State in which maintenance payments are taxable, does not arise in the present case, as it is common ground that maintenance payments are not taxable in Austria.

39 As to the undisputed fact that, if Mr Schempp's former spouse had resided in Germany, he would have been entitled to deduct the maintenance paid to her, even though in such a case the maintenance would not have been taxed because his former spouse's income in Germany during the period in question was below the tax thresholds applied by German tax legislation, that cannot call into question the conclusion in paragraph 36 above. As the Commission of the European Communities rightly observes, the non-taxation of maintenance payments on those grounds in Germany cannot be equated to the non-taxation of the maintenance in Austria on the ground of its non-taxable character in that Member State, since the fiscal consequences which attach to each of those situations as regards the taxation of income are different for the taxpayers concerned.

Application of Article 18 EC

40 Under Article 18(1) EC, '[e]very citizen of the Union shall have the right to move and reside freely within the territory of the Member States, subject to the limitations and conditions laid down in [the] Treaty and by the measures adopted to give it effect'.

41 As a national of a Member State and hence a citizen of the Union, Mr Schempp is entitled to rely on that provision.

42 In his observations, Mr Schempp submits that Article 18(1) EC protects not only the right to move and settle in other Member States but also the right to choose one's residence. He submits that, since the maintenance payments are not deductible from taxable income where the recipient resides in another Member State, the recipient could be subject to a certain pressure not to leave Germany, thus constituting a restriction on the exercise of the rights guaranteed by Article 18(1) EC. That pressure could materialise specifically at the time when the amount of the maintenance is determined, since that determination takes the tax implications into account.

43 On this point, it is clear that, as the German and Netherlands Governments and the Commission submit, the national legislation in question does not in any way obstruct Mr Schempp's right, as a citizen of the Union, to move and reside in other Member States under Article 18(1) EC.

44 As has been observed, it is true that the transfer of his former spouse's residence to Austria entailed unfavourable tax consequences for Mr Schempp in his Member State of residence.

45 However, the Court has already held that the Treaty offers no guarantee to a citizen of the Union that transferring his activities to a Member State other than that in which he previously resided will be neutral as regards taxation. Given the disparities in the tax legislation of the Member States, such a transfer may be to the citizen's advantage in terms of indirect taxation or not, according to circumstances (see, to that effect, Case C‑365/02 Lindfors [2004] ECR I‑7183, paragraph 34).

46 The same principle applies a fortiori to a situation such as that at issue in the main proceedings where the person concerned has not himself made use of his right of movement, but claims to be the victim of a difference in treatment following the transfer of his former spouse's residence to another Member State.

47 In those circumstances, the answer to the questions referred must be that the first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as not precluding a taxpayer resident in Germany from being unable, under national legislation such as that at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in another Member State in which the maintenance is not taxable, where he would be entitled to do so if his former spouse were resident in Germany.

Costs

48 Since these proceedings are, for the parties to the main proceedings, a step in the action pending before the national court, the decision on costs is a matter for that court. Costs incurred in submitting observations to the Court, other than the costs of those parties, are not recoverable.

On those grounds, the Court (Grand Chamber) rules as follows:

The first paragraph of Article 12 EC and Article 18(1) EC must be interpreted as not precluding a taxpayer resident in Germany from being unable, under national legislation such as that at issue in the main proceedings, to deduct from his taxable income in that Member State the maintenance paid to his former spouse resident in another Member State in which the maintenance is not taxable, where he would be entitled to do so if his former spouse were resident in Germany.

[Signatures]

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* Language of the case: German.

Briefs and Other Related Documents

Supreme Court of the United States
METROPOLITAN LIFE INSURANCE COMPANY, et al., Appellants
v.
W.G. WARD, Jr., et al.
No. 83-1274.

Argued Oct. 31, 1984.
Decided March 26, 1985.
Rehearing Denied May 20, 1985.
See 471 U.S. 1120, 105 S.Ct. 2370.

****1677** ***869*** *Syllabus*[*]

An Alabama statute imposes a substantially lower gross premiums tax rate on domestic insurance companies than on out-of-state (foreign) insurance companies. The statute permits foreign companies to reduce but not to eliminate the differential by investing in Alabama assets and securities. Appellant foreign insurance companies filed claims for refunds of taxes paid, contending that the statute, as applied to them, violated the Equal Protection Clause. The State Commissioner of Insurance denied the claims. On consolidated appeals to a county Circuit Court, in which several domestic companies intervened, the statute was upheld on summary judgment. The court ruled that the statute did not violate the Equal Protection Clause because, in addition to raising revenue, it served the legitimate state purposes of encouraging the formation of new insurance companies in Alabama and capital investment by foreign insurance companies in Alabama assets and securities, and that the distinction between foreign and domestic companies was rationally related to those purposes. The Alabama Court of Civil Appeals affirmed the finding as to legitimate state purposes, but remanded for an evidentiary hearing on the issue of rational relationship. On certiorari to the Alabama Supreme Court, appellants waived their rights to such an evidentiary hearing, and the court entered judgment for the State and the intervenors on appellants' equal protection challenge to the statute.

Held: The Alabama domestic preference tax statute violates the Equal Protection Clause as applied to appellants. Pp. 1679-1684.

(a) Under the circumstances of this case, promotion of domestic business by discriminating against nonresidents is not a legitimate state purpose. *Western & Southern Life Ins. Co. v. State Board of Equalization of California*, 451 U.S. 648, 101 S.Ct. 2070, 68 L.Ed.2d 514 distinguished. Alabama's aim to promote domestic industry is purely and completely discriminatory, designed only to favor domestic industry within the State, no matter what the cost to foreign corporations also seeking to do business there. Alabama's purpose constitutes the very sort of parochial discrimination that the Equal Protection Clause was intended to prevent. A State may not constitutionally favor its own residents by taxing foreign corporations at a higher rate solely because of their residence. Although the McCarran-Ferguson Act exempts the insurance industry from Commerce Clause ***870** restrictions, it does not purport to limit the applicability of the Equal Protection Clause. Equal protection restraints are applicable even though the *effect* of the discrimination is similar to the type of burden with which the Commerce Clause also would be concerned. Pp. 1680-1684.

****1678** (b) Nor is the encouragement of the investment in Alabama assets and securities a legitimate state purpose. Domestic insurers remain entitled to the more favorable tax rate regardless of whether they invest in Alabama assets. Moreover, since the investment incentive provision does not enable foreign insurers to eliminate the statute's discriminatory effect, it does not cure but reaffirms the impermissible classification based solely on residence. P. 1684.

447 So.2d 142 (Ala.), reversed and remanded.

[**OPINION**]

***871** Justice POWELL delivered the opinion of the Court.

This case presents the question whether Alabama's domestic preference tax statute, Ala.Code § § 27-4-4 and 27-4-5 (1975), that taxes out-of-state insurance

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

companies at a higher rate than domestic insurance companies, violates the Equal Protection Clause.

I

Since 1955, the State of Alabama has granted a preference to its domestic insurance companies by imposing a substantially lower gross premiums tax rate on them than on out-of-state (foreign) companies. Under the current statutory provisions, foreign life insurance companies pay a tax on their gross premiums received from business conducted in Alabama at a rate of three percent, and foreign companies selling other types of insurance pay at a rate of four percent. Ala.Code § 27-4-4(a) (1975). All domestic insurance companies, in contrast, pay at a rate of only one percent on all types of insurance premiums. § 27-4-5(a). As a result, a foreign ***872** insurance company doing the same type and volume of business in Alabama as a domestic company generally will pay three to four times as much in gross premiums taxes as its domestic competitor.

Alabama's domestic preference tax statute does provide that foreign companies may reduce the differential in gross premiums taxes by investing prescribed percentages of their worldwide assets in specified Alabama assets and securities. § 27-4-4(b). By investing 10 percent or more of its total assets in Alabama investments, for example, a foreign life insurer may reduce its gross premiums tax rate from 3 to 2 percent. Similarly, a foreign property and casualty insurer may reduce its tax rate from four to three percent. Smaller tax reductions are available based on investment of smaller percentages of a company's assets. *Ibid.* Regardless of how much of its total assets a foreign company places in Alabama investments, it can never reduce its gross premiums tax rate to the same level paid by comparable domestic companies. These are entitled to the one-****1679** percent tax rate even if they have no investments in the State. Thus, the investment provision permits foreign insurance companies to reduce, but never to eliminate, the discrimination inherent in the domestic preference tax statute.

II

Appellants, a group of insurance companies incorporated outside of the State of Alabama, filed claims with the Alabama Department of Insurance in 1981, contending that the domestic preference tax statute, as applied to them, violated the Equal Protection Clause. They sought refunds of taxes paid for the tax years 1977 through 1980. The Commissioner of Insurance denied all of their claims on July 8, 1981.

***873** Appellants appealed to the Circuit Court for Montgomery County, seeking a judgment declaring the statute to be unconstitutional and requiring the Commissioner to make the appropriate refunds. Several domestic companies intervened, and the court consolidated all of the appeals, selecting two claims as lead cases to be tried and binding on all claimants. On cross-motions for summary judgment, the court ruled on May 17, 1982, that the statute was constitutional. Relying on this Court's opinion in *Western & Southern Life Ins. Co. v. State Board of Equalization of California*, 451 U.S. 648, 101 S.Ct. 2070, 68 L.Ed.2d 514 (1981), the court ruled that the Alabama statute did not violate the Equal Protection Clause because it served "at least two purposes, in addition to raising revenue: (1) encouraging the formation of new insurance companies in Alabama, and (2) encouraging capital investment by foreign insurance companies in the Alabama assets and governmental securities set forth in the statute." App. to Juris. Statement 20a-21a. The court also found that the distinction the statute created between foreign and domestic companies was rationally related to those two purposes and that the Alabama Legislature reasonably could have believed that the classification would have promoted those purposes. *Id.*, at 21a.

After their motion for a new trial was denied, appellants appealed to the Court of Civil Appeals. It affirmed the Circuit Court's rulings as to the existence of the two legitimate state purposes, but remanded for an evidentiary hearing on the issue of rational relationship, concluding that summary judgment was inappropriate on that question because the evidence was in conflict. 437 So.2d 535 (1983). Appellants petitioned the Supreme Court of Alabama for certiorari on the affirmance of the legitimate state purpose issue, and the State and the intervenors petitioned for review of ***874** the remand order. Appellants then waived their right to an evidentiary hearing on the issue whether the statute's classification bore a rational relationship to the two purposes found by the Circuit Court to be legitimate, and they requested a final determination of the legal issues with respect to their equal protection challenge to the statute. The Supreme Court denied certiorari on all claims. Appellants again waived their rights to an evidentiary hearing on the rational relationship issue and filed a joint motion with the other parties seeking rehearing and entry of a final judgment. The motion was granted, and judgment was entered for the State and the intervenors. 447 So.2d 142 (1983). This appeal followed, and we noted probable jurisdiction. 466 U.S. 935, 104 S.Ct. 1905, 80 L.Ed.2d 455 (1984). We now reverse.

III

Prior to our decision in *Western & Southern Life Ins. Co. v. State Board of Equalization of California, supra*, the jurisprudence of the applicability of the Equal Protection Clause to discriminatory tax statutes had a somewhat checkered history. *Lincoln National Life Ins. Co. v. Read*, 325 U.S. 673, 65 S.Ct. 1220, 89 L.Ed. 1861 (1945), held that so-called "privilege" ****1680** taxes, required to be paid by a foreign corporation before it would be permitted to do business within a State, were immune from equal protection challenge. That case stood in stark contrast, however, to the Court's prior decisions in *Southern R. Co. v. Greene*, 216 U.S. 400, 30 S.Ct. 287, 54 L.Ed. 536 (1910), and *Hanover Fire Ins. Co. v. Harding*, 272 U.S. 494, 47 S.Ct. 179, 71 L.Ed. 372 (1926), as well as to later decisions, in which the Court had recognized that the Equal Protection Clause placed limits on other forms of discriminatory taxation imposed on out-of-state corporations solely because of their residence. See, *e.g., WHYY, Inc. v. Glassboro*, 393 U.S. 117, 89 S.Ct. 286, 21 L.Ed.2d 242 (1968); *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 79 S.Ct. 437, 3 L.Ed.2d 480 (1959); *Wheeling Steel Corp. v. Glander*, 337 U.S. 562, 69 S.Ct. 1291, 93 L.Ed. 1544 (1949).

In *Western & Southern, supra*, we reviewed all of these cases for the purpose of deciding whether to permit an equal ***875** protection challenge to a California statute imposing a retaliatory tax on foreign insurance companies doing business within the State, when the home States of those companies imposed a similar tax on California insurers entering their borders. We concluded that *Lincoln* was no more than "a surprising throwback" to the days before enactment of the Fourteenth Amendment and in which incorporation of a domestic corporation or entry of a foreign one had been granted only as a matter of privilege by the State in its unfettered discretion. 451 U.S., at 665, 101 S.Ct., at 2081. We therefore rejected the longstanding but "anachronis[tic]" rule of *Lincoln* and explicitly held that the Equal Protection Clause imposes limits upon a State's power to condition the right of a foreign corporation to do business within its borders. 451 U.S., at 667, 101 S.Ct., at 2082. We held that "[w]e consider it now established that, whatever the extent of a State's authority to exclude foreign corporations from doing business within its boundaries, that authority does not justify imposition of more onerous taxes or other burdens on foreign corporations than those imposed on domestic corporations, unless the discrimination between foreign and domestic corporations bears a rational relation to a legitimate state purpose." *Id.*, at 667-668, 101 S.Ct., at 2082-2083.

Because appellants waived their right to an evidentiary hearing on the issue whether the classification in the Alabama domestic preference tax statute bears a rational relation to the two purposes upheld by the Circuit Court, the only question before us is whether those purposes are legitimate.

FN5. The State and the intervenors advanced some 15 additional purposes in support of the Alabama statute. As neither the Circuit Court nor the Court of Civil Appeals ruled on the legitimacy of those purposes, that question is not before us, and we express no view as to it. On remand, the State will be free to advance again its arguments relating to the legitimacy of those purposes.

***876** A

(1)

The first of the purposes found by the trial court to be a legitimate reason for the statute's classification between foreign and domestic corporations is that it encourages the formation of new domestic insurance companies in Alabama. The State, agreeing****1681** with the Court of Civil Appeals, contends that this Court has long held that the promotion of domestic industry, in and of itself, is a legitimate state purpose that will survive equal protection scrutiny. In so contending, it relies on a series of cases, including *Western & Southern*, that are said to have upheld discriminatory taxes. See *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984); *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970); *Allied Stores of Ohio, Inc. v. Bowers, supra; Parker v. Brown*, 317 U.S. 341, 63 S.Ct. 307, 87 L.Ed. 315 (1943); *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 57 S.Ct. 868, 81 L.Ed. 1245 (1937); *Board of*

Education v. Illinois, 203 U.S. 553, 27 S.Ct. 171, 51 L.Ed. 314 (1906).

[1] The cases cited lend little or no support to the State's contention. In *Western & Southern,* the case principally relied upon, we did not hold as a general rule that promotion of domestic industry is a legitimate state purpose under equal protection analysis. Rather, we held that California's purpose***877** in enacting the retaliatory tax-to promote the *interstate* business of domestic insurers by deterring *other States* from enacting discriminatory or excessive taxes-was a legitimate one. 451 U.S., at 668, 101 S.Ct., at 2083. In contrast, Alabama asks us to approve its purpose of promoting the business of its domestic insurers *in Alabama* by penalizing foreign insurers who also want to do business in the State. Alabama has made no attempt, as California did, to influence the policies of ***878** other States in order to enhance its domestic companies' ability to operate interstate; rather, it has erected barriers to foreign companies who wish to do interstate business in order to improve its domestic insurers' ability to compete at home.

FN6. We find the other cases on which the State relies also to be inapposite to this inquiry. *Bacchus Imports, Pike,* and *Parker* discussed whether promotion of local industry is a valid state purpose under the Commerce Clause. The Commerce Clause, unlike the Equal Protection Clause, is integrally concerned with whether a state purpose implicates local or national interests. The Equal Protection Clause, in contrast, is concerned with whether a state purpose is impermissibly discriminatory; whether the discrimination involves local or other interests is not central to the inquiry to be made. Thus, the fact that promotion of local industry is a legitimate state interest in the Commerce Clause context says nothing about its validity under equal protection analysis. See *infra,* at 1683.

The crucial distinction between the two cases lies in the fact that Alabama's aim to promote domestic industry is purely and completely discriminatory, designed only to favor domestic industry within the State, no matter what the cost to foreign corporations also seeking to do business there. Alabama's purpose, contrary to California's, constitutes the very sort of parochial discrimination that the Equal Protection Clause was intended to prevent. As Justice BRENNAN, joined by Justice Harlan, ****1682** observed in his concurrence in *Allied Stores of Ohio, Inc. v. Bowers,* 358 U.S. 522, 79 S.Ct. 437, 3 L.Ed.2d 480 (1959), this Court always has held that the Equal Protection Clause forbids a State to discriminate in favor of its own residents solely by burdening "the residents of other state members of our federation." *Id.,* at 533, 79 S.Ct., at 444. Unlike the retaliatory tax involved in *Western & Southern,* which only burdens residents of a State that imposes its own discriminatory tax on outsiders, the domestic preference tax gives the "home team" an advantage by burdening *all* foreign corporations seeking to do business within the State, no matter what they or their States do.

[2] The validity of the view that a State may not constitutionally favor its own residents by taxing foreign corporations at a higher rate solely because of their residence is confirmed by a long line of this Court's cases so holding. *WHYY, Inc. v. Glassboro,* 393 U.S., at 119-120, 89 S.Ct., at 287; *Wheeling Steel Corp. v. Glander,* 337 U.S., at 571, 69 S.Ct., at 1296; *Hanover Fire Ins. Co. v. Harding,* 272 U.S., at 511, 47 S.Ct., at 183; *Southern R. Co. v. Greene,* 216 U.S., at 417, 30 S.Ct., at 291. See *Reserve Life Ins. Co. v. Bowers,* 380 U.S. 258, 85 S.Ct. 951 (1965) (*per curiam*). As the Court stated in *Hanover Fire Ins. Co.,* with respect to general tax burdens on business, "the foreign corporation stands equal, and is to be classified with domestic corporations of the same kind." ***879** 272 U.S., at 511, 47 S.Ct., at 183. In all of these cases, the discriminatory tax was imposed by the State on foreign corporations doing business within the State solely because of their residence, presumably to promote domestic industry within the State. In relying on these cases and rejecting *Lincoln* in *Western & Southern,* we reaffirmed the continuing viability of the Equal Protection Clause as a means of challenging a statute that seeks to benefit domestic industry within the State only by grossly discriminating against foreign competitors.

FN7. Although the promotion of domestic business was not a purpose advanced by the States in support of their taxes in these cases, such promotion is logically the primary reason for enacting discriminatory taxes such as those at issue here.

The State contends that *Allied Stores of Ohio, Inc. v. Bowers, supra,* shows that this principle has not always held true. In that case, a domestic merchandiser challenged on equal protection grounds an Ohio statute that exempted foreign corporations from a tax on the value of merchandise held for storage within the State. The Court upheld the tax, finding that the purpose of encouraging foreign companies to build warehouses within Ohio was a legitimate state purpose. The State contends that this case shows that promotion of domestic business *is* a legitimate state purpose under equal protection analysis.

[3][4] We disagree with the State's interpretation of *Allied Stores* and find that the case is not inconsistent with the other cases on which we rely. We agree with the holding of *Allied Stores* that a State's goal of bringing in new business is legitimate and often admirable. *Allied Stores* does not, however, hold that promotion of domestic business by *discriminating* against foreign corporations is legitimate. The case involves instead a statute that *encourages nonresidents*-who are not competitors of residents-to build warehouses within the State. The discriminatory tax involved did not favor residents by burdening outsiders; rather, it granted the ***880** nonresident business an exemption that residents did not share. Since the foreign and domestic companies involved were not competing to provide warehousing services, granting the former an exemption did not even directly affect adversely the domestic companies subject to the tax. On its facts, then, *Allied Stores* is not inconsistent with our holding here that promotion of domestic business within a State, by discriminating against foreign corporations that wish to compete by doing business there, is not a legitimate state purpose. See ****1683**358 U.S., at 532-533, 79 S.Ct., at 443-444 (BRENNAN, J., concurring).

(2)

[5] The State argues nonetheless that it is impermissible to view a discriminatory tax such as the one at issue here as violative of the Equal Protection Clause. This approach, it contends, amounts to no more than “Commerce Clause rhetoric in equal protection clothing.” Brief for Appellee Ward 22. The State maintains that because Congress, in enacting the McCarran-Ferguson Act, 15 U.S.C. § § 1011-1015, intended to authorize States to impose taxes that burden interstate commerce in the insurance field, the tax at issue here must stand. Our concerns are much more fundamental than as characterized by the State. Although the McCarran-Ferguson Act exempts the insurance industry from Commerce Clause restrictions, it does not purport to limit in any way the applicability of the Equal Protection Clause. As noted above, our opinion in *Western & Southern* expressly reaffirmed the viability of equal protection restraints on discriminatory taxes in the insurance context.

[6][7] ***881** Moreover, the State's view ignores the differences between Commerce Clause and equal protection analysis and the consequent different purposes those two constitutional provisions serve. Under Commerce Clause analysis, the State's interest, if legitimate, is weighed against the burden the state law would impose on interstate commerce. In the equal protection context, however, if the State's purpose is found to be legitimate, the state law stands as long as the burden it imposes is found to be rationally related to that purpose, a relationship that is not difficult to establish. See *Western & Southern,* 451 U.S., at 674, 101 S.Ct., at 2086 (if purpose is legitimate, equal protection challenge may not prevail so long as the question of rational relationship is “ ‘at least debatable’ ” (quoting *United States v. Carolene Products Co.*, 304 U.S. 144, 154, 58 S.Ct. 778, 784, 82 L.Ed. 1234 (1938)).

[8] The two constitutional provisions perform different functions in the analysis of the permissible scope of a State's power-one protects interstate commerce, and the other protects persons from unconstitutional discrimination by the States. See *Bethlehem Motors Corp. v. Flynt*, 256 U.S. 421, 423-424, 41 S.Ct. 571, 572, 65 L.Ed. 1029 (1921). The effect of the statute at issue here is to place a discriminatory tax burden on foreign insurers who desire to do business within the State, thereby also incidentally placing a burden on interstate commerce. Equal protection restraints are applicable even though the *effect* of the discrimination in this case is similar to the type of burden with which the Commerce Clause also would be concerned. We reaffirmed the importance of the Equal Protection Clause in the insurance context in *Western & Southern* and see no reason now for reassessing that view.

FN9. It is well established that a corporation is a “person” within the meaning of the Fourteenth Amendment. *E.g.*, *Western & Southern*, 451 U.S., at 660, n. 12, 101 S.Ct., at 2079, n. 12.

***882** In whatever light the State's position is cast, acceptance of its contention that promotion of domestic industry is always a legitimate state purpose under equal protection analysis would eviscerate the

Equal Protection Clause in this context. A State's natural inclination frequently would be to prefer domestic business over foreign. If we accept the State's view here, then any discriminatory tax would be valid if the State could show it reasonably was ****1684** intended to benefit domestic business. A discriminatory tax would stand or fall depending primarily on how a State framed its purpose-as benefiting one group or as harming another. This is a distinction without a difference, and one that we rejected last Term in an analogous context arising under the Commerce Clause. *Bacchus Imports, Ltd. v. Dias*, 468 U.S., at 273, 104 S.Ct., at 3056. See n. 6, *supra.* We hold that under the circumstances of this case, promotion of domestic business by discriminating against nonresident competitors is not a legitimate state purpose.

FN10. Indeed, under the State's analysis, *any* discrimination subject to the rational relation level of scrutiny could be justified simply on the ground that it favored one group at the expense of another. This case does not involve or question, as the dissent suggests, *post,* at 1693, the broad authority of a State to promote and regulate its own economy. We hold only that such regulation may not be accomplished by imposing discriminatorily higher taxes on nonresident corporations solely because they are nonresidents.

B

[9] The second purpose found by the courts below to be legitimate was the encouragement of capital investment in the Alabama assets and governmental securities specified in the statute. We do not agree that this is a legitimate state purpose when furthered by discrimination. Domestic insurers remain entitled to the more favorable rate of tax regardless of whether they invest in Alabama assets. Moreover, the investment incentive provision of the Alabama statute does not enable foreign insurance companies to eliminate the discriminatory effect of the statute. No matter how much of ***883** their assets they invest in Alabama, foreign insurance companies are still required to pay a higher gross premiums tax than domestic companies. The State's investment incentive provision therefore does not cure, but reaffirms, the statute's impermissible classification based solely on residence. We hold that encouraging investment in Alabama assets and securities in this plainly discriminatory manner serves no legitimate state purpose.

IV

We conclude that neither of the two purposes furthered by the Alabama domestic preference tax statute and addressed by the Circuit Court for Montgomery County, see *supra,* at 1679, is legitimate under the Equal Protection Clause to justify the imposition of the discriminatory tax at issue here. The judgment of the Alabama Supreme Court accordingly is reversed, and the case is remanded for further proceedings not inconsistent with this opinion.

It is so ordered.

Justice O'CONNOR, with whom Justice BRENNAN, Justice MARSHALL, and Justice REHNQUIST join, dissenting.

This case presents a simple question: Is it legitimate for a State to use its taxing power to promote a domestic insurance industry and to encourage capital investment within its borders? In a holding that can only be characterized as astonishing, the Court determines that these purposes are illegitimate. This holding is unsupported by precedent and subtly distorts the constitutional balance, threatening the freedom of both state and federal legislative bodies to fashion appropriate classifications in economic legislation. Because I disagree with both the Court's method of analysis and its conclusion, I respectfully dissent.

I

Alabama's legislature has chosen to impose a higher tax on out-of-state insurance companies and insurance companies incorporated in Alabama that do not maintain their principal ***884** place of business or invest assets within the State. Ala.Code § 27-4-4 *et seq.* (1975). This tax seeks to promote both a domestic insurance industry and capital investment in Alabama. App. to Juris. Statement 20a-21a. Metropolitan Life Insurance Company, joined by many other out-of-state insurers, alleges that this discrimination violates its rights under the Equal Protection Clause of the Fourteenth Amendment, which provides ****1685** that a State shall not "deny to any person within its jurisdiction the equal protection of the laws." Appellants rely on the Equal Protection Clause because, as corporations, they are not "citizens" protected by the Privileges and

Immunities Clauses of the Constitution. *Hemphill v. Orloff*, 277 U.S. 537, 548-550, 48 S.Ct. 577, 579, 72 L.Ed. 978 (1928). Similarly, they cannot claim Commerce Clause protection because Congress in the McCarran-Ferguson Act, 59 Stat. 33, as amended 15 U.S.C. § 1011 *et seq.*, explicitly suspended Commerce Clause restraints on state taxation of insurance and placed insurance regulation firmly within the purview of the several States. *Western & Southern Life Ins. Co. v. State Board of Equalization of California*, 451 U.S. 648, 655, 101 S.Ct. 2070, 2076, 68 L.Ed.2d 514 (1981).

Our precedents impose a heavy burden on those who challenge local economic regulation solely on Equal Protection Clause grounds. In this context, our long-established jurisprudence requires us to defer to a legislature's judgment if the classification is rationally related to a legitimate state purpose. Yet the Court evades this careful framework for analysis, melding the proper two-step inquiry regarding the State's purpose and the classification's relationship to that purpose into a single unarticulated judgment. This tactic enables the Court to characterize state goals that have been legitimated by Congress itself as improper solely because it disagrees with the concededly rational means of differential taxation selected by the legislature. This unorthodox approach leads to further error. The Court gives only the most cursory attention to the factual and legal bases supporting the State's purposes and ignores both precedent ***885** and significant evidence in the record establishing their legitimacy. Most troubling, the Court discovers in the Equal Protection Clause an implied prohibition against classifications whose purpose is to give the "home team" an advantage over interstate competitors even where Congress has authorized such advantages. *Ante*, at 1682.

The Court overlooks the unequivocal language of our prior decisions. "Unless a classification trammels fundamental personal rights or is drawn upon inherently suspect distinctions such as race, religion, or alienage, our decisions presume the constitutionality of the statutory discriminations and require only that the classification challenged be rationally related to a legitimate state interest." *New Orleans v. Dukes*, 427 U.S. 297, 303, 96 S.Ct. 2513, 2516, 49 L.Ed.2d 511 (1976). See, *e.g.*, *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 93 S.Ct. 1001, 35 L.Ed.2d 351 (1973). Judicial deference is strongest where a tax classification is alleged to infringe the right to equal protection. "[I]n taxation, even more than in other fields, legislatures possess the greatest freedom in classification." *Madden v. Kentucky*, 309 U.S. 83, 88, 60 S.Ct. 406, 408, 84 L.Ed. 590 (1940). "Where the public interest is served one business may be left untaxed and another taxed, in order to promote the one or to restrict or suppress the other." *Carmichael v. Southern Coal & Coke Co.*, 301 U.S. 495, 512, 57 S.Ct. 868, 873, 81 L.Ed. 1245 (1937) (citations omitted). As the Court emphatically noted in *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S. 522, 528, 79 S.Ct. 437, 441, 3 L.Ed.2d 480 (1959) (citations omitted):

"[I]t has repeatedly been held and appears to be entirely settled that a statute which encourages the location within the State of needed and useful industries by exempting them, though not also others, from its taxes is not arbitrary and does not violate the Equal Protection Clause of the Fourteenth Amendment. Similarly, it has long been settled that a classification, though discriminatory, is not arbitrary or violative of the Equal Protection Clause of the Fourteenth Amendment if any ***886** state of facts reasonably can be conceived that would sustain it." 358 U.S. 522, 528, 79 S.Ct., at 441 (1959) (citations omitted).

See also ****1686***Western & Southern Life Ins. Co. v. State Board of Equalization of California, supra*, 451 U.S., at 674, 101 S.Ct., at 2086; *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 464, 101 S.Ct. 715, 723, 66 L.Ed.2d 659 (1981).

Appellants waived their right to an evidentiary hearing and conceded that Alabama's classification was rationally related to its purposes of encouraging the formation of domestic insurance companies and bringing needed services and capital to the State. Thus the only issue in dispute is the legitimacy of these purposes. Yet it is obviously legitimate for a State to seek to promote local business and attract capital investment, and surely those purposes animate a wide range of legislation in all 50 States.

Appellees claim that Alabama's insurance tax, in addition to raising revenue and promoting investment, promotes the formation of new domestic insurance companies and enables them to compete with the many large multistate insurers that currently occupy some 75% to 85% of the Alabama insurance market. App. 80. Economic studies submitted by the State document differences between the two classes of insurers that are directly relevant to the well-being of Alabama's citizens. See *id.*, at 46-129. Foreign insurers typically concentrate on affluent, high volume, urban markets and offer standardized national policies. In contrast, domestic insurers such as intervenors American Educators Life Insurance Company and Booker T. Washington Life Insurance Company are more likely to serve Alabama's rural areas, and to write low-cost industrial and burial policies not offered by the larger national ****1687** companies. Additionally, Appellees argue ***888** persuasively that Alabama can more readily regulate domestic insurers and more effectively safeguard their solvency than that of insurers domiciled and having their principal places of business in other States.

FN1. "Industrial insurance" is the trade term for a low face-value policy typically sold door-to-door and maintained through home collection of monthly or weekly premiums. Alabama currently has more industrial insurance in force than any other State. Burial insurance is another form of insurance popular in rural Alabama that is offered exclusively by local insurers. By contrast, Metropolitan Life, like many multistate insurers, has discontinued writing even whole-life policies with face values below $15,000. App. 173-176.

Ignoring these policy considerations, the Court insists that Alabama seeks only to benefit local business, a purpose the Court labels invidious. Yet if the classification chosen by the State can be shown *actually* to promote the public welfare, this is strong evidence of a legitimate state purpose. See Note, Taxing Out-of-State Corporations After *Western & Southern:* An Equal Protection Analysis, 34 Stan.L.Rev. 877, 896 (1982). In this regard, Justice Frankfurter wisely observed:

"[T]he great divide in the [equal protection] decisions lies in the difference between emphasizing the actualities or the abstractions of legislation.

"... To recognize marked differences that exist in fact is living law; to disregard practical differences and concentrate on some abstract identities is lifeless logic." *Morey v. Doud*, 354 U.S. 457, 472, 77 S.Ct. 1344, 1353, 1 L.Ed.2d 1485 (1957) (dissenting).

A thoughtful look at the "actualities of [this] legislation" compels the conclusion that the State's goals are legitimate by any test.

III

Despite abundant evidence of a legitimate state purpose, the majority condemns Alabama's tax as "purely and completely discriminatory" and "the very sort of parochial discrimination that the Equal Protection Clause was intended to prevent." *Ante,* at 1681-1682. Apparently, the majority views any favoritism of domestic commercial entities as inherently ***894** suspect. The majority ignores a long line of our decisions. In the past this Court has not hesitated to apply the rational basis test to regulatory classifications that distinguish between domestic and out-of-state corporations or burden foreign interests to protect local concerns. The Court has always recognized that there are certain legitimate restrictions or policies in which, "[b]y definition, discrimination against nonresidents would inhere."

A State may use its taxing power to entice useful foreign industry, see *Allied Stores of Ohio, Inc. v. Bowers*, 358 U.S., at 528, 79 S.Ct., at 441, or to make residence within its boundaries more attractive, see *Zobel v. Williams*, 457 U.S. 55, 67-68, 102 S.Ct. 2309, 2316-2317, 72 L.Ed.2d 672 (1982) (BRENNAN, J., concurring). Though such measures might run afoul of the Commerce Clause, "[n]o one disputes that a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 271, 104 S.Ct. 3049, 3055, 82 L.Ed.2d 200 (1984); *Western & Southern Life Ins. Co. v. State Board of Equalization of California*, *supra*, 451 U.S., at 668, 101 S.Ct., at 2083. Cf. *Edgar v. MITE Corp.*, 457 U.S. 624, 646, 102 S.Ct. 2629, 2643, 73 L.Ed.2d 269 (1982) (POWELL, J., concurring in part) (noting State's interest in protecting regionally based corporations from acquisition by foreign corporations).

***895** Moreover, the Court has held in the dormant Commerce Clause context that a State may provide subsidies or rebates to domestic but not to foreign enterprises if it rationally believes that the former contribute to the State's welfare in ways that the latter do not. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 96 S.Ct. 2488, 49 L.Ed.2d 220 (1976). Although the Court has divided on the circumstances in which the dormant Commerce Clause allows such measures, see *id.*, at 817, 96 S.Ct., at 2501 (BRENNAN, J., dissenting), surely there can be no dispute that they are constitutionally permitted where Congress itself has affirmatively authorized the States to promote local business concerns free of Commerce Clause constraints. Neither the Commerce Clause nor the Equal Protection Clause bars Congress from enacting or authorizing the States to enact legislation to protect industry in one State "from disadvantageous competition" with less stringently regulated businesses in other States. *Hodel v. Indiana,* 452 U.S. 314, 329, 101 S.Ct. 2376, 2385, 69 L.Ed.2d 40 (1981). See also *Western & Southern, supra,* 451 U.S., at 669, 101 S.Ct., at 2083 ****1691** (with congressional approval, States may promote domestic insurers by seeking to deter other States from enacting discriminatory or excessive taxes).

The majority's attempts to distinguish these precedents are unconvincing. First the majority suggests that a state purpose might be legitimate for purposes of the Commerce Clause but somehow illegitimate for purposes of the Equal Protection Clause. No basis is advanced for this theory because no basis exists. The test of a legitimate state purpose must be whether it addresses valid state concerns. To suggest that the purpose's legitimacy, chameleon-like, changes according to the constitutional clause cited in the complaint is merely another pretext to escape the clear message of this Court's precedents.

IV

Because Alabama's classification bears a rational relationship to a legitimate purpose, our precedents demand that it be sustained. The Court avoids this clear directive by a remarkable evasive tactic. It simply declares that the ends of promoting a domestic insurance industry and attracting investments to the State *when accomplished through the means of discriminatory taxation* are not legitimate state purposes. This bold assertion marks a drastic and unfortunate departure from established equal protection doctrine

Western & Southern established that a State may validly tax out-of-state corporations at a higher rate if its goal is to promote the ability of its domestic businesses to compete in *interstate* markets. Nevertheless, the Court today concludes that the converse policy is forbidden, striking down legislation whose purpose is to encourage the *intrastate* activities of local business concerns by permitting them to compete effectively on their home turf. In essence, the Court declares: "We will excuse an unequal burden on foreign ***900** insurers if the State's purpose is to foster its domestic insurers' activities in *other* States, but the same unequal burden will be unconstitutional when employed to further a policy that places a higher social value on the domestic insurer's *home State* than interstate activities." This conclusion is not drawn from the Commerce Clause, the textual source of constitutional restrictions on state interference with interstate competition. Reliance on the Commerce Clause would, of course, be unavailing here in view of the McCarran-Ferguson Act. Instead the Court engrafts its own economic values on the Equal Protection Clause. Beyond guarding against arbitrary or irrational discrimination, as interpreted by the Court today this Clause now prohibits the effectuation of economic policies, even where sanctioned by Congress, that elevate local concerns over interstate competition. *Ante,* at 1680-1682. "But a constitution is not intended to embody a particular economic theory.... It is made for people of fundamentally differing views." *Lochner v. New York,* 198 U.S. 45, 75-76, 25 S.Ct. 539, 546-547, 49 L.Ed. 937 (1905) (Holmes, J., dissenting). In the heyday of economic due process, Justice Holmes warned:

"Courts should be careful not to extend [the express] prohibitions [of the Constitution] beyond their obvious meaning by reading into them conceptions of public policy that the particular Court may happen to entertain." *Tyson & Brother v. Banton,* 273 U.S. 418, 445-446, 47 S.Ct. 426, 433, 71 L.Ed. 718 (1927) (Holmes, J., dissenting, joined by Brandeis, J.).

Ignoring the wisdom of this observation, the Court fashions its own brand of economic equal protection. In so doing, it supplants a legislative policy endorsed by both Congress and the individual States that explicitly sanctioned the very parochialism in regulation and taxation of insurance that the Court's decision holds illegitimate. This newly unveiled power of the Equal Protection Clause would come as a surprise to the Congress that passed the McCarran-Ferguson Act and the Court that sustained the Act against constitutional attack. In the McCarran-Ferguson Act, Congress ***901** expressly sanctioned such economic parochialism in the context of state regulation and taxation of insurance.

The doctrine adopted by the majority threatens the freedom not only of the States but also of the Federal Government to formulate economic policy. The dangers in discerning in the Equal Protection Clause a prohibition against barriers to interstate business irrespective of the Commerce Clause should be self-evident. The Commerce Clause is a flexible tool of economic policy that Congress may use as it ****1694** sees fit, letting it lie dormant or invoking it to limit as well as promote the free flow of commerce. Doctrines of equal protection are constitutional limits that constrain the acts of federal and state legislatures alike. See, *e.g., Califano v. Webster,* 430 U.S. 313, 97 S.Ct. 1192, 51 L.Ed.2d 360 (1977); Cohen, Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma, 35 Stan.L.Rev. 387, 400-413 (1983). The Court's analysis casts a shadow over numerous congressional enactments that adopted as federal policy "the type of parochial favoritism" the Court today finds unconstitutional. *White v. Massachusetts Council of Construction Employers, Inc., supra*, 460 U.S., at 213, 103 S.Ct., at 1047. Contrary to the reasoning in *Benjamin,* the Court today indicates the Equal Protection Clause stands as an independent barrier if courts should determine that either Congress or a State has ventured the "wrong" direction down what has become, by judicial fiat, the one-way street of the Commerce Clause. Nothing in the Constitution or our past decisions supports forcing such an economic straightjacket on the federal system.

V

Today's opinion charts an ominous course. I can only hope this unfortunate adventure away from the safety of our precedents will be an isolated episode. I had thought the Court had finally accepted that

"the judiciary may not sit as a superlegislature to judge the wisdom or desirability of legislative policy determinations***902** made in areas that neither affect fundamental rights nor proceed along suspect lines; in the local economic sphere, it is only the invidious discrimination, the wholly arbitrary act, which cannot stand consistently with the Fourteenth Amendment." *New Orleans v. Dukes*, 427 U.S., at 303-304, 96 S.Ct., at 2516-2517 (citations omitted).

Because I believe that the Alabama law at issue here serves legitimate state purposes through concededly rational means, and thus is neither invidious nor arbitrary, I would affirm the court below. I respectfully dissent.

END OF DOCUMENT

Briefs and Other Related Documents

Supreme Court of the United States
CITY OF PHILADELPHIA et al., Appellants,
v.
State of NEW JERSEY et al.
No. 77-404.

Argued March 27, 1978.
Decided June 23, 1978.

Syllabus[*]

***617** New Jersey statute (ch. 363) that prohibits the importation of most "solid or liquid waste which originated or was collected outside the territorial limits of the State . . . " *held* to violate the Commerce Clause of the United States Constitution. Pp. 2534-2538.

(a) All objects of interstate trade merit Commerce Clause protection and none is excluded from the definition of "commerce" at the outset; hence, contrary to the suggestion of the court below, there can be no doubt that the banning of "valueless" out-of-state wastes by ch. 363 implicates constitutional protection. *Bowman v. Chicago & Northwestern R. Co.,* 125 U.S. 465, 8 S.Ct. 689, 31 L.Ed. 700, distinguished. Pp. 2534-2535.

(b) The crucial inquiry here must be directed to determining whether ch. 363 is basically an economic protectionist measure, and thus virtually *per se* invalid, or a law directed at legitimate local concerns that has only incidental effects on interstate commerce. *Pike v. Bruce Church, Inc.,* 397 U.S. 137, 142, 90 S.Ct. 844, 25 L.Ed.2d 174. Pp. 2535-2536.

(c) Since the evil of protectionism can reside in legislative means as well as legislative ends, it is immaterial whether the legislative purpose of ch. 363 is to protect New Jersey's environment or its economy, for whatever the purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently. Both on its face and in its plain effect ch. 363 violates this principle of nondiscrimination. A State may not attempt to isolate itself from a problem common to many by erecting a barrier against the movement of interstate trade, as ch. 363 seeks to do by imposing on out-of-state commercial interests the full burden of conserving New Jersey's remaining landfill space. Pp. 2536-2538.

(d) The New Jersey statute cannot be likened to a quarantine law which bans importation of articles of commerce because of their innate harmfulness and not because of their origin. Though New Jersey concedes that out-of-state waste is no different from domestic waste, it has banned the former while leaving its landfill sites open to the latter, thus trying to saddle those outside the State with the entire burden of slowing the flow of wastes into New Jersey's remaining landfill sites. P. 2538.

73 N.J. 562, 376 A.2d 888, reversed.

***618** Herbert F. Moore, Princeton, N. J., for appellants.
Stephen Skillman, Trenton, N. J., for appellees.

[OPINION]

Mr. Justice STEWART delivered the opinion of the Court.

A New Jersey law prohibits the importation of most "solid or liquid waste which originated or was collected outside the territorial limits of the State . . .." In this case we are required to decide whether this statutory prohibition violates the Commerce Clause of the United States Constitution.

I

The statutory provision in question is ch. 363 of 1973 N.J. Laws, which took effect in early 1974. In pertinent part it provides:

"No person shall bring into this State any solid or

[*] The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed.2d 499.

liquid waste which originated or was collected outside the territorial limits of the State, except garbage to be fed to swine in the State of New Jersey, until the commissioner [of the State Department of Environmental Protection] shall determine that such action can be permitted without endangering the public health, safety and ***619** welfare and has promulgated****2533** regulations permitting and regulating the treatment and disposal of such waste in this State." N.J.Stat.Ann. § 13:1I-10 (West Supp. 1978).

As authorized by ch. 363, the Commissioner promulgated regulations permitting four categories of waste to enter the State. Apart from these narrow exceptions, however, New Jersey closed its borders to all waste from other States.

> Immediately affected by these developments were the operators of private landfills in New Jersey, and several cities in other States that had agreements with these operators for waste disposal. They brought suit against New Jersey and its Department of Environmental Protection in state court, attacking the statute and regulations on a number of state and federal grounds. In an oral opinion granting the plaintiffs' motion for summary judgment, the trial court declared the law unconstitutional because it discriminated against interstate commerce. The New Jersey Supreme Court consolidated this case with another reaching the same conclusion, ***620** *Hackensack Meadowlands Development Comm'n v. Municipal Sanitary Landfill Auth.*, 127 N.J.Super. 160, 316 A.2d 711, and reversed, 68 N.J. 451, 348 A.2d 505. It found that ch. 363 advanced vital health and environmental objectives with no economic discrimination against, and with little burden upon, interstate commerce, and that the law was therefore permissible under the Commerce Clause of the Constitution.

II

Before it addressed the merits of the appellants' claim, the New Jersey Supreme Court questioned whether the interstate movement of those wastes banned by ch. 363 is "commerce" at all within the meaning of the Commerce Clause. Any doubts on that score should be laid to rest at the outset.

The state court expressed the view that there may be two definitions of "commerce" for constitutional purposes. When relied on "to support some exertion of federal control or regulation," the Commerce Clause permits "a very sweeping concept" of commerce. 68 N.J., at 469, 348 A.2d, at 514. But when relied on "to strike down or restrict state legislation," that Clause and the term "commerce" have a "much more confined . . . reach." *Ibid.*

The state court reached this conclusion in an attempt to ***622** reconcile modern Commerce Clause concepts with several old cases of this Court holding that States can prohibit the importation of some objects because they "are not legitimate subjects of trade and commerce." *Bowman v. Chicago & Northwestern R. Co.*, 125 U.S. 465, 489, 8 S.Ct. 689, 700, 31 L.Ed. 700. These articles include items "which, on account of their existing condition, would bring in and spread disease, pestilence, and death, such as rags or other substances infected with the germs of yellow fever or the virus of small-pox, or cattle or meat or other provisions that are diseased or decayed, or otherwise, from their condition and quality, unfit for human use or consumption." *Ibid.* See also *Baldwin v. G. A. F. Seelig, Inc.*, 294 U.S. 511, 525, 55 S.Ct. 497, 501, 79 L.Ed. 1032 and cases cited therein. The state court found that ch. 363 as narrowed by the state regulations, see n. 2, *supra*, banned only "those wastes which can[not] be put to effective use," and therefore those wastes were not commerce at all, unless "the mere transportation and disposal of valueless waste between states constitutes interstate commerce within the meaning of the constitutional provision." 68 N.J., at 468, 348 A.2d, at 514.

[2][3] We think the state court misread our cases, and thus erred in assuming that they require a two-tiered definition of commerce. In saying that innately harmful articles "are not legitimate subjects of trade and commerce," the *Bowman* Court was stating its conclusion, not the starting point of its reasoning. All objects of interstate trade merit Commerce Clause protection; none is excluded by definition at the outset. In *Bowman* and similar cases, the Court held simply that because the articles' worth in interstate commerce was far outweighed by the dangers inhering in their very movement, States could prohibit their transportation across state lines. Hence, ****2535** we reject the state court's suggestion that the banning of "valueless" out-of-state wastes by ch. 363 implicates no constitutional protection. Just as Congress has power to regulate the interstate movement of these wastes, States are ***623** not free from constitutional scrutiny when they restrict that

movement. Cf. *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 802-814, 96 S.Ct. 2488, 2494-2500, 49 L.Ed.2d 220; *Meat Drivers v. United States*, 371 U.S. 94, 83 S.Ct. 162, 9 L.Ed.2d 150.

III

A

[4] Although the Constitution gives Congress the power to regulate commerce among the States, many subjects of potential federal regulation under that power inevitably escape congressional attention "because of their local character and their number and diversity." *South Carolina State Highway Dept. v. Barnwell Bros., Inc.*, 303 U.S. 177, 185, 58 S.Ct. 510, 513, 82 L.Ed. 734. In the absence of federal legislation, these subjects are open to control by the States so long as they act within the restraints imposed by the Commerce Clause itself. See *Raymond Motor Transportation, Inc. v. Rice*, 434 U.S. 429, 440, 98 S.Ct. 787, 793, 794, 54 L.Ed.2d 664. The bounds of these restraints appear nowhere in the words of the Commerce Clause, but have emerged gradually in the decisions of this Court giving effect to its basic purpose. That broad purpose was well expressed by Mr. Justice Jackson in his opinion for the Court in *H. P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 537-538, 69 S.Ct. 657, 665, 93 L.Ed. 865:

"This principle that our economic unit is the Nation, which alone has the gamut of powers necessary to control of the economy, including the vital power of erecting customs barriers against foreign competition, has as its corollary that the states are not separable economic units. As the Court said in *Baldwin v. Seelig*, 294 U.S. 511, 527, 55 S.Ct. 497, 79 L.Ed. 1032, 38 A.L.R. 286, 'what is ultimate is the principle that one state in its dealings with another may not place itself in a position of economic isolation.' "

[5] The opinions of the Court through the years have reflected an alertness to the evils of "economic isolation" and protectionism, while at the same time recognizing that incidental ***624** burdens on interstate commerce may be unavoidable when a State legislates to safeguard the health and safety of its people. Thus, where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected. See, *e. g., H. P. Hood & Sons, Inc. v. Du Mond, supra*; *Toomer v. Witsell*, 334 U.S. 385, 403-406, 68 S.Ct. 1156, 1165-1167, 92 L.Ed. 1460; *Baldwin v. G. A. F. Seelig, Inc., supra*; *Buck v. Kuykendall*, 267 U.S. 307, 315-316, 45 S.Ct. 324, 325-326, 69 L.Ed. 623. The clearest example of such legislation is a law that overtly blocks the flow of interstate commerce at a State's borders. Cf. *Welton v. Missouri*, 91 U.S. 275, 23 L.Ed. 347. But where other legislative objectives are credibly advanced and there is no patent discrimination against interstate trade, the Court has adopted a much more flexible approach, the general contours of which were outlined in *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174:

"Where the statute regulates evenhandedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the putative local benefits. . . . If a legitimate local purpose is found, then the question becomes one of degree. And the extent of the burden that will be tolerated will of course depend on the nature of the local interest involved, and on whether it could be promoted as well with a lesser impact on interstate activities."

See also *Raymond Motor Transportation, Inc. v. Rice, supra*, 437 U.S., at 441-442, ****2536**98 S.Ct., at 787; *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 352-354, 97 S.Ct. 2434, 2446-2447, 53 L.Ed.2d 383; *Great A & P Tea Co. v. Cottrell*, 424 U.S. 366, 371-372, 96 S.Ct. 923, 927-928, 47 L.Ed.2d 55.

The crucial inquiry, therefore, must be directed to determining whether ch. 363 is basically a protectionist measure, or whether it can fairly be viewed as a law directed to legitimate local concerns, with effects upon interstate commerce that are only incidental.

***625** B

[6] The purpose of ch. 363 is set out in the statute itself as follows:

"The Legislature finds and determines that . . . the volume of solid and liquid waste continues to rapidly increase, that the treatment and disposal of these wastes continues to pose an even greater threat to the quality of the environment of New Jersey, that the available and appropriate land fill sites within the State are being diminished, that the environment continues to be threatened by the treatment and disposal of waste which originated or was collected outside the State, and that the public health, safety and welfare require that the treatment and disposal within this State of all wastes generated outside of the State be prohibited."

The New Jersey Supreme Court accepted this statement of the state legislature's purpose. The state court additionally found that New Jersey's existing landfill sites will be exhausted within a few years; that to go on using these sites or to develop new ones will take a heavy environmental toll, both from pollution and from loss of scarce open lands; that new techniques to divert waste from landfills to other methods of disposal and resource recovery processes are under development, but that these changes will require time; and finally, that "the extension of the lifespan of existing landfills, resulting from the exclusion of out-of-state waste, may be of crucial importance in preventing further virgin wetlands or other undeveloped lands from being devoted to landfill purposes." 68 N.J., at 460-465, 348 A.2d, at 509-512. Based on these findings, the court concluded that ch. 363 was designed to protect, not the State's economy, but its environment, and that its substantial benefits outweigh its "slight" burden on interstate commerce. *Id.*, at 471-478, 348 A.2d, at 515-519.

The appellants strenuously contend that ch. 363, "while outwardly cloaked 'in the currently fashionable garb of environmental***626** protection,' . . . is actually no more than a legislative effort to suppress competition and stabilize the cost of solid waste disposal for New Jersey residents . . . ." They cite passages of legislative history suggesting that the problem addressed by ch. 363 is primarily financial: Stemming the flow of out-of-state waste into certain landfill sites will extend their lives, thus delaying the day when New Jersey cities must transport their waste to more distant and expensive sites.

The appellees, on the other hand, deny that ch. 363 was motivated by financial concerns or economic protectionism. In the words of their brief, "[n]o New Jersey commercial interests stand to gain advantage over competitors from outside the state as a result of the ban on dumping out-of-state waste." Noting that New Jersey landfill operators are among the plaintiffs, the appellee's brief argues that "[t]he complaint is not that New Jersey has forged an economic preference for its own commercial interests, but rather that it has denied a small group of its entrepreneurs an economic opportunity to traffic in waste in order to protect the health, safety and welfare of the citizenry at large."

This dispute about ultimate legislative purpose need not be resolved, because its resolution would not be relevant to the constitutional issue to be decided in this case. Contrary to the evident assumption of the state court and the parties, the evil of protectionism****2537** can reside in legislative means as well as legislative ends. Thus, it does not matter whether the ultimate aim of ch. 363 is to reduce the waste disposal costs of New Jersey residents or to save remaining open lands from pollution, for we assume New Jersey has every right to protect its residents' pocketbooks as well as their environment. And it may be assumed as well that New Jersey may pursue those ends by slowing the flow of *all* waste into the State's remaining landfills, even though interstate commerce may incidentally be affected. But whatever New Jersey's ultimate purpose, it may not be accomplished by discriminating against ***627** articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently. Both on its face and in its plain effect, ch. 363 violates this principle of nondiscrimination.

The Court has consistently found parochial legislation of this kind to be constitutionally invalid, whether the ultimate aim of the legislation was to assure a steady supply of milk by erecting barriers to allegedly ruinous outside competition, *Baldwin v. G. A. F. Seelig, Inc.*, 294 U.S., at 522-524, 55 S.Ct., at 500, or to create jobs by keeping industry within the State, *Foster-Fountain Packing Co. v. Haydel*, 278 U.S. 1, 10, 49 S.Ct. 1, 3, 73 L.Ed. 147; *Johnson v. Haydel*, 278 U.S. 16, 49 S.Ct. 6, 73 L.Ed. 155; *Toomer v. Witsell*, 334 U.S., at 403-404, 68 S.Ct., at 1166; or to preserve the State's financial resources from depletion by fencing out indigent immigrants, *Edwards v. California*, 314 U.S. 160, 173-174, 62 S.Ct. 164, 166-167, 86 L.Ed. 119. In each of these cases, a presumably legitimate goal was sought to be achieved by the illegitimate means of isolating the State from the national economy.

Also relevant here are the Court's decisions holding that a State may not accord its own inhabitants a preferred right of access over consumers in other States to natural resources located within its borders. *West, Attorney General of Oklahoma v. Kansas Natural Gas Co.*, 221 U.S. 229, 31 S.Ct. 564, 55 L.Ed. 716; *Pennsylvania v. West Virginia*, 262 U.S. 553, 43 S.Ct. 658, 67 L.Ed. 1117. These cases stand for the basic principle that a "State is without power to prevent privately owned articles of trade from being shipped and sold in interstate commerce on the ground that they are required to satisfy local demands or because they are needed by the people of the State." *Foster-Fountain Packing Co. v. Haydel, supra*, 278 U.S. at 10, 49 S.Ct. at 4.

FN6. We express no opinion about New Jersey's power, consistent with the Commerce Clause, to restrict to state residents access to state-owned resources, compare *Douglas v. Seacoast Products, Inc.*, 431 U.S. 265, 283-287, 97 S.Ct. 1740, 1750-1753, 52 L.Ed.2d 304, with *id.*, at 287-290, 97 S.Ct., at 1753-1754 (REHNQUIST, J., concurring and dissenting); *Toomer v. Witsell*, 334 U.S. 385, 404, 68 S.Ct. 1156, 1166, 92 L.Ed. 1460, or New Jersey's power to spend state funds solely on behalf of state residents and businesses, compare *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 805-810, 96 S.Ct. 2488, 2495-2498, 49 L.Ed.2d 220; *id.*, at 815, 96 S.Ct. at 2500 (STEVENS, J., concurring) with *id.*, at 817, 96 S.Ct., at 2501 (BRENNAN, J., dissenting). Also compare *South Carolina State Highway Dept. v. Barnwell Bros., Inc.*, 303 U.S. 177, 187, 58 S.Ct. 510, 514, 82 L.Ed. 734, with *Southern Pacific Co. v. Arizona ex rel. Sullivan*, 325 U.S. 761, 783, 65 S.Ct. 1515, 1527, 89 L.Ed. 1915.

[7] ***628** The New Jersey law at issue in this case falls squarely within the area that the Commerce Clause puts off limits to state regulation. On its face, it imposes on out-of-state commercial interests the full burden of conserving the State's remaining landfill space. It is true that in our previous cases the scarce natural resource was itself the article of commerce, whereas here the scarce resource and the article of commerce are distinct. But that difference is without consequence. In both instances, the State has overtly moved to slow or freeze the flow of commerce for protectionist reasons. It does not matter that the State has shut the article of commerce inside the State in one case and outside the State in the other. What is crucial is the ****2538** attempt by one State to isolate itself from a problem common to many by erecting a barrier against the movement of interstate trade.

The appellees argue that not all laws which facially discriminate against out-of-state commerce are forbidden protectionist regulations. In particular, they point to quarantine laws, which this Court has repeatedly upheld even though they appear to single out interstate commerce for special treatment. See *Baldwin v. G. A. F. Seelig, Inc., supra*, 294 U.S., at 525, 55 S.Ct., at 501; *Bowman v. Chicago & Northwestern R. Co.*, 125 U.S., at 489, 8 S.Ct., at 700. In the appellees' view, ch. 363 is analogous to such health-protective measures, since it reduces the exposure of New Jersey residents to the allegedly harmful effects of landfill sites.

It is true that certain quarantine laws have not been considered forbidden protectionist measures, even though they were directed against out-of-state commerce. See *Asbell v. Kansas*, 209 U.S. 251, 28 S.Ct. 485, 52 L.Ed. 778; *Reid v. Colorado*, 187 U.S. 137, 23 S.Ct. 92, 47 L.Ed. 108; *Bowman v. Chicago & Northwestern R. Co.*, 125 U.S., at 489, 8 S.Ct., at 700. But those quarantine laws banned the importation of articles such as diseased livestock that required destruction as soon ***629** as possible because their very movement risked contagion and other evils. Those laws thus did not discriminate against interstate commerce as such, but simply prevented traffic in noxious articles, whatever their origin.

The New Jersey statute is not such a quarantine law. There has been no claim here that the very movement of waste into or through New Jersey endangers health, or that waste must be disposed of as soon and as close to its point of generation as possible. The harms caused by waste are said to arise after its disposal in landfill sites, and at that point, as New Jersey concedes, there is no basis to distinguish out-of-state waste from domestic waste. If one is inherently harmful, so is the other. Yet New Jersey has banned the former while leaving its landfill sites open to the latter. The New Jersey law blocks the importation of waste in an obvious effort to saddle those outside the State with the entire burden of slowing the flow of refuse into New Jersey's remaining landfill sites. That legislative effort is clearly impermissible under the Commerce Clause of the Constitution.

Today, cities in Pennsylvania and New York find it expedient or necessary to send their waste into New Jersey for disposal, and New Jersey claims the right to close its borders to such traffic. Tomorrow, cities in New Jersey may find it expedient or necessary to send their waste into Pennsylvania or New York for disposal, and those States might then claim the right to close their borders. The Commerce Clause will protect New Jersey in the future, just as it protects her neighbors now, from efforts by one State to isolate itself in the stream of interstate commerce from a problem shared by all. The judgment is

Reversed.

Mr. Justice REHNQUIST, with whom THE CHIEF JUSTICE joins, dissenting.

A growing problem in our Nation is the sanitary treatment and disposal of solid waste. For many years, solid waste was ***630** incinerated. Because of the significant environmental problems attendant on incineration, however, this method of solid waste disposal has declined in use in many localities, including New Jersey. "Sanitary" landfills have replaced incineration as the ****2539** principal method of disposing of solid waste. In ch. 363 of the 1973 N.J. Laws, the State of New Jersey legislatively recognized the unfortunate fact that landfills also present extremely serious health and safety problems. First, in New Jersey, "virtually all sanitary landfills can be expected to produce leachate, a noxious and highly polluted liquid which is seldom visible and frequently pollutes . . . ground and surface waters." App. 149. The natural decomposition process which occurs in landfills also produces large quantities of methane and thereby presents a significant explosion hazard. *Id.*, at 149, 156-157. Landfills can also generate "health hazards caused by rodents, fires and scavenger birds" and, "needless to say, do not help New Jersey's aesthetic appearance nor New Jersey's noise or water or air pollution problems." Supp.App. 5.

The health and safety hazards associated with landfills present appellees with a currently unsolvable dilemma. Other, hopefully safer, methods of disposing of solid wastes are still in the development stage and cannot presently be used. But appellees obviously cannot completely stop the tide of solid waste that its citizens will produce in the interim. For the moment, therefore, appellees must continue to use sanitary landfills to dispose of New Jersey's own solid waste despite the critical environmental problems thereby created.

***631** The question presented in this case is whether New Jersey must also continue to receive and dispose of solid waste from neighboring States, even though these will inexorably increase the health problems discussed above. The Court answers this question in the affirmative. New Jersey must either prohibit *all* landfill operations, leaving itself to cast about for a presently nonexistent solution to the serious problem of disposing of the waste generated within its own borders, or it must accept waste from every portion of the United States, thereby multiplying the health and safety problems which would result if it dealt only with such wastes generated within the State. Because past precedents establish that the Commerce Clause does not present appellees with such a Hobson's choice, I dissent.

The Court recognizes, *ante*, at 2534-2535, that States can prohibit the importation of items " 'which, on account of their existing condition, would bring in and spread disease, pestilence, and death, such as rags or other substances infected with the germs of yellow fever or the virus of small-pox, or cattle or meat or other provisions that are diseased or decayed or otherwise, from their condition and quality, unfit for human use or consumption.' " *Bowman v. Chicago & Northwestern R. Co.*, 125 U.S. 465, 489, 8 S.Ct. 689, 700, 31 L.Ed. 700 (1888). See *Baldwin v. G. A. F. Seelig, Inc.*, 294 U.S. 511, 525, 55 S.Ct. 497, 501, 79 L.Ed. 1032 (1935); *Sligh v. Kirkwood*, 237 U.S. 52, 59-60, 35 S.Ct. 501, 502, 59 L.Ed. 835 (1915); *Asbell v. Kansas*, 209 U.S. 251, 28 S.Ct. 485, 52 L.Ed. 778 (1908); *Railroad Co. v. Husen*, 95 U.S. 465, 472, 24 L.Ed. 527 (1878). As the Court points out, such "quarantine laws have not been considered forbidden protectionist measures, *even though they were directed against out-of-state commerce*." *Ante*, at 2538 (emphasis added).

***632** In my opinion, these cases are dispositive of the present one. Under them, New Jersey may require germ-infected rags or diseased meat to be disposed of as best as possible within the State, but at the same time prohibit the *importation* of such items for disposal at the facilities that are set up within New Jersey for disposal of such material generated *within* the State. The physical fact of life that New Jersey must ****2540** somehow dispose of its own noxious items does not mean that it must serve as a depository for those of every other State. Similarly, New Jersey should be free under our past precedents to prohibit the importation of solid waste because of the health and safety problems that such waste poses to its citizens. The fact that New Jersey continues to, and indeed must continue to, dispose of its own solid waste does not mean that New Jersey may not prohibit the importation of even more solid waste into the State. I simply see no way to distinguish solid waste, on the record of this case, from germ-infected rags, diseased meat, and other noxious items.

The Court's effort to distinguish these prior cases is unconvincing. It first asserts that the quarantine laws which have previously been upheld "banned the importation of articles such as diseased livestock that required destruction as soon as possible because their very movement risked contagion and other evils." *Ante*, at 2538. According to the Court, the New Jersey law is distinguishable from these other laws, and invalid, because the concern of New Jersey is not with the *movement* of solid waste but with the present inability to safely *dispose* of it once it reaches its destination. But I think it far from clear that the State's law has as limited a focus as the Court imputes to it: Solid waste which is a health hazard when it reaches its destination may in all likelihood be an equally great health hazard in transit.

Even if the Court is correct in its characterization of New Jersey's concerns, I do not see why a State may ban the importation of items whose movement risks contagion, but ***633** cannot ban the importation of items which, although they may be transported into the State without undue hazard, will then simply pile up in an ever increasing danger to the public's health and safety. The Commerce Clause was not drawn with a view to having the validity of state laws turn on such pointless distinctions.

Second, the Court implies that the challenged laws must be invalidated because New Jersey has left its landfills open to domestic waste. But, as the Court notes, *ante*, at 2538, this Court has repeatedly upheld quarantine laws "even though they appear to single out interstate commerce for special treatment." The fact that New Jersey has left its landfill sites open for domestic waste does not, of course, mean that solid waste is not innately harmful. Nor does it mean that New Jersey prohibits importation of solid waste for reasons other than the health and safety of its population. New Jersey must out of sheer necessity treat and dispose of its solid waste in some fashion, just as it must treat New Jersey cattle suffering from hoof-and-mouth disease. It does not follow that New Jersey must, under the Commerce Clause, accept solid waste or diseased cattle from outside its borders and thereby exacerbate its problems.

The Supreme Court of New Jersey expressly found that ch. 363 was passed "to preserve the health of New Jersey residents by keeping their exposure to solid waste and landfill areas to a minimum." 68 N.J. 451, 473, 348 A.2d 505, 516. The Court points to absolutely no evidence that would contradict this finding by the New Jersey Supreme Court. Because I find no basis for distinguishing the laws under challenge here from our past cases upholding state laws that prohibit the importation of items that could endanger the population of the State, I dissent.

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Supreme Court of the United States
Joseph D. BIBB, Director of the Department of Public Safety of the State of Illinois, et al., Appellants,
v.
NAVAJO FREIGHT LINES, INC., a New Mexico Corporation, Ringsby Truck Lines, Inc., a Nebraska Corporation, et al.
No. 94.

Argued March 30, 31, 1959.
Decided May 25, 1959.

****963 *520** Mr. William C. Wines, Chicago, Ill., for appellants.

***521** Mr. David Axelrod, Chicago, Ill., for appellees.

Mr. Justice DOUGLAS delivered the opinion of the Court.

We are asked in this case to hold that an Illinois statute [FN1] requiring the use ****964** of a certain type of rear fender ***522** mudguard on trucks and trailers operated on the highways of that State conflicts with the Commerce Clause of the Constitution. The statutory specification for this type of mudguard provides that the guard shall contour the rear wheel, with the inside surface being relatively parallel to the top 90 degrees of the rear 180 degrees of the whole surface. [FN2] The surface of the guard must extend downward to within 10 inches from the ground when the truck is loaded to its maximum legal capacity. The guards must be wide enough to cover the width of the protected tire, must be installed not more than 6 inches from the tire surface when the vehicle is loaded ***523** to maximum capacity, and must have a lip or flange on its outer edge of not less than 2 inches. [FN3]

***

Appellees, interstate motor carriers holding certificates from the Interstate Commerce Commission, challenged the constitutionality of the Illinois Act. A specially constituted three-judge District Court concluded that it unduly and unreasonably burdened and obstructed interstate commerce, because it made the conventional or straight mudflap, which is legal in at least 45 States, illegal in Illinois, and because the statute, taken together with a Rule of the Arkansas Commerce Commission [FN4] requiring straight mudflaps, rendered the use of the same motor vehicle equipment in both States impossible. The statute was declared to be violative of the Commerce Clause and appellants were enjoined from enforcing it. 159 F.Supp. 385. An appeal was taken and we noted probable jurisdiction. 358 U.S. 808, 79 S.Ct. 26, 3 L.Ed.2d 53.

***

[1] The power of the State to regulate the use of its highways is broad and pervasive. We have recognized the peculiarly local nature of this subject of safety, and have upheld state statutes applicable alike to interstate and intrastate commerce, despite the fact that they may have an impact on interstate commerce. South Carolina State Highway Dept. v. Barnwell Bros., 303 U.S. 177, 58 S.Ct. 510, 82 L.Ed. 734; Maurer v. Hamilton, 309 U.S. 598, 60 S.Ct. 726, 84 L.Ed. 969; Sproles v. Binford, 286 U.S. 374, 52 S.Ct. 581, 76 L.Ed. 1167. The regulation of highways 'is akin to quarantine ***524** measures, same laws, and like local regulations of rivers, harbors, ****965** piers, and docks, with respect to which the state has exceptional scope for the exercise of its regulatory power, and which, Congress not acting, have been sustained even though they materially interfere with interstate commerce.' Southern Pacific Co. v. State of Arizona, 325 U.S. 761, 783, 65 S.Ct. 1515, 1527, 89 L.Ed. 1915.

[2][3][4][5] These safety measures carry a strong presumption of validity when challenged in court. If there are alternative ways of solving a problem, we do not sit to determine which of them is best suited to achieve a valid state objective. Policy decisions are for the state legislature, absent federal entry into the field. [FN5] Unless we can conclude on the whole record that 'the total effect of the law as a safety measure in reducing accidents and casualties is so slight or problematical as not to outweigh the national interest in keeping interstate commerce free from interferences which seriously impede it' (Southern Pacific Co. v. State of Arizona, supra, 325 U.S. at pages 775--776, 65 S.Ct. at page 1523) we must uphold the statute.

***

Illinois introduced evidence seeking to establish that contour mudguards had a decided safety factor in that they prevented the throwing of debris into the faces of drivers of passing cars and into the windshields of a following vehicle. But the District Court in its opinion stated that it was 'conclusively shown that the contour mud flap possesses no advantages over the conventional or straight mud flap previously required in Illinois and presently required in most of the states,' (159 F.Supp. at page 388) and that 'there is rather convincing testimony that use of the contour flap creates hazards previously unknown to those using the highways.' Id., at page 390.

***

This case presents a different issue. The equipment in the Sproles, Barnwell, and Maurer cases could pass muster in any State, so far as the records in those cases reveal. We were not faced there with the question whether one State could prescribe standards for interstate carriers that would conflict with the standards of another State, making it necessary, say, for an interstate carrier to shift its cargo to differently designed vehicles once another state line was reached. We had a related problem in Southern Pacific Co. v. State of Arizona, supra, where the Court invalidated a statute of Arizona prescribing a maximum length of 70 cars for freight trains moving through that State. More closely in point is Morgan v. Commonwealth of Virginia, 328 U.S. 373, 375, 66 S.Ct. 1050, 1052, 90 L.Ed. 1317, where a local law required a reseating of passengers on interstate ***527** busses entering Virginia in order to comply with a local segregation law. Diverse seating arrangements for people of different races imposed by several States interfered, we concluded, with 'the need for national uniformity in the regulations for interstate travel.' Id., 328 U.S. at page 386, 66 S.Ct. at page 1058. Those cases indicate the dimensions of our present problem.

An order of the Arkansas Commerce Commission, already mentioned, [FN6] requires that trailers operating in that State be equipped with straight or conventional mudflaps. Vehicles equipped to meet the standards of the Illinois statute would not comply with Arkansas standards, and vice versa. Thus if a trailer is to be operated in both States, mudguards would have to be interchanged, causing a significant delay in an operation where prompt movement may be of the essence. It was found that from two to four hours of labor are required to install or remove a contour mudguard. Moreover, the contour guard is attached to the trailer by welding and if the trailer is conveying a cargo of explosives (e.g., for the United States Government) it would be exceedingly dangerous to attempt to weld on a contour mudguard without unloading the trailer.

***

It was also found that the Illinois statute seriously interferes with the 'interline' operations of motor carriers--that is to say, with the interchanging of trailers between an originating carrier and another carrier when the latter serves an area not served by the ****967** former. These 'interline' operations provide a speedy through-service for the shipper. Interlining contemplates the physical transfer of the entire trailer; there is no unloading and reloading of the cargo. The interlining process is particularly vital in connection with shipment of perishables, which would spoil if unloaded before reaching their destination, or with the movement of explosives carried ***528** under seal. Of course, if the originating carrier never operated in Illinois, it would not be expected to equip its trailers with contour mudguards. Yet if an interchanged trailer of that carrier were hauled to or through Illinois, the statute would require that it contain contour guards. Since carriers which operate in and through Illinois cannot compel the originating carriers to equip their trailers with contour guards, they may be forced to cease interlining with those who do not meet the Illinois requirements. Over 60 percent of the business of 5 of the 6 plaintiffs is interline traffic. For the other it constitutes 30 percent. All of the plaintiffs operate extensively in interstate commerce, and the annual mileage in Illinois of none of them exceeds 7 percent of total mileage.

This is summary is the rather massive showing of burden on interstate commerce which appellees made at the hearing.

***

[11][12] This is one of those cases--few in number--where local safety measures that are nondiscriminatory place an unconstitutional burden on interstate commerce. This conclusion is especially underlined by the deleterious ****968** effect which the Illinois law will have on the 'interline' operation of interstate motor carriers. The conflict between the Arkansas regulation and the Illinois regulation also suggests that this regulation of mudguards is not one of those matters 'admitting of diversity of treatment, according to the special

requirements of local conditions,' to use the words of Chief Justice Hughes in Sproles v. Binford, supra, 286 U.S. at page 390, 52 S.Ct. at page 585. A State which insists on a design out of line with the requirements of almost all the other States may sometimes place a great burden of delay and inconvenience on those interstate motor carriers ***530** entering or crossing its territory. Such a new safety device--out of line with the requirements of the other States--may be so compelling that the innovating State need not be the one to give way. But the present showing--balanced against the clear burden on commerce--is far too inconclusive to make this mudguard meet that test.

[13] We deal not with absolutes but with questions of degree. The state legislatures plainly have great leeway in providing safety regulations for all vehicles--interstate as well as local. Our decisions so hold. Yet the heavy burden which the Illinois mudguard law places on the interstate movement of trucks and trailers seems to us to pass the permissible limits even for safety regulations.

Affirmed.

Mr. Justice HARLAN, whom Mr. Justice STEWART joins, concurring.

[concurring opinion deleted]

359 U.S. 520, 79 S.Ct. 962, 3 L.Ed.2d 1003

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Supreme Court of the United States
MOORMAN MANUFACTURING COMPANY,
Appellant,
v.
G. D. BAIR, etc.
No. 77-454.

Argued March 21, 1978.
Decided June 15, 1978.
Rehearing Denied Oct. 2, 1978.
See 439 U.S. 885, 99 S.Ct. 233.

****2341** *Syllabus*[*]

***267** An Iowa statute prescribes a so-called single-factor sales formula for apportioning an interstate corporation's income for state income tax purposes. Under this formula, the part of income from such a corporation's sale of tangible personal property attributable to business within the State and hence subject to the state income tax is deemed to be in that proportion which the corporation's gross sales made within the State bear to its total gross sales. Appellant, an Illinois corporation that sells animal feed it manufactures in Illinois to Iowa customers through Iowa salesmen and warehouses, brought an action in an Iowa court challenging the constitutionality of the single-factor formula. The trial court held the formula invalid under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause, but the Iowa Supreme Court reversed. *Held* :

1. Iowa's single-factor formula is not invalid under the Due Process Clause. Pp. 2343-2345.

(a) Any assumption that at least some portion of appellant's income from Iowa sales was generated by Illinois activities is too speculative to support a claim that Iowa in fact taxed profits not attributable to activities within the State. Pp. 2343-2344.

(b) An apportionment formula, such as the single-factor formula, that is necessarily employed as a rough approximation of a corporation's income reasonably related to the activities conducted within the taxing State will only be disturbed when the taxpayer has proved by "clear and cogent evidence" that the income attributed to the State is in fact "out of all reasonable proportion to the business transacted . . . in that State," *Hans Rees' Sons v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135, 51 S.Ct. 385, 389, 75 L.Ed. 879 or has "led to a grossly distorted result," ****2342***Norfolk & western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 326, 88 S.Ct. 995, 1001, 19 L.Ed.2d 1201. Here, the Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case, but the record contains no such showing. Pp. 2344-2345.

2. Nor is Iowa's single-factor formula invalid under the Commerce Clause. Pp. 2346-2348.

***268** (a) On this record, the existence of duplicative taxation as between Iowa and Illinois (which uses the so-called three-factor--property, payroll, and sales--formula) is speculative, but even assuming some overlap, appellant's argument that Iowa, rather than Illinois, was necessarily at fault in a constitutional sense cannot be accepted. Where the record does not reveal the sources of appellant's profits, its Commerce Clause claim cannot rest on the premise that profits earned in Illinois were included in its Iowa taxable income and therefore the Iowa formula was at fault for whatever overlap may have existed. P. 2346.

(b) The Commerce Clause itself, without implementing legislation by Congress, does not require, as appellant urges, that Iowa compute corporate net income under the Illinois three-factor formula. If the Constitution were read to mandate a prohibition against any overlap in the computation of taxable income by the States, the consequences would extend far beyond this particular case and would require extensive judicial lawmaking. Pp. 2346-2348.

254 N.W.2d 737, affirmed.

Donald K. Barnes, Detroit, Mich., for appellant.

Harry M. Griger, Des Moines, Iowa, for appellee.

[**OPINION**]

***269** Mr. Justice STEVENS delivered the opinion of

[*] FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed.2d 499.

the Court.

The question in this case is whether the single-factor sales formula employed by Iowa to apportion the income of an interstate business for income tax purposes is prohibited by the Federal Constitution.

I

Appellant, Moorman Manufacturing Co., is an Illinois corporation engaged in the manufacture and sale of animal feeds. Although the products it sells to Iowa customers are manufactured in Illinois, appellant has over 500 salesmen in Iowa and it owns six warehouses in the State from which deliveries are made to Iowa customers. Iowa sales account for about 20% of appellant's total sales.

Corporations, both foreign and domestic, doing business in Iowa are subject to the State's income tax. The taxable income for federal income tax purposes, with certain adjustments, is treated as the corporation's "net income" under the Iowa statute. If a corporation's business is not conducted entirely within Iowa, the statute imposes a tax only on the portion of its income "reasonably attributable" to the business within the State.

There are essentially two steps in computing the share of a corporation's income "reasonably attributable" to Iowa. First, certain income, "the geographical source of which is easily identifiable," is attributed entirely to a particular State. [FN1] ***270** Second, if the remaining income is derived from the manufacture or sale of tangible personal property, "the part thereof attributable to business within the state shall be in that ****2343** proportion which the gross sales made within the state bear to the total gross sales." [FN2] This is the single-factor formula that appellant challenges in this case.

FN1. The statute provides:
"Interest, dividends, rents, and royalties (less related expenses) received in connection with business in the state, shall be allocated to the state, and where received in connection with business outside the state, shall be allocated outside of the state." Iowa Code § 422.33(1)(*a*) (1977).
In describing this section, the Iowa Supreme Court stated that "certain income, the geographical source of which is easily identifiable, is allocated to the appropriate state." 254 N.W.2d 737, 739. Thus, for example, rental income would be attributed to the State where the property was located. And in appellant's case, this section operated to exclude its investment income from the tax base.

FN2. Iowa Code § 422.33(1)(*b*) (1977).

If the taxpayer believes that application of this formula subjects it to taxation on a greater portion of its net income than is "reasonably attributable" to business within the State, it may file a statement of objections and submit an alternative method of apportionment. If the evidence submitted by the taxpayer persuades the Director of Revenue that the statute is "inapplicable and inequitable" as applied to it, he may recalculate the corporation's taxable income.

During the fiscal years 1949 through 1960, the State Tax Commission allowed appellant to compute its Iowa income on the basis of a formula consisting of three, equally weighted factors--property, payroll, and sales--rather than the formula prescribed by statute. [FN3] For the fiscal years 1961 through 1964, appellant complied with a directive of the State Tax Commission to compute its income in accordance with the statutory formula. Since 1965, however, appellant has resorted to the three-factor formula without the consent of the commission.

FN3. The operation of the two formulas may be briefly described. The single-factor sales formula yields a percentage representing a ratio of gross sales in Iowa to total gross sales. The three-factor formula yields a percentage representing an average of three ratios: property within the State to total property, payroll within the State to total payroll, and sales within the State to total sales.
These percentages are multiplied by the adjusted total net income to arrive at Iowa taxable net income. This net income figure is then multiplied by the tax rate to compute the actual tax obligation of the taxpayer.

In 1974, the Iowa Director of Revenue revised appellant's tax assessment for the fiscal years 1968 through 1972. This assessment was based on the statutory formula, which produced ***271** a higher percentage of taxable income than appellant, using the three-factor formula, had reported on its return in each of the disputed years. [FN4] The higher percentages, of course produced a correspondingly greater tax obligation for those years. [FN5]

FN4. For those years the two formulas resulted in the following percentages:

Fiscal Year Ended	Sales Factor Percentage	Three-Factor Percentage
3/31/68	21.8792%	14.1088%
3/31/69	21.2134%	14.3856%
3/31/70	19.9492%	14.0200%
3/31/71	18.9544%	13.2186%
3/31/72	18.6713%	12.2343%

For a description of how these percentages are computed, see n.3, *supra.*

FN5. Thus, in 1968, for example, Moorman's three-factor computation resulted in a tax of $81,466, whereas the Director's single-factor computation resulted in a tax of $121,363.

After the Tax Commission had rejected Moorman's appeal from the revised assessment, appellant challenged the constitutionality of the single-factor formula in the Iowa District Court for Polk County. That court held the formula invalid under the Due Process Clause of the Fourteenth Amendment and the Commerce Clause. The Supreme Court of Iowa reversed, holding that an apportionment formula that is necessarily only a rough approximation of the income properly attributable to the taxing State is not subject to constitutional attack unless the taxpayer proves that the formula has produced an income attribution "out of all proportion to the business transacted" within the State. The court concluded that appellant had not made such a showing.

We noted probable jurisdiction of Moorman's appeal, 434 U.S. 953, 98 S.Ct. 478, 54 L.Ed.2d 311 and now affirm.

II

[1] Appellant contends that Iowa's single-factor formula results in extraterritorial taxation in violation of the Due Process ***272** Clause. This argument rests on two premises: first, that appellant's Illinois operations were responsible for some of the profits generated by sales in Iowa; and, second, ****2344** that a formula that reaches any income not in fact earned within the borders of the taxing State violates due process. The first premise is speculative and the second is foreclosed by prior decisions of this Court.

[2] Appellant does not suggest that it has shown that a significant portion of the income attributed to Iowa in fact was generated by its Illinois operations; the record does not contain any separate accounting analysis showing what portion of appellant's profits was attributable to sales, to manufacturing, or to any other phase of the company's operations. But appellant contends that we should proceed on the assumption that at least some portion of the income from Iowa sales was generated by Illinois activities.

Whatever merit such an assumption might have from the standpoint of economic theory or legislative policy, it cannot support a claim in this litigation that Iowa in fact taxed profits not attributable to activities within the State during the years 1968 through 1972. For all this record reveals, appellant's manufacturing operations in Illinois were only marginally profitable during those years and the high-volume sales to Iowa customers from Iowa warehouses were responsible for the lion's share of the income generated by those sales. Indeed, a separate accounting analysis might have revealed that losses in Illinois operations prevented appellant from earning more income from exploitation of a highly favorable Iowa market. Yet even were we to assume that the Illinois activities made some contribution to the profitability of the Iowa sales, appellant's claim that the Constitution invalidates an apportionment formula whenever it may result in taxation of some income that did not have its source in the taxing State is incorrect.

[3] The Due Process Clause places two restrictions on a State's power to tax income generated by the activities of an interstate ***273** business. First, no tax may be imposed, unless there is some minimal connection between those activities and the taxing State. *National Bellas Hess, Inc. v. Department of Revenue*, 386 U.S. 753, 756, 87 S.Ct. 1389, 1390, 18 L.Ed.2d 505. This requirement was plainly satisfied here. Second, the income attributed to the State for tax purposes must be rationally related to "values connected with the taxing State." *Norfolk & Western R. Co. v. State Tax Comm'n*, 390 U.S. 317, 325, 88 S.Ct. 995, 1001, 19 L.Ed.2d 1201.

[4] Since 1934 Iowa has used the formula method of computing taxable income. This method, unlike separate accounting, does not purport to identify the precise geographical source of a corporation's profits; rather, it is employed as a rough approximation of a corporation's income that is reasonably related to the activities conducted within the taxing State. The single-factor formula used by Iowa, therefore, generally will not produce a figure that represents the actual profits earned within the State. But the same is true of the Illinois three-factor formula. Both will occasionally over-reflect or under-reflect income attributable to the taxing State. Yet despite this imprecision, the Court has refused to impose strict constitutional restraints on a State's selection of a particular formula. [FN6]

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Thus, we have repeatedly held that a single-factor formula is presumptively valid. In *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 41 S.Ct. 45, 65 L.Ed. 165, for example, the taxpayer challenged Connecticut's use of such a formula to apportion its net income. Underwood's manufacturing operations were conducted entirely within Connecticut. Its main office, however was in New York City and it had branch offices in many States where its typewriters were sold and repaired. Applying a single-factor property formula, Connecticut taxed 47% of the company's net ****2345** income. Claiming that 97% of its profits were ***274** generated by transactions in tangible personal property outside Connecticut, Underwood contended that the formula taxed "income arising from business conducted beyond the boundaries of the State" in violation of the Due Process Clause. *Id.*, at 120, 41 S.Ct., at 46.

Rejecting this claim, the Court noted that Connecticut "adopted a method of apportionment which, for all that appears in this record, reached, and was meant to reach, only the profits earned within the State," *id.*, at 121, 41 S.Ct., at 47, and held that the taxpayer had failed to carry its burden of proving that "the method of apportionment adopted by the state was inherently arbitrary, or that its application to this corporation produced an unreasonable result." *Ibid.* (footnote omitted). [FN7]

***

In individual cases, it is true, the Court has found that the *application* of a single-factor formula to a particular taxpayer violated due process. See *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 51 S.Ct. 385, 75 L.Ed. 879; *Norfolk & Western R. Co. v. State Tax Comm'n, supra*. In *Hans Rees'*, for example, the Court concluded that proof that the formula produced a tax on 83% of the taxpayer's income when only 17% of that income actually had its source in the State would suffice to invalidate the assessment under the Due Process Clause. But in neither *Hans Rees'* nor *Norfolk & Western* did the Court depart from the basic principles that the States have wide latitude in the selection of apportionment formulas and that a formula-produced assessment will only be disturbed when the taxpayer has proved by "clear and cogent evidence" that the income attributed to the State is in fact "out of all appropriate proportion to the business transacted . . . in that State," 283 U.S., at 135, 51 S.Ct., at 389, or has "led to a grossly distorted result," 390 U.S., at 326, 88 S.Ct., at 1002.

275General Motors Corp. v. District of Columbia*, 380 U.S. 553, 85 S.Ct. 1156, 14 L.Ed.2d 68 on which appellant relies, does not suggest a contrary result. In that case the Court held that a regulation prescribing a single-factor sales formula was not authorized by the District of Columbia Code. It concluded that the formula violated the statutory requirement that the net income of a corporation doing business both inside and outside the District must be deemed to arise from "sources" both inside and outside the District. But that statutory requirement has no counterpart in the Constitution, and the Court in *General Motors* made clear that it did "not mean to take any position on the constitutionality of a state income tax based on the sales factor alone." *Id.*, at 561, 85 S.Ct., at 1161. [FN8]

FN8. The Court, it is true, expressed doubts about the wisdom of the economic assumptions underlying the challenged formula and noted that its use in the context of the more prevalent three-factor formula would not advance the policies underlying the Commerce Clause. But these considerations were deemed relevant to the question of legislative intent, not constitutional interpretation.

The Iowa statute afforded appellant an opportunity to demonstrate that the single-factor formula produced an arbitrary result in its case. But this record contains no such showing and therefore the Director's assessment is not subject to challenge under the Due Process Clause. [FN9]

FN9. In his concurring opinion, Justice McCormick of the Iowa Supreme Court made this point:

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[N]o basis was presented for comparison of the corporation's Iowa income and the income apportioned to Iowa under the formula. In this era of sophisticated accounting techniques, it should not be impossible for a unitary corporation to prove its actual income from activities in a particular state. However, Moorman showed only that its tax liability would be substantially less if Iowa employed a three-factor apportionment formula. We have no basis to assume that the three-factor formula produced a result equivalent to the corporation's actual income from Iowa activities.

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***276 **2346** III

[5] Appellant also contends that during the relevant years Iowa and Illinois imposed a tax on a portion of the income derived from the Iowa sales that was also taxed by the other State in violation of the Commerce Clause. [FN10] Since most States use the three-factor formula

that Illinois adopted in 1970, appellant argues that Iowa's longstanding single-factor formula must be held responsible for the alleged duplication and declared unconstitutional. We cannot agree.

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[6] In the first place, this record does not establish the essential factual predicate for a claim of duplicative taxation. Appellant's net income during the years in question was approximately $9 million. Since appellant did not prove the portion derived from sales to Iowa customers, rather than sales to customers in other States, we do not know whether Illinois and Iowa together imposed a tax on more than 100% of the relevant net income. The income figure that appellant contends was subject to duplicative taxation was computed by comparing gross sales in Iowa to total gross sales. As already noted, however, this figure does not represent *actual* profits earned from Iowa sales. Obviously, all sales are not equally profitable. Sales in Iowa, although only 20% of gross sales, may have yielded a much higher percentage of appellant's profits. Thus, profits from Iowa sales may well have exceeded the $2.5 million figure that appellant contends was taxed by the two States. If so, there was no duplicative taxation of the net income generated by Iowa sales. In any event, on this record its existence is speculative. [FN11]

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***277** Even assuming some overlap, we could not accept appellant's argument that Iowa, rather than Illinois, was necessarily at fault in a constitutional sense. It is, of course, true that if Iowa had used Illinois' three-factor formula, a risk of duplication in the figures computed by the two States might have been avoided. But the same would be true had Illinois used the Iowa formula. Since the record does not reveal the sources of appellant's profits, its Commerce Clause claim cannot rest on the premise that profits earned in Illinois were included in its Iowa taxable income and therefore the Iowa formula was at fault for whatever overlap may have existed. Rather, the claim must be that even if the presumptively valid Iowa formula yielded no profits other than those properly attributable to appellant's activities within Iowa, the importance of avoiding any risk of duplication in the taxable income of an interstate concern justifies invalidation of the Iowa statute.

[7] Appellant contends that, to the extent this overlap is permitted, the corporation that does business in more than one State shoulders a tax burden not shared by those operating entirely within a State. [FN12] ****2347** To alleviate the burden, appellant ***278** invites us to hold that the Commerce Clause itself, without implementing legislation by Congress, requires Iowa to compute corporate net income under the Illinois equally weighted, three-factor formula. For the reasons that follow, we hold that the Constitution does not require such a result.

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> [W]hatever disparity may have existed is not attributable to the Iowa statute. It treats both local and foreign concerns with an even hand; the alleged disparity can only be the consequence of the combined effect of the Iowa *and* Illinois statutes, and Iowa is not responsible for the latter.
>
> Thus, appellant's "discrimination" claim is simply a way of describing the potential consequences of the use of different formulas by the two States. These consequences, however, could be avoided by the adoption of any uniform rule; the "discrimination" does not inhere in either State's formula.

The only conceivable constitutional basis for invalidating the Iowa statute would be that the Commerce Clause prohibits any overlap in the computation of taxable income by the States. If the Constitution were read to mandate such precision in interstate taxation, the consequences would extend far beyond this particular case. For some risk of duplicative taxation exists whenever the States in which a corporation does business do not follow identical rules for the division of income. Accepting appellant's view of the Constitution, therefore, would require extensive judicial lawmaking. Its logic is not limited to a prohibition on use of a single-factor apportionment formula. The asserted constitutional flaw in that formula is that it is different from that presently employed by a majority of States and that difference creates a risk of duplicative taxation. But a host of other division-of-income problems create precisely the same risk and would similarly rise to constitutional proportions.

Thus, it would be necessary for this Court to prescribe a uniform definition of each category in the three-factor formula. For if the States in which a corporation does business have different rules regarding where a "sale" takes place, and each includes the same sale in its three-factor computation of the corporation's income, there will be duplicative taxation despite the apparent identity of the formulas employed. [FN13] A similar ***279** risk of multiple taxation is created by the diversity among the States in the attribution of "nonbusiness" income, generally defined as that portion of a taxpayer's income that does not arise from activities in the regular course of its business. [FN14] Some States do not distinguish between business and nonbusiness income for apportionment purposes. Other States, however, have adopted special rules that attribute nonbusiness income to specific locations. Moreover, even among the latter, there is diversity in the definition of nonbusiness income and in the designation of the locations to which it is deemed attributable. The potential for attribution of the same income to more than one State is plain. [FN15]

FN13. Thus, while some States such as Iowa assign sales by destination, "sales can be assigned to the state . . . of origin, the state in which the sales office is located, the state where an employee of the business making the sale carries on his activities or where the order is first accepted, or the state in which an interstate shipment is made." Note, State Taxation of Interstate Businesses and the Multistate Tax Compact: The Search for a Delicate Uniformity, 11 Colum.J.Law & Soc.Prob. 231, 237 n.20 (1975) (citation omitted).

FN14. See, *e. g.,* Uniform Division of Income for Tax Purposes Act § 1(a).

FN15. Thus, one State in which a corporation does business may consider a particular type of income business income and simply include it in its apportionment formula; a second State may deem that same income nonbusiness income and attribute it to itself as the "commercial domicile" of the company; and a third State, though also considering it nonbusiness income, may attribute it to itself as the "legal domicile" of the company. See Note, *supra* n.13, at 239.

The prevention of duplicative taxation, therefore, would require national uniform rules for the division of income. Although the adoption of a uniform code would undeniably advance the policies that underlie the Commerce Clause, it would require a policy decision based on political and economic considerations that vary from State to State. The Constitution, however, is neutral with respect to the content of any uniform rule. If division-of-income problems were to be constitutionalized, therefore, ****2348** they would have to be resolved in the manner suggested by appellant for resolution of formula diversity--the prevalent practice would be endorsed as the constitutional rule. This rule would at best be an amalgam of independent state decisions, based on considerations unique to each State. Of most importance, it could not reflect the ***280** national interest, because the interests of those States whose policies are subordinated in the quest for uniformity would be excluded from the calculation. [FN16]

FN16. This process is especially unsettling if a longstanding tax policy in one State, such as Iowa's, becomes the object of constitutional attack simply because it is different from the recently adopted practice of its neighbor.

While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to the interests of all affected States. It is clear that the legislative power granted to Congress by the Commerce Clause of the Constitution would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body, and not this Court, that the Constitution has committed such policy decisions.

Finally, it would be an exercise in formalism to declare appellant's income tax assessment unconstitutional based on speculative concerns with multiple taxation. For it is evident that appellant would have had no basis for complaint if, instead of an income tax, Iowa had imposed a more burdensome gross-receipts tax on the gross receipts from sales to Iowa customers. In *Standard Pressed Steel Co. v. Washington Revenue Dept.,* 419 U.S. 560, 95 S.Ct. 706, 42 L.Ed.2d 719, the Court sustained a tax on the entire gross receipts from sales made by the taxpayer into Washington State. Because receipts from sales made to States other than Washington were not included in Standard Pressed Steel's taxable gross receipts, the Court concluded that the tax was " 'apportioned exactly to the activities taxed.' " *Id.,* at 564, 95 S.Ct. at 709.

In this case appellant's actual income tax obligation was the rough equivalent of a 1% tax on the entire gross receipts from its Iowa sales. Thus, the actual burden on interstate commerce would have been the same had Iowa imposed a plainly ***281** valid gross-receipts tax instead of the challenged income tax. Of more significance, the gross-receipts tax sustained in *Standard Pressed Steel* and *General Motors Corp. v. Washington,* 377 U.S. 436, 84 S.Ct. 1564, 12 L.Ed.2d 430, is inherently more burdensome than the Iowa income tax. It applies whether or not the interstate concern is profitable and its imposition may make the difference between profit and loss. In contrast, the income tax is only imposed on enterprises showing a profit and the tax obligation is not heavy unless the profits are high.

[8] Accordingly, until Congress prescribes a different rule, Iowa is not constitutionally prohibited from requiring taxpayers to prove that application of the single-

factor formula has produced arbitrary results in a particular case.

The judgment of the Iowa Supreme Court is affirmed.

So ordered.

Mr. Justice BRENNAN, dissenting.

I agree with the Court that, for purposes of constitutional review, there is no distinction between a corporate income tax and a gross-receipts tax. I do not agree, however, that Iowa's single-factor sales apportionment formula meets the Commerce Clause requirement that a State's taxation of interstate business must be "fairly apportioned to the commerce carried on within the taxing state." *Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 256, 58 S.Ct. 546, 549, 82 L.Ed. 823 (1938). As I have previously explained:

> "[Where a sale] exhibits significant contacts with more than one State . . . ****2349** it is the commercial activity within the State, and not the sales volume, which determines the State's power to tax, and by which the tax must be apportioned. While the ratio of in-state to out-of-state sales is often taken into account as one factor among others in apportioning a firm's total net income, see, *e. g.,* the description of the 'Massachusetts Formula' in Note, 75 Harv.L.Rev. 953, 1011 (1962), it nevertheless remains true that ***282** if commercial activity in more than one State results in a sale in one of them, that State may not claim as all its own the gross receipts to which the activity within its borders has contributed only a part. Such a tax must be apportioned to reflect the business activity within the taxing State." *General Motors Corp. v. Washington*, 377 U.S. 436, 450-451, 84 S.Ct. 1564, 1573, 12 L.Ed.2d 430 (1964) (dissenting opinion).

I would therefore reverse.

Mr. Justice BLACKMUN, dissenting.

The unspoken, but obvious, premise of the majority opinion is the fear that a Commerce Clause invalidation of Iowa's single-factor sales formula will lead the Court into problems and difficulties in other cases yet to come. I reject that premise.

I agree generally with the content of Mr. Justice POWELL'S opinion in dissent. I join that opinion because I, too, feel that the Court has a duty to resolve, not to avoid, these problems of "delicate adjustment," *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329, 97 S.Ct. 599, 606, 50 L.Ed.2d 514 (1977), and because the opinion well demonstrates that Iowa's now anachronistic single-factor sales formula runs headlong into overriding Commerce Clause considerations and demands.

Today's decision is bound to be regressive. [FN1] Single-factor formulas are relics of the early days of state income taxation. [FN2] The three-factor formulas were inevitable improvements and, while not perfect, reflect more accurately the realities of the business and tax world. With their almost universal adoption by the States, the Iowa system's adverse and parochial im pact on commerce comes vividly into focus. But with its ***283** single-factor formula now upheld by the Court, there is little reason why other States, perceiving or imagining a similar advantage to local interests, may not go back to the old ways. The end result, in any event, is to exacerbate what the Commerce Clause, absent governing congressional action, was devised to avoid.

FN1. Iowa is not a member of the Multistate Tax Commission. Tr. of Oral Arg. 33. See *United States Steel Corp. v. Multistate Tax Comm'n*, 434 U.S. 452, 98 S.Ct. 799, 54 L.Ed.2d 682 (1978).

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Mr. Justice POWELL, with whom Mr. Justice BLACKMUN joins, dissenting.

It is the duty of this Court "to make the delicate adjustment between the national interest in free and open trade and the legitimate interest of the individual States in exercising their taxing powers." *Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 329, 97 S.Ct. 599, 606, 50 L.Ed.2d 514 (1977). This duty must be performed with careful attention to the settings of particular cases and consideration of their special facts. See *Raymond Motor Transp., Inc. v. Rice*, 434 U.S. 429, 447-448 n. 25, 98 S.Ct. 787, 797, 54 L.Ed.2d 664 (1978). Consideration of all the circumstances of this case leads me to conclude that Iowa's use of a single-factor sales formula to apportion the net income of multistate corporations results in the imposition of "a tax which discriminates against interstate commerce . . . by providing a direct commercial advantage to local business." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959). I therefore dissent.

****2350** I

Iowa's use of a single-factor sales-apportionment formula--though facially neutral--operates as a tariff on goods manufactured in other States (including the District of Columbia), and as a subsidy to Iowa manufacturers selling their goods outside of Iowa. Because 44 of the 45 other States which impose corporate income taxes use a three-factor formula involving property, payroll, and sales, [FN1] Iowa's practice insures that out-***284** of-statebusinesses selling in Iowa will have higher total tax payments than local businesses. This result follows from the fact that Iowa attributes to itself all of the income derived from sales in Iowa, while other taxing States--using the three-factor formula--are also taxing some portion of the same income through attribution to property or payroll in those States.

FN1. Those 44 States are as follows: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Virginia, and Wisconsin.
West Virginia, the 45th State, uses a two-factor formula which omits the sales component. Colorado also has a two-factor property and sales formula, and Missouri a one-factor sales formula, which are available to taxpayers at their option as alternatives to the three-factor formula.

This surcharge on Iowa sales increases to the extent that a business' plant and labor force are located outside Iowa. It can be avoided altogether only by locating all property and payroll in Iowa; an Iowa manufacturer selling only in Iowa will never have any portion of its income attributed to any other State. And to the extent that an Iowa manufacturer makes its sales in States other than Iowa, its overall state tax liability will be reduced. Assuming comparable tax rates, its liability to other States, in which sales constitute only one-third of the apportionment formula, will be far less than the amount it would have owed with a comparable volume of sales in Iowa, where sales are the exclusive mode of apportioning income. The effect of Iowa's formula, then, is to penalize out-of-state manufacturers for selling in Iowa and to subsidize Iowa manufacturers for selling in other States.

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***285 **2351** This appeal requires us to determine whether these economic effects of the Iowa apportionment formula violate either the Due Process Clause or the Commerce Clause. I now turn to those questions.

***286** II

For the reasons given by the Court, *ante*, at 2343-2345, I agree that application of Iowa's formula does not violate the Due Process Clause. The decisions of this Court make it clear that arithmetical perfection is not to be expected from apportionment formulae. *International Harvester Co. v. Evatt*, 329 U.S. 416, 67 S.Ct. 444, 91 L.Ed. 390 (1947). It has been said that the "apportionment theory is a mongrel one, a cross between desire not to interfere with state taxation and desire at the same time not utterly to crush out interstate commerce." *Northwest Airlines, Inc. v. Minnesota*, 322 U.S. 292, 306, 64 S.Ct. 950, 957, 88 L.Ed. 1283 (1944) (Jackson, J., concurring). It owes its existence to the fact that with respect to a business earning income through a series of transactions beginning with manufacturing in one State and ending with a sale in another, a precise--or even wholly logical--determination of the State in which any specific portion of the income was earned is impossible. *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 120-121, 41 S.Ct. 45, 46-47, 65 L.Ed. 165 (1920).

Hence, the fact that a particular formula--like the one at issue here--may permit a State to tax some income actually "located" in another State is not in and of itself a basis for ***287** finding a due process violation. [FN3] Were it otherwise, any formula deviating in the smallest detail from that used in other States would be invalid. Because there is no ideal means of "locating" any State's rightful share, such uniformity cannot be dictated by this Court. Hence, the decisions of this Court properly require the taxpayer claiming a due process violation to show that the apportionment is "out of all appropriate proportion to the business transacted." *Hans Rees' Sons, Inc. v. North Carolina ex rel. Maxwell*, 283 U.S. 123, 135, 51 S.Ct. 385, 389, 75 L.Ed.2d 879 (1931). As appellant has failed to make any such showing, I agree with the Court that no due process violation has been made out here.

FN3. This does not mean, as the Court suggests, *ante*, at 2346- 2348, that this Court is disabled from ever determining whether a particular apportionment formula imposes multiple burdens upon or discriminates against interstate commerce. See *General Motors Corp. v. District of Columbia*, 380 U.S. 553, 85 S.Ct. 1156, 14 L.Ed.2d 68 (1965); *Bass, Ratcliff & Gretton, Ltd. v. State Tax Comm'n*, 266 U.S. 271, 45 S.Ct. 82, 69 L.Ed. 282 (1924); *Underwood Typewriter Co. v. Chamberlain*, 254 U.S. 113, 41 S.Ct. 45, 65 L.Ed. 165 (1920). Regardless of which formula more accurately locates the State in which any particular segment of income is earned, it is a mathematical fact that the use of different formulae may result in taxation on more than 100% of the corporation's income under the State's own definitions, as well as in skewed tax effects. See n. 2, *supra*. When this result has a predictably burdensome or discriminatory effect, Commerce Clause scrutiny is triggered. See Part III, *infra*. The effects of the challenged formula upon the particular corporation's income is strictly related only to inquiry under the Due Process Clause, since Commerce Clause analysis focuses on the impact upon commerce in general.

This conclusion does not *ipso facto* mean that Commerce Clause strictures are satisfied as well. This Court's decisions dealing with state levies that discriminate against out-of-state business, as Iowa's formula does, compel a more detailed inquiry.

****2352** III

A

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[T]he constitutional inquiry relates not simply to the form of the particular tax, but to its effect on competition in the several States.

As indicated in Part I above, application of Iowa's single factor-sales apportionment formula, in the context of general use of three-factor formulae, inevitably handicaps out-of-state businesses competing for sales in Iowa. The handicap will diminish to the extent that the corporation locates its plant and labor force in Iowa, but some competitive disadvantage will remain unless all of the corporate property and payroll are relocated in Iowa. [FN4] In the absence of congressional ****2353** action, the Commerce Clause constrains us to view the State's interest in retaining this particular levy as against the constitutional preference for an open economy. See, *e. g., Raymond Motor Transp., Inc. v. Rice*, 434 U.S., at 440-442, 98 S.Ct., at 793-794; *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970); *Di Santo v. Pennsylvania*, 273 U.S. 34, 44, 47 S.Ct. 267, 271, 71 L.Ed. 524 (1927) (Stone, J., dissenting); Dowling, Interstate Commerce and State Power, 27 Va.L.Rev. 1, 14-15, and n. 20 (1940).

FN4. The clog on commerce present here is similar to the risk of imposing "multiple burdens" on interstate commerce against which the Court has warned in various decisions. See, *e. g., Western Live Stock v. Bureau of Revenue*, 303 U.S. 250, 255-256, 58 S.Ct. 546, 548-549, 82 L.Ed. 823 (1938);

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In this case, Iowa corporations will not risk additional burdens when they make out-of-state sales. Cf. *Hunt v. Washington Apple Advertising Comm'n*, 432 U.S. 333, 351, 97 S.Ct. 2434, 2445, 53 L.Ed.2d 383 (1977). Indeed, to the extent that they shift sales out of Iowa, their overall state tax liability will decrease. Out-of-state corporations selling in Iowa, however, do face the prospect of multiple burdens. Hence, there is clear discrimination against out-of-state corporations, which is the consequence of the particular multiple burden imposed.

***290** B

Iowa's interest in any particular level of tax revenues is not affected by the use of the single-factor sales formula. It cannot be predicted with certainty that its application will result in higher revenues than any other formula. [FN5] If Iowa needs more revenue, it can adjust its tax rates. That adjustment would not have the discriminatory impact necessarily flowing from the choice of the single-factor sales formula. [FN6] Hence, if Iowa's choice is to be sustained, it cannot be by virtue of the State's interest in protecting its fisc or its power to tax. No other justification is offered. If we are to uphold Iowa's apportionment formula, it must be because no consistent principle can be developed that could account for the invalidation of the Iowa formula, yet support application of other States' imprecise formulae.

FN5. For example, if Iowa switched to a three-factor formula and retained the same rates, revenues from out-of-state corporations would decrease, since Iowa would no longer be attributing to itself all of the income earned by Iowa sales of such corporations. Revenues from corporations located in Iowa, however, would increase, since Iowa would now be attributing to itself some portion of the income earned by those corporations' out-of-state sales. See also n. 2, *supra*.

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***291** C

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The opposite is true here. In the context of virtually universal use of the basic three-factor formula, Iowa's use of the single-factor sales formula necessarily discriminates against out-of-state manufacturers. The only remaining question, then, is whether Iowa's scheme may be saved by the fact that its discriminatory nature depends on context: If other States were not virtually unanimous in their use of an opposing ***293** formula, past decisions would make it difficult to single out Iowa's scheme as more offensive than any other.

D

On several occasions, this Court has compared a state statutory requirement against the practice in other States in determining the statute's validity under the Commerce Clause.

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These cases lead me to believe that it is not only proper but essential to determine the validity of the Iowa formula against the background of practices in the other States. If one State's regulatory or taxing statute is significantly "out of line" with other States' rules, *Bibb, supra,* 359 U.S., at 530, 79 S.Ct., at 968, and if by virtue of that departure from the general practice it burdens or discriminates against interstate commerce, Commerce Clause scrutiny is triggered, and this Court must invalidate it unless it is justified by a legitimate local purpose outweighing the harm to interstate commerce, *Pike v. Bruce Church, Inc.*, 397 U.S., at 142, 90 S.Ct., at 847; accord, *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 804, 96 S.Ct. 2488, 2495, 49 L.Ed.2d 220 (1976). There probably can be no fixed rule ***296** as to how nearly uniform the countervailing state policies must be; that is, there can be no rule of 26 States, of 35, or of 45. Commerce Clause inquiries generally do not run in such precise channels. The degree of conflict and its resulting impact on commerce must be weighed in the circumstances of each case. But the difficulty of engaging in that weighing process does not permit this Court to avoid its constitutional duty and allow an individual State to erect "an unreasonable clog upon the mobility of commerce," *Baldwin v. G. A. F. Seelig, Inc.,* 294 U.S., at 527, 55 S.Ct. at 502, by taking advantage of the other States' commendable trend toward uniformity.

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437 U.S. 267, 98 S.Ct. 2340, 57 L.Ed.2d 197

Supreme Court of the United States
DEAN MILK CO.
v.
CITY OF MADISON, WIS., et al.
No. 258.

Argued Dec. 7, 1950.
Jan. 15, 1951.

West Headnotes

****296 *350** Messrs. Jacob Geffs and George S. Geffs, Janesville, Wis., for appellant.
Messrs. Harold E. Hanson and Walter P. Ela, Madison, Wis., for appellees.

Mr. Justice CLARK delivered the opinion of the Court.
This appeal challenges the constitutional validity of two sections of an ordinance of the City of Madison, Wisconsin, regulating the sale of milk and milk products within the municipality's jurisdiction. One section in issue makes it unlawful to sell any milk as pasteurized unless it has been processed and bottled at an approved pasteurization plant within a radius of five miles from the central square of Madison. Another section, which prohibits the sale of milk, or the importation, receipt or storage of milk for sale, in Madison unless from a source of supply possessing a permit issued after inspection by Madison officials, is attacked insofar as it expressly relieves municipal authorities from any duty to inspect farms ***351** located beyond twenty-five miles from the center of the city.

FN1 & 2 *** [giving Madison statutory language]

Appellant is an Illinois corporation engaged in distributing milk and milk products in Illinois and Wisconsin. It contended below, as it does here, that both the five-mile limit on pasteurization plants and the twenty-five-mile limit on sources of milk violate the Commerce Clause and the Fourteenth Amendment to the Federal Constitution. The Supreme Court of Wisconsin upheld the five-mile limit on pasteurization. As to the twenty-five-mile limitation the court ordered the complaint dismissed for want of a justiciable controversy. 1950, 257 Wis. 308, 43 N.W.2d 480. This appeal, contesting both rulings, invokes the jurisdiction of this Court under 28 U.S.C. s 1257(2), 28 U.S.C.A. s 1257(2).

FN3. ***

The City of Madison is the county seat of Dane County. Within the county are some 5,600 dairy farms with total ***352** raw milk production in excess of 600,000,000 pounds annually and more than ten times the requirements of Madison. Aside from the milk supplied to Madison, fluid milk produced****297** in the county moves in large quantities to Chicago and more distant consuming areas, and the remainder is used in making cheese, butter and other products. At the time of trial the Madison milkshed was not of ‘Grade A’ quality by the standards recommended by the United States Public Health Service, and no milk labeled ‘Grade A’ was distributed in Madison.

The area defined by the ordinance with respect to milk sources encompasses practically all of Dane County and includes some 500 farms which supply milk for Madison. Within the five-mile area for pasteurization are plants of five processors, only three of which are engaged in the general wholesale and retail trade in Madison. Inspection of these farms and plants is scheduled once every thirty days and is performed by two municipal inspectors, one of whom is full-time. The courts below found that the ordinance in question promotes convenient, economical and efficient plant inspection.

Appellant purchases and gathers milk from approximately 950 farms in northern Illinois and southern Wisconsin, none being within twenty-five miles of Madison. Its pasteurization plants are located at Chemung and Huntley, Illinois, about 65 and 85 miles respectively from Madison. Appellant was denied a license to sell its products within Madison solely because its pasteurization plants were more than five miles away.

It is conceded that the milk which appellant seeks to sell in Madison is supplied from farms and processed in plants licensed and inspected by public health authorities of Chicago, and is labeled ‘Grade A’ ***

[1] Upon these facts we find it necessary to determine only the issue raised under the Commerce Clause, for we agree with appellant that the ordinance imposes an undue burden on interstate commerce.

*** We assume that difficulties in sanitary regulation of milk and milk products originating in remote areas may present a situation in which 'upon a consideration of all the relevant facts and circumstances it appears that the matter is one which may appropriately be regulated in the interest of the safety, health and well-being of local communities * * *.' Parker v. Brown, 1943, 317 U.S. 341, 362-363, 63 S.Ct. 307, 319, 87 L.Ed. 315; see H. P. Hood & Sons v. Du Mond, 1949, 336 U.S. 525, 531-532, 69 S.Ct. 657, 661, 93 L.Ed. 865. We also assume that since Congress has not spoken to the contrary, the subject matter of the ordinance lies within the sphere of state regulation even though interstate commerce***354** may be affected. Milk Control Board v. Eisenberg Farm Products, 1939, 306 U.S. 346, 59 S.Ct. 528, 83 L.Ed. 752; see Baldwin v. G.A.F. Seelig, Inc., 1935, 294 U.S. 511, 524, 55 S.Ct. 497, 500, 79 L.Ed. 1032.

[7][8] But this regulation, like the provision invalidated in Baldwin v. G.A.F. Seelig, Inc., supra, in practical effect excludes****298** from distribution in Madison wholesome milk produced and pasteurized in Illinois. 'The importer * * * may keep his milk or drink it, but sell it he may not.' Id., 294 U.S. at page 521, 55 S.Ct. at page 500. In thus erecting an economic barrier protecting a major local industry against competition from without the State, Madison plainly discriminates against interstate commerce. This it cannot do, even in the exercise of its unquestioned power to protect the health and safety of its people, if reasonable nondiscriminatory alternatives, adequate to conserve legitimate local interests, are available. Cf. Baldwin v. G.A.F. Seelig, Inc., supra, 294 U.S. at page 524, 55 S.Ct. at page 500; State of Minnesota v. Barber, 1890, 136 U.S. 313, 328, 10 S.Ct. 862, 866, 34 L.Ed. 455. A different view, that the ordinance is valid simply because it professes to be a health measure, would mean that the Commerce Clause of itself imposes no limitations on state action other than those laid down by the Due Process Clause, save for the rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods. ***

> FN4. It is immaterial that Wisconsin milk from outside the Madison area is subjected to the same proscription as that moving in interstate commerce. Cf. Brimmer v. Rebman, 1891, 138 U.S. 78, 82-83, 11 S.Ct. 213, 214, 34 L.Ed. 862.

It appears that reasonable and adequate alternatives are available. If the City of Madison prefers to rely upon its own officials for inspection of distant milk ***355** sources, such inspection is readily open to it without hardship for it could charge the actual and reasonable cost of such inspection to the importing producers and processors. *** [Under the Model Milk Ordinance recommended by the United States Public Health Service] the importing city obtains milk ratings based on uniform standards and established by health authorities in the jurisdiction where production and processing occur. The receiving city may ***356** determine the extent of enforcement of sanitary standards in the exporting area by verifying the accuracy of safety ratings of specific plants or of the milkshed in the distant jurisdiction through the United States Public Health Service, which routinely and on request spot checks the local ratings. The ****299** Commissioner testified that Madison consumers 'would be safeguarded adequately' under either proposal and that he had expressed no preference. The milk sanitarian of the Wisconsin State Board of Health testified that the State Health Department recommends the adoption of a provision based on the Model Ordinance. Both officials agreed that a local health officer would be justified in relying upon the evaluation by the Public Health Service of enforcement conditions in remote producing areas.

> FN5. ***

[9][10] To permit Madison to adopt a regulation not essential for the protection of local health interests and placing a discriminatory burden on interstate commerce would invite a multiplication of preferential trade areas destructive of the very purpose of the Commerce Clause. Under the circumstances here presented, the regulation must yield to the principle that 'one state in its dealings with another may not place itself in a position of economic isolation.' Baldwin v. G.A.F. Seelig, Inc., supra, 294 U.S. at page 527, 55 S.Ct. at page 502.

For these reasons we conclude that the judgment below sustaining the five-mile provision as to pasteurization must be reversed.

[11] The Supreme Court of Wisconsin thought it

unnecessary to pass upon the validity of the twenty-five-mile limitation, apparently in part for the reason that this issue was made academic by its decision upholding the five-mile section. In view of our conclusion as to the latter provision, a determination of appellant's contention as to the other section is now necessary. As to this ***357** issue, therefore, we vacate the judgment below and remand for further proceedings not inconsistent with the principles announced in this opinion. It is so ordered.

Judgment vacated and cause remanded.

Mr. Justice BLACK, with whom Mr. Justice DOUGLAS and Mr. Justice MINTON concur, dissenting.
Today's holding invalidates s 7.21 of the Madison, Wisconsin, ordinance on the following reasoning: (1) the section excludes wholesome milk coming from Illinois; (2) this imposes a discriminatory burden on interstate commerce; (3) such a burden cannot be imposed where, as here, there are reasonable, nondiscriminatory and adequate alternatives available. I disagree with the Court's premises, reasoning, and judgment.

(1) This ordinance does not exclude wholesome milk coming from Illinois or anywhere else. It does require that all milk sold in Madison must be pasteurized within five miles of the center of the city. But there was no finding in the state courts, nor evidence to justify a finding there or here, that appellant, Dean Milk Company, is unable to have its milk pasteurized within the defined geographical area. As a practical matter, so far as the record shows, Dean can easily comply with the ordinance whenever it wants to. Therefore, Dean's personal preference to pasteurize in Illinois, not the ordinance, keeps Dean's milk out of Madison.

***

(3) This health regulation should not be invalidated merely because the Court believes that alternative milk-inspection methods might insure the cleanliness and healthfulness of Dean's Illinois milk. *** In my view, to use this ground now elevates the right to traffic in commerce for profit above ***359** the power of the people to guard the purity of their daily diet of milk.

***

From what this record shows, and from what it fails to show, I do not think that either of the alternatives suggested by the Court would assure the people of Madison as pure a supply of milk as they receive under their own ordinance. On this record I would uphold the Madison law. At the very least, however, I would not invalidate it without giving the parties a chance to present evidence and get findings on the ultimate issues the Court thinks crucial-namely, the relative merits of the Madison ordinance and the alternatives suggested by the Court today.

U.S. 1951.
Dean Milk Co. v. City of Madison, Wis.
340 U.S. 349, 71 S.Ct. 295, 95 L.Ed. 329

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Briefs and Other Related Documents

Supreme Court of the United States
James B. HUNT, Jr., Governor of the State of North Carolina, et al., Appellants,
v.
WASHINGTON STATE APPLE ADVERTISING COMMISSION.
No. 76-63.

Argued Feb. 22, 1977.
Decided June 20, 1977.

****2436 *333** Syllabus*

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Appellee, a statutory agency for the promotion and protection of the Washington State apple industry and composed of 13 state growers and dealers chosen from electoral districts by their fellow growers and dealers, all of whom by mandatory assessments finance appellees operations, brought this suit challenging the constitutionality of a North Carolina statute requiring that all apples sold or shipped into North Carolina in closed containers be identified by no grade on the container other than the applicable federal grade or a designation that the apples are not graded. A three-judge District Court granted the requested injunctive and declaratory relief, holding that appellee had standing to challenge the statute, that the $10,000 jurisdictional amount of 28 U.S.C. s 1331 was satisfied, and that the challenged statute unconstitutionally discriminated against commerce insofar as it affected the interstate shipment of Washington apples, Held:

1. Appellee has standing to bring this action in a representational capacity. Pp. 2440-2443.

(a) An association has standing to bring suit on behalf of its members when (1) its members would otherwise have standing to sue in their own right; (2) the interests it seeks to protect are germane to the organization's purpose; and (3) neither the claim asserted nor the relief requested requires the participation in the lawsuit of each of the individual members. Warth v. Seldin, 422 U.S. 490, 95 S.Ct. 2197, 45 L.Ed.2d 343. Pp. 2441-2442.

*** [standing issue deleted]

3. The North Carolina statute violates the Commerce Clause by burdening and discriminating against the interstate sale of Washington apples. Pp. 2444-2447.

(a) The statute raises the costs of doing business in the North Carolina market for Washington growers and dealers while leaving unaffected their North Carolina counterparts, who were still free to market apples under the federal grade or none at all. Pp. 2445-2446.

(b) The statute strips the Washington apple industry of the competitive and economic advantages it has earned for itself by an expensive, stringent mandatory state inspection and grading system that exceeds federal requirements. By requiring Washington apples to be sold under the inferior grades of their federal counterparts, the North Carolina statute offers the North Carolina apple industry the very sort of protection against out-of-state competition that the Commerce Clause was designed to prohibit. Pp. 2445-2446.

***335** (c) Even if the statute was not intended to be discriminatory and was enacted for the declared purpose of protecting consumers from deception and fraud because of the multiplicity of state grades, the statute does remarkably little to further that goal, at least with respect to Washington apples and grades, for it permits marketing of apples in closed containers under no grades at all and does nothing to purify the flow of information at the retail level. Moreover, Washington grades could not have led to the type of deception at which the statute was assertedly aimed, since those grades equal or surpass the comparable federal standards. Pp. 2446-2447.

(d) Nondiscriminatory alternatives to the outright ban of Washington State grades are readily available. Pp. 2446-2447. 408 F.Supp. 857, affirmed.

John R. Jordan, Jr., Raleigh, N. C., for appellants.
Slade Gorton, Atty. Gen., Olympia, Wash., for appellee.

* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Timber & Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499

Mr. Chief Justice BURGER delivered the opinion of the Court.

In 1973, North Carolina enacted a statute which required, inter alia, all closed containers of apples sold, offered for sale, or shipped into the State to bear "no grade other than the applicable U.S. grade or standard." N.C.Gen.Stat. s 106-189.1 (1973). In an action brought by the Washington State Apple Advertising Commission, a three-judge Federal District Court invalidated the statute insofar as it prohibited the display of Washington State apple grades on the ground that it unconstitutionally discriminated against interstate commerce.

***336 **2438** The specific questions presented on appeal are (a) whether the Commission had standing to bring this action; (b) if so, whether it satisfied the jurisdictional-amount requirement of 28 U.S.C. s 1331; and (c) whether the challenged North Carolina statute constitutes an unconstitutional burden on interstate commerce.

FN1. ***

(1)

Washington State is the Nation's largest producer of apples, its crops accounting for approximately 30% of all apples grown domestically and nearly half of all apples shipped in closed containers in interstate commerce. As might be expected, the production and sale of apples on this scale is a multimillion dollar enterprise which plays a significant role in Washington's economy. Because of the importance of the apple industry to the State, its legislature has undertaken to protect and enhance the reputation of Washington apples by establishing a stringent, mandatory inspection program, administered by the State's Department of Agriculture, which requires all apples shipped in interstate commerce to be tested under strict quality standards and graded accordingly. In all cases, the Washington State grades, which have gained substantial acceptance in the trade, are the equivalent of, or superior to, the comparable grades and standards adopted by the United States Department of Agriculture (USDA). Compliance with the Washington inspection scheme costs the State's growers approximately $1 million each year.

In addition to the inspection program, the state legislature has sought to enhance the market for Washington apples through the creation of a state agency, the Washington State Apple Advertising Commission, charged with the statutory ***337** duty of promoting and protecting the State's apple industry. The Commission itself is composed of 13 Washington apple growers and dealers who are nominated and elected within electoral districts by their fellow growers and dealers. Wash.Rev.Code ss 15.24.020, 15.24.030 (1974). Among its activities are the promotion of Washington apples in both domestic and foreign markets through advertising, market research and analysis, and public education, as well as scientific research into the uses, development, and improvement of apples. Its activities are financed entirely by assessments levied upon the apple industry, s 15.24.100; in the year during which this litigation began, these assessments totaled approximately $1.75 million. The assessments, while initially fixed by statute, can be increased only upon the majority vote of the apple growers themselves. s 15.24.090.

In 1972, the North Carolina Board of Agriculture adopted an administrative regulation, unique in the 50 States, which in effect required all closed containers of apples shipped into or sold in the State to display either the applicable USDA grade or none at all. State grades were expressly prohibited. In addition to its obvious consequence prohibiting the display of Washington State apple grades on containers of apples shipped into North Carolina, the regulation presented the Washington apply industry with a marketing problem of potentially nationwide significance. Washington apple growers annually ship in commerce approximately 40 million closed containers of apples, nearly 500,000 of which eventually find their way into North Carolina, stamped with the applicable Washington State variety ***338** and grade. It is the industry's practice to purchase these containers preprinted with the various apple varieties ****2439** and grades, prior to harvest. After these containers are filled with apples of the appropriate type and grade, a substantial portion of them are placed in cold-storage warehouses where the grade labels identify the product and facilitate its handling. These apples are then shipped as needed throughout the year; after February 1 of each year, they constitute approximately two-thirds of all apples sold in fresh markets in this country. Since the ultimate destination of these apples is unknown at the time they are placed in storage, compliance with North Carolina's unique regulation would have required Washington growers to obliterate the printed labels on containers shipped to North Carolina, thus giving their product a damaged appearance. Alternatively, they could have changed their marketing practices to accommodate the needs of the

North Carolina market, i. e., repack apples to be shipped to North Carolina in containers bearing only the USDA grade, and/or store the estimated portion of the harvest destined for that market in such special containers. As a last resort, they could discontinue the use of the preprinted containers entirely. None of these costly and less efficient options was very attractive to the industry. Moreover, in the event a number of other States followed North Carolina's lead, the resultant inability to display the Washington grades could force the Washington growers to abandon the State's expensive inspection and grading system which their customers had come to know and rely on over the 60-odd years of its existence.

FN2. & 3 *** [giving NC statute]

*** [Court's conclusion that the standing and amount in controversy requirements were satisfied was deleted]

(4)

We turn finally to the appellants' claim that the District Court erred in holding that the North Carolina statute violated the Commerce Clause insofar as it prohibited the display of Washington State grades on closed containers of apples shipped into the State. Appellants do not really contest the District Court's determination that the challenged statute burdened the Washington apple industry by increasing its ***349** costs of doing business in the North Carolina market and causing it to lose accounts there. Rather, they maintain that any such burdens on the interstate sale of Washington apples were far outweighed by the local benefits flowing from what they contend was a valid exercise of North Carolina's inherent police powers designed to protect its citizenry from fraud and deception in the marketing of apples.

Prior to the statute's enactment, appellants point out, apples from 13 different States were shipped into North Carolina for sale. Seven of those States, including the State of Washington, had their own grading systems which, while differing in their standards, used similar descriptive labels (e. g., fancy, extra fancy, etc.). This multiplicity of inconsistent state grades, as the District Court itself found, posed dangers of deception and confusion not only in the North Carolina market, but in the Nation as a whole. The North Carolina statute, appellants claim, was enacted to eliminate this source of deception and confusion by replacing the numerous state grades with a single uniform standard. Moreover, it is contended that North Carolina sought to accomplish this goal of uniformity in an evenhanded manner as evidenced by the fact that its statute applies to all apples sold in closed containers in the State without regard to their point of origin. Nonetheless, appellants argue that the District Court gave "scant attention" to the obvious benefits flowing from the challenged legislation and to the long line of decisions from this Court holding that the States possess "broad powers" to protect local purchasers from fraud and deception in the marketing of foodstuffs. E. g., Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 83 S.Ct. 1210, 10 L.Ed.2d 248 (1963); ****2445**Pacific States Box & Basket Co. v. White, 296 U.S. 176, 56 S.Ct. 159, 80 L.Ed. 138 (1935); Corn Products Refining Co. v. Eddy, 249 U.S. 427, 39 S.Ct. 325, 63 L.Ed. 689 (1919).

[9][10] As the appellants properly point out, not every exercise of state authority imposing some burden on the free flow of commerce is invalid. E. g., ***350**Great Atlantic & Pacific Tea Co. v. Cottrell, 424 U.S. 366, 371, 96 S.Ct. 923, 928, 47 L.Ed.2d 55 (1976); Freeman v. Hewit, 329 U.S. 249, 252, 67 S.Ct. 274, 276, 91 L.Ed. 265 (1946). Although the Commerce Clause acts as a limitation upon state power even without congressional implementation, e. g., Great Atlantic & Pacific Tea Co., supra, 424 U.S. at 370-371, 96 S.Ct., at 927-928; Freeman v. Hewit, supra, 329 U.S. at 252, 67 S.Ct., at 276; Cooley v. Board of Wardens, 12 How. 299, 13 L.Ed. 996 (1852), our opinions have long recognized that,

"in the absence of conflicting legislation by Congress, there is a residuum of power in the state to make laws governing matters of local concern which nevertheless in some measure affect interstate commerce or even, to some extent, regulate it." Southern Pacific Co. v. Arizona, ex rel. Sullivan, 325 U.S. 761, 767, 65 S.Ct. 1515, 1519, 89 L.Ed. 1915 (1945).

Moreover, as appellants correctly note, that "residuum" is particularly strong when the State acts to protect its citizenry in matters pertaining to the sale of foodstuffs. Florida Lime & Avocado Growers, Inc., supra, 373 U.S. at 146, 83 S.Ct., at 1219. By the same token, however, a finding that state legislation furthers matters of legitimate local concern, even in the health and consumer protection areas, does not end the inquiry. Such a view, we have noted, "would mean that the Commerce Clause of itself imposes no limitations on state action . . . save for the rare instance where a state artlessly discloses an avowed purpose to discriminate against interstate goods."

Dean Milk Co. v. Madison, 340 U.S. 349, 354, 71 S.Ct. 295, 298, 95 L.Ed. 329 (1951). Rather, when such state legislation comes into conflict with the Commerce Clause's overriding requirement of a national "common market," we are confronted with the task of effecting an accommodation of the competing national and local interests. Pike v. Bruce Church, Inc., 397 U.S. 137, 142, 90 S.Ct. 844, 847, 25 L.Ed.2d 174 (1970); Great Atlantic & Pacific Tea Co., supra, 424 U.S. at 370-372, 96 S.Ct., at 927-928. We turn to that task.

As the District Court correctly found, the challenged statute has the practical effect of not only burdening interstate sales of Washington apples, but also discriminating against them. This discrimination takes various forms. The first, and most ***351** obvious, is the statute's consequence of raising the costs of doing business in the North Carolina market for Washington apple growers and dealers, while leaving those of their North Carolina counterparts unaffected. As previously noted, this disparate effect results from the fact that North Carolina apple producers, unlike their Washington competitors, were not forced to alter their marketing practices in order to comply with the statute. They were still free to market their wares under the USDA grade or none at all as they had done prior to the statute's enactment. Obviously, the increased costs imposed by the statute would tend to shield the local apple industry from the competition of Washington apple growers and dealers who are already at a competitive disadvantage because of their great distance from the North Carolina market.

Second, the statute has the effect of stripping away from the Washington apple industry the competitive and economic advantages it has earned for itself through its expensive inspection and grading system. The record demonstrates that the Washington apple-grading system has gained nationwide acceptance in the apple trade. Indeed, it contains numerous affidavits from apple brokers and dealers located both inside and outside of North Carolina who state their preference, and that of their customers, for apples graded under the Washington, as opposed to the USDA, system because of the former's greater consistency,****2446** its emphasis on color, and its supporting mandatory inspections. Once again, the statute had no similar impact on the North Carolina apple industry and thus operated to its benefit.

Third, by prohibiting Washington growers and dealers from marketing apples under their State's grades, the statute has a leveling effect which insidiously operates to the advantage of local apple producers. As noted earlier, the Washington State grades are equal or superior to the USDA grades in all corresponding categories. Hence, with free market forces at ***352** work, Washington sellers would normally enjoy a distinct market advantage vis-a-vis local producers in those categories where the Washington grade is superior. However, because of the statute's operation, Washington apples which would otherwise qualify for and be sold under the superior Washington grades will now have to be marketed under their inferior USDA counterparts. Such "downgrading" offers the North Carolina apple industry the very sort of protection against competing out-of-state products that the Commerce Clause was designed to prohibit. At worst, it will have the effect of an embargo against those Washington apples in the superior grades as Washington dealers withhold them from the North Carolina market. At best, it will deprive Washington sellers of the market premium that such apples would otherwise command.

[11] Despite the statute's facial neutrality, the Commission suggests that its discriminatory impact on interstate commerce was not an unintended byproduct and there are some indications in the record to that effect. The most glaring is the response of the North Carolina Agriculture Commissioner to the Commission's request for an exemption following the statue's passage in which he indicated that before he could support such an exemption, he would "want to have the sentiment from our apple producers since they were mainly responsible for this legislation being passed . . . ." App. 21 (emphasis added). Moreover, we find it somewhat suspect that North Carolina singled out only closed containers of apples, the very means by which apples are transported in commerce, to effectuate the statute's ostensible consumer protection purpose when apples are not generally sold at retail in their shipping containers. However, we need not ascribe an economic protection motive to the North Carolina Legislature to resolve this case; we conclude that the challenged statute cannot stand insofar as it prohibits the ***353** display of Washington State grades even if enacted for the declared purpose of protecting consumers from deception and fraud in the marketplace.

[12] When discrimination against commerce of the type we have found is demonstrated, the burden falls on the State to justify it both in terms of the local benefits flowing from the statute and the unavailability of nondiscriminatory alternatives adequate to preserve the local interests at stake. Dean Milk Co. v. Madison, 340 U.S. at 354, 71 S.Ct., at

297. See also Great Atlantic & Pacific Tea Co., 424 U.S., at 373, 96 S.Ct., at 929; Pike v. Bruce Church, Inc., 397 U.S., at 142, 90 S.Ct., at 847; Polar Ice Cream & Creamery Co. v. Andrews, 375 U.S. 361, 375 n.9, 84 S.Ct. 378, 386, 11 L.Ed.2d 389 (1964); Baldwin v. G. A. F. Seelig, Inc., 294 U.S. 511, 524, 55 S.Ct. 497, 500, 79 L.Ed. 1032 (1935). North Carolina has failed to sustain that burden on both scores.

The several States unquestionably possess a substantial interest in protecting their citizens from confusion and deception in the marketing of foodstuffs, but the challenged statute does remarkably little to further that laudable goal at least with respect to Washington apples and grades. The statute, as already noted, permits the marketing of closed containers of apples under no grades at all. Such a result can hardly be thought to eliminate the problems of deception and confusion created by the multiplicity of differing state grades; indeed, it magnifies them by depriving purchasers of all information concerning the quality of the contents of closed apple containers. Moreover,****2447** although the statute is ostensibly a consumer protection measure, it directs its primary efforts, not at the consuming public at large, but at apple wholesalers and brokers who are the principal purchasers of closed containers of apples. And those individuals are presumably the most knowledgeable individuals in this area. Since the statute does nothing at all to purify the flow of information at the retail level, it does little to protect consumers against the problems it was designed to eliminate. Finally, we note that any potential***354** for confusion and deception created by the Washington grades was not of the type that led to the statute's enactment. Since Washington grades are in all cases equal or superior to their USDA counterparts, they could only "deceive" or "confuse" a consumer to his benefit, hardly a harmful result.

FN8. Indeed, the District Court specifically indicated in its findings of fact that there had been no showing that the Washington State grades had caused any confusion in the North Carolina market. 408 F.Supp., at 859.

[13] In addition, it appears that nondiscriminatory alternatives to the outright ban of Washington State grades are readily available. For example, North Carolina could effectuate its goal by permitting out-of-state growers to utilize state grades only if they also marked their shipments with the applicable USDA label. In that case, the USDA grand would serve as a benchmark against which the consumer could evaluate the quality of the various state grades. If this alternative was for some reason inadequate to eradicate problems caused by state grades inferior to those adopted by the USDA, North Carolina might consider banning those state grades which, unlike Washington's could not be demonstrated to be equal or superior to the corresponding USDA categories. Concededly, even in this latter instance, some potential for "confusion" might persist. However, it is the type of "confusion" that the national interest in the free flow of goods between the States demands be tolerated.

FN9. Our conclusion in this regard necessarily rejects North Carolina's suggestion that the burdens on commerce imposed by the statute are justified on the ground that the standardization required by the statute serves the national interest in achieving uniformity in the grading and labeling of foodstuffs.

The judgment of the District Court is

Affirmed.

Mr. Justice REHNQUIST took no part in the consideration or decision of the case.
U.S.N.C., 1977.
Hunt v. Washington State Apple Advertising Com'n
432 U.S. 333, 97 S.Ct. 2434, 53 L.Ed.2d 383

Briefs and Other Related Documents (Back to top)

• 1976 WL 181265 (Appellate Brief) Brief of Appellee (Dec. 20, 1976)

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Briefs and Other Related Documents

Supreme Court of the United States
CAMPS NEWFOUND/OWATONNA, INC., Petitioner,
v.
TOWN OF HARRISON, MAINE, et al.
No. 94-1988.

Argued Oct. 9, 1996.
Decided May 19, 1997.

*****1591** Syllabus* [*]
Petitioner, a Maine nonprofit corporation, operates a church camp for children, most of whom are not Maine residents. Petitioner****1592** is financed through camper tuition and other revenues. From 1989 to 1991, it paid over $20,000 per year in real estate and personal property taxes. A state statute provides a general exemption from those taxes for charitable institutions incorporated in Maine. With respect to institutions operated principally for the benefit of Maine nonresidents, however, a charity may only qualify for a more limited tax benefit, and then only if its weekly charge for services does not exceed $30 per person. Petitioner was ineligible for any exemption, because its campers were largely nonresidents and its weekly tuition was roughly $400 per camper. After respondent town of Harrison (Town) rejected its request for a refund of taxes already paid and a continuing exemption from future taxes, which was based principally on a claim that the tax exemption statute violated the Commerce Clause, petitioner filed suit and was awarded summary judgment by the Superior Court. The Maine Supreme Judicial Court reversed, holding that petitioner had not met its burden of persuasion that the statute is unconstitutional.

Held: An otherwise generally applicable state property tax violates the Commerce Clause if its exemption for property owned by charitable institutions excludes organizations operated principally for the benefit of nonresidents. Pp. 1595-1608.

(a) Because the Government lacked power to regulate interstate commerce during the Nation's first years, the States freely adopted measures fostering local interests without regard to possible prejudice to nonresidents, resulting in a “conflict of commercial regulations, destructive to the harmony of the States.” *Gibbons v. Ogden*, 9 Wheat. 1, 224, 6 L.Ed. 23 (Johnson, J., concurring in judgment). Arguably, this was the cause of the Constitutional Convention. *Ibid.* The Commerce Clause not only granted Congress express authority to override restrictive and conflicting state commercial regulations, but also effected a curtailment of state power even absent congressional legislation. Pp. 1595-1596.

(b) The Court is unpersuaded by the Town's arguments that the dormant Commerce Clause is inapplicable here, either because campers are ***565** not “articles of commerce,” or more generally because interstate commerce is not implicated. The camp is unquestionably engaged in commerce, not only as a purchaser, see *e.g.*, *Katzenbach v. McClung*, 379 U.S. 294, 300-301, 85 S.Ct. 377, 382, 13 L.Ed.2d 290, but also as a provider of goods and services akin to a hotel, see, *e.g.*, *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 244, 258, 85 S.Ct. 348, 351, 358, 13 L.Ed.2d 258. Although the latter case involved Congress' affirmative powers, its reasoning is applicable in the dormant Commerce Clause context. See, *e.g.*, *Hughes v. Oklahoma*, 441 U.S. 322, 326, n. 2, 99 S.Ct. 1727, 1731, n. 2, 60 L.Ed.2d 250. The Town's further argument that the dormant Clause is inapplicable because a real estate tax is at issue is also rejected. Even assuming, as the Town argues, that Congress could not impose a national real estate tax, States are not free to levy such taxes in a manner that discriminates against interstate commerce. *Pennsylvania v. West Virginia*, 262 U.S. 553, 596, 43 S.Ct. 658, 665, 67 L.Ed. 1117. Pp. 1596-1598.

(c) There is no question that if this statute targeted profit-making entities, it would violate the dormant Commerce Clause. The statute discriminates on its face against interstate commerce: It expressly

[*] FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Timber & Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

distinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market, singling out camps that serve mostly in-staters for beneficial tax treatment, and penalizing those camps that do a principally interstate business. Such laws are virtually *per se* invalid. *E.g., Fulton Corp. v. Faulkner,* 516 U.S. 325, 331, 116 S.Ct. 848, 854, 133 L.Ed.2d 796. Because the Town did not attempt to defend the statute by demonstrating that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives, *e.g., Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.,* 511 U.S. 93, 101, 114 S.Ct. 1345, 1351, 128 L.Ed.2d 13, the Court does not address this question. See *Fulton Corp.,* 516 U.S., at 333, 116 S.Ct., at 855. Pp. 1598-1602.

****1593** (d) The rule applicable to profit-making enterprises also applies to a discriminatory tax exemption for charitable and benevolent institutions. The dormant Commerce Clause's applicability to the nonprofit sector follows from this Court's decisions holding not-for-profit institutions subject to laws regulating commerce, *e.g., Associated Press v. NLRB,* 301 U.S. 103, 129, 57 S.Ct. 650, 654, 81 L.Ed. 953, and to the federal antitrust laws, *e.g., National Collegiate Athletic Assn. v. Board of Regents of Univ. of Okla.,* 468 U.S. 85, 100, n. 22, 104 S.Ct. 2948, 2960, n. 22, 82 L.Ed.2d 70. The Court has already held that the dormant Clause applies to activities not intended to earn a profit, *Edwards v. California,* 314 U.S. 160, 172, n. 1, 62 S.Ct. 164, 166, n. 1, 86 L.Ed. 119, and there is no reason why an enterprise's nonprofit character should exclude it from the coverage of either the affirmative or the negative aspect of the Clause, see, *e.g., Hughes v. Oklahoma,* 441 U.S., at 326, n. 2, 99 S.Ct., at 1731, n. 2. Whether operated on a for-profit or ***566** nonprofit basis, camps such as petitioner's purchase goods and services in competitive markets, offer their facilities to a variety of patrons, and derive revenues from a variety of local and out-of-state sources. Any categorical distinction on the basis of profit is therefore wholly illusory. Pp. 1602-1604.

(e) The Town's arguments that the exemption statute should be viewed as either a legitimate discriminatory subsidy of those charities that focus on local concerns, see, *e.g., West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 199, 114 S.Ct. 2205, 2214, 129 L.Ed.2d 157, or alternatively as a governmental "purchase" of charitable services falling within the narrow exception to the dormant Commerce Clause for States in their role as "market participants," see, *e.g., Hughes v. Alexandria Scrap Corp.,* 426 U.S. 794, 96 S.Ct. 2488, 49 L.Ed.2d 220; *Reeves, Inc. v. Stake,* 447 U.S. 429, 100 S.Ct. 2271, 65 L.Ed.2d 244, are unpersuasive. Although tax exemptions and subsidies serve similar ends, they differ in important and relevant respects that preclude approval of the statute at issue. See, *e.g., West Lynn,* 512 U.S., at 186, 200-201, 114 S.Ct., at 2215-2216 (SCALIA, J., concurring in judgment). As for the "market participant" argument, the Court has already rejected the Town's position in *New Energy Co. of Ind. v. Limbach,* 486 U.S. 269, 277, 108 S.Ct. 1803, 1809, 100 L.Ed.2d 302, and in any event respondents' open-ended exemption is not analogous to the industry-specific state actions approved in *Alexandria Scrap* and *Reeves.* Pp. 1604-1607.

(f) This case's facts, viewed in isolation, do not appear to pose any threat to the national economy's health. Nevertheless, history, including the history of commercial conflict that preceded the Constitutional Convention as well as the uniform course of Commerce Clause jurisprudence animated and enlightened by that early history, has shown that even the smallest discrimination invites significant inroads on national solidarity. See *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 523, 55 S.Ct. 497, 500, 79 L.Ed. 1032. Pp. 1607-1608.

655 A.2d 876, reversed.

[**OPINION**]

***

Justice STEVENS delivered the opinion of the Court. The question presented is whether an otherwise generally applicable state property tax violates the Commerce Clause of the United States Constitution, Art. I, § 8, cl. 3, because its exemption for property owned by charitable institutions excludes organizations ****1594** operated principally for the benefit of nonresidents.

I

Petitioner is a Maine nonprofit corporation that operates a summer camp for the benefit of children of the Christian Science faith. *** About 95 percent of the campers are not residents of Maine.

*** The Maine statute at issue, provides a general exemption from real estate and personal property taxes for "benevolent and charitable institutions incorporated" in the State. With respect to institutions that are "in fact conducted or operated principally for the benefit of persons who are not residents of Maine," however, a charity may only qualify for a more limited tax benefit, and then only if the weekly charge for services provided does not exceed $30 per person. § 652(1)(A)(1). Because most of the campers come from out ***569** of State, petitioner could not qualify for a complete exemption. And, since the weekly tuition was roughly $400, ****1595** petitioner was ineligible for any charitable tax exemption at all.

[FN2. & 3 deleted]

In 1992 petitioner made a formal request to the Town for a refund of taxes paid from 1989 through 1991, and a continuing exemption from future property taxes, based principally on a claim that the tax exemption statute violated the Commerce Clause of the Federal Constitution. ***

***

III

[1] We are unpersuaded by the Town's argument that the dormant Commerce Clause is inapplicable here, either because campers are not "articles of commerce," or, more generally, because the camp's "product is delivered and 'consumed' entirely within Maine." Brief for Respondents ***573** 17-18. Even though petitioner's camp does not make a profit, it is unquestionably engaged in commerce, not only as a purchaser, see *Katzenbach v. McClung*, 379 U.S. 294, 300-301, 85 S.Ct. 377, 382, 13 L.Ed.2d 290 (1964); *United States v. Lopez*, 514 U.S. 549, 558, 115 S.Ct. 1624, 1629, 131 L.Ed.2d 626 (1995), but also as a provider of goods and services. It markets those services, together with an opportunity to enjoy the natural beauty of an inland lake in Maine, to campers who are attracted to its facility from all parts of the Nation. The record reflects that petitioner "advertises for campers in [out-of-state] periodicals ... and sends its Executive Director annually on camper recruiting trips across the country." App. 49-50. Petitioner's efforts are quite successful; 95 percent of its campers come from out of State. The attendance of these campers necessarily generates the transportation of persons across state lines that has long been recognized as a form of "commerce." *Edwards v. California*, 314 U.S. 160, 172, 62 S.Ct. 164, 166, 86 L.Ed. 119 (1941); see also *Caminetti v. United States*, 242 U.S. 470, 491, 37 S.Ct. 192, 197, 61 L.Ed. 442 (1917); *Hoke* v. *United States*, 227 U.S. 308, 320, 33 S.Ct. 281, 283, 57 L.Ed. 523 (1913).

****1597** Summer camps are comparable to hotels that offer their guests goods and services that are consumed locally. In *Heart of Atlanta Motel, Inc. v. United States*, 379 U.S. 241, 85 S.Ct. 348, 13 L.Ed.2d 258 (1964), we recognized that interstate commerce is substantially affected by the activities of a hotel that "solicits patronage from outside the State of Georgia through various national advertising media, including magazines of national circulation." *Id.*, at 243, 85 S.Ct., at 350. In that case, we held that commerce was substantially affected by private race discrimination that limited access to the hotel and thereby impeded interstate commerce in the form of travel. *Id.*, at 244, 258, 85 S.Ct., at 351, 358; see *Lopez*, 514 U.S., at 558-559, 115 S.Ct., at 1629-1630. Official discrimination that limits the access of nonresidents to summer camps creates a similar impediment. Even when business activities are purely local, if " 'it is interstate commerce that feels the pinch, it does not matter how local the operation which applies the squeeze.' " *Heart of Atlanta*, 379 U.S., at 258, 85 S.Ct., at 358 ***574** quoting *United States v. Women's Sportswear Mfrs. Assn.*, 336 U.S. 460, 464, 69 S.Ct. 714, 716, 93 L.Ed. 805 (1949)).

Although *Heart of Atlanta* involved Congress' affirmative Commerce Clause powers, its reasoning is applicable here. As we stated in *Hughes v. Oklahoma*, 441 U.S. 322, 99 S.Ct. 1727, 60 L.Ed.2d 250 (1979): "The definition of 'commerce' is the same when relied on to strike down or restrict state legislation as when relied on to support some exertion of federal control or regulation." *Id.*, at 326, n. 2, 99 S.Ct., at 1731, n. 2. ***

The Town's arguments that the dormant Commerce Clause is inapplicable to petitioner because the campers are not "articles of commerce," or more generally that interstate commerce is not at issue here, are therefore unpersuasive. The services that petitioner provides to its principally out-of-state campers clearly have a substantial effect on commerce, as do state restrictions on making those services available to nonresidents. Cf. *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 391, 114 S.Ct. 1677, 1682-1683, 128 L.Ed.2d 399 (1994).

[2] The Town also argues that the dormant Commerce Clause is inapplicable because a real estate tax is at issue. We disagree. A tax on real estate, like any other tax, may impermissibly burden interstate commerce. We may assume as the Town argues (though the question is not before us) that Congress could not impose a national real estate tax. It does not follow that the States may impose real estate taxes in a manner that discriminates against interstate commerce. A State's "power to lay and collect taxes, comprehensive and necessary as that power is, cannot be exerted in a way which ***575** involves a discrimination against [interstate] commerce." *Pennsylvania v. West Virginia*, 262 U.S. 553, 596, 43 S.Ct. 658, 665, 67 L.Ed. 1117 (1923).

To allow a State to avoid the strictures of the dormant Commerce Clause by the simple device of labeling its discriminatory tax a levy on real estate would destroy the barrier against protectionism that the Constitution provides. We noted in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 114 S.Ct. 2205, 129 L.Ed.2d 157 (1994), that "[t]he paradigmatic ... law discriminating against interstate commerce is the protective [import] tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State." *Id.*, at 193, 114 S.Ct., at 2211. Such tariffs are "so patently unconstitutional that our cases reveal not a single attempt by a State ****1598** to enact one." *Ibid.* Yet, were the Town's theory adopted, a State could create just such a tariff with ease. The State would need only to pass a statute imposing a special real estate tax on property used to store, process, or sell imported goods. By gearing the increased tax to the value of the imported goods at issue, the State could create the functional equivalent of an import tariff. As this example demonstrates, to accept the Town's theory would have radical and unacceptable results.

We therefore turn to the question whether our prior cases preclude a State from imposing a higher tax on a camp that serves principally nonresidents than on one that limits its services primarily to residents.

*** [Analysis concluding that non-profit and benevolent institutions engage in interstate commerce deleted]

FEDERAL REPUBLIC OF GERMANY v. COMMISSION OF THE EUROPEAN COMMUNITIES

2000 E.C.R. 6864

19 September 2000

Case C-156/98

Germany brought action under (now) Article 230 EC for annulment of Commission Decision 98/476/EC of 21 January 1998 concerning tax concessions under Paragraph 52(8) of the German Income Tax Act (the EStG).

Article 87(1) of the Treaty prohibits state aid that distorts or threatens to distort competition between Member States, because such aid is incompatible with the common market (paragraph 3). However, Article 87(2) of the Treaty provides derogations for certain areas of Germany affected by the "division of Germany, in so far as such aid is required to compensate for the economic disadvantages caused by that division" (paragraph 4). Under Article 87(3)(a) and (c), "aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;... [and] aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest" are considered compatible with the common market (paragraph 5).

Under Article 52(8) of the EStG, certain natural persons and legal persons with their registered office and central administration in one of the new *Länder* that were formerly part of East Germany were granted certain tax advantages, such as the ability to deduct profits made on the sale of shares in capital companies from the cost of purchasing new shares in capital companies (paragraphs 8-9).

Applicability of Article 87(1)

Pursuant to Article 88(2) EC, the Commission, after giving Germany notice and opportunity to respond, decided that Article 52(8) of the EStG should be abolished because it constituted state aid to companies in the new *Länder* and West Berlin and was incompatible with the common market (paragraph 13). Germany applied to the ECJ for an annulment of the Commission's decision.

Germany first argued that the tax concessions in Article 52(8) ("the tax concessions") were not aids as defined by Article 87(1) because they were temporary, did not involve any transfer of state resources, and did not directly control the actions of investors (paragraphs 18-20). The ECJ held that even temporary state aids were prohibited if they threatened to distort competition (paragraph 24). Also, an indirect advantage conferred by the renunciation of tax revenue was a transfer of state resources (paragraph 25). Since the aid in this case would reduce the affected companies' operating budgets, the Commission did not err when it concluded that the German law threatened to distort competition (paragraph 31). Likewise, despite the small size of the aid, the ECJ held that the Commission correctly concluded that it would affect trade between Member States (paragraph 35).

The *De Minimis* Principle

The ECJ ruled that the Commission did not err in concluding that Article 52(8) of the EStG did not meet the *de minimis* exception to Article 87(1) EC because there was no guarantee that the aid granted under the law would not exceed the *de minimis* amount (paragraphs 37-42).

Applicability of Article 87(2)(c)

Germany argued that even if Article 52(8) EStG constituted state aid, that aid was compatible with the common market because it fell under the Article 87(2)(c) EC derogation for areas in East Germany, which applied even after the reunification of Germany. Germany argued that the contested provision was necessary to address the economic disadvantages borne by small and medium-sized undertakings in the former East German areas, because those undertakings had difficulty finding capital financing (paragraphs 44-45).

While the ECJ agreed that Article 87(2)(c) applied even after the reunification of Germany,[70] as a derogation from the general prohibition on state aid, the Court also found that Article 87(2)(c) must be construed narrowly (paragraph 48). The ECJ held that the Article only granted an exception from the prohibition on state aid to remedy economic disadvantages caused by the *physical division* of Germany, "such as the breaking of communication links and the loss of markets" (paragraph 52). It did not permit state aid to remedy the economic backwardness suffered by the new *Länder* due to the different politico-economic system that was adopted in East Germany (paragraph 55). Since Germany did not show that the contested measure was necessary to repair economic disadvantage caused by the geographic division of Germany, it was not protected under Article 87(2)(c).

[70] The provision was not repealed by the EU Treaty or the Treaty of Amsterdam.

Applicability of Article 87(3)(a) and (c)

The ECJ upheld the Commission's findings that the aid could not be prevented from benefiting large undertakings outside the former East German areas, and that it was not shown that the aid would result in improved economic activity in the areas eligible for aid under Article 87(3)(a) and (c) (paragraph 69).

Article 43

Germany argued that the Commission should not have analyzed the contested provision under Article (now) 43 EC. However, the ECJ found that once the Commission determined that the contested provision was a state aid incompatible with the common market, it had to go on to consider its compatibility with specific provisions of the EC Treaty, such as the Article 43 freedom of establishment (paragraph 78).

The ECJ noted that Article 43 included, under Article 48, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration, or principal place of business within the Community to pursue their activities in the Member State concerned through a subsidiary, branch, or agency (paragraph 81). For companies, the registered office is similar to nationality for natural persons. The ECJ held that even though not *all* German companies were eligible for the tax concessions, the fact that *only* German companies were eligible amounted to nationality discrimination (paragraph 86). While residents and non-residents are generally not similarly situated, in this case there was

> no objective difference of situation between a company established in a Member State other than the Federal Republic of Germany and carrying on economic activity in the new *Länder* through a branch, agency or fixed establishment, a company which cannot claim the benefit of the contested measure, and a company having its registered office on German territory, which does profit from the tax concession (paragraph 86).

Since the difference in treatment was unjustified, it was a discrimination prohibited under Article 43.

Obligation to State Reasons

Finally, Germany argued that the Commission had not sufficiently stated the reasoning for its decision. However, the ECJ found that the Commission gave sufficient reasoning from which Germany and the rest of the

Community could understand why it found a breach of the Article 87(1) prohibition on state aid. Also, although the Commission was brief in its reasoning on the applicability of the Article 87(2)(c) derogation for former East Germany, EC law on the point was well-settled.

Germany's application for annulment was dismissed.

COMMISSION OF THE EUROPEAN COMMUNITIES v. KINGDOM OF BELGIUM

2000 E.C.R. 7589

26 September 2000

Case C-478/98

The Commission, after giving Belgium an opportunity to respond, brought action against the State under (now) Article 226 EC for failure to fulfill obligations under (now) Article 56 EC by prohibiting certain Belgian residents from participating in a Eurobond offering by the Belgian government. Under the terms of the bond issue, Belgium waived withholding taxes as required for the Eurobond market, but it prohibited participation in the offering by Belgians other than banks, financial institutions, and institutional investors. Individual Belgians were prohibited from participating. After Belgium reported to the Commission that it believed that the prohibition did not violate the Treaty, the Commission brought action in the ECJ arguing that the prohibition impaired the freedom of capital movement, in violation of Article 56 EC.

Restriction

The ECJ held that the prohibition was not a purely internal matter, since the bonds were issued in German marks, subscribed by a syndicate of banks and financial institutions, listed on the Frankfurt stock exchange, and governed by German law (paragraph 16). Moreover, since banning non-institutional Belgian residents from participating in the issue went well beyond dissuading such investment, it had to be considered a restriction on capital movement (paragraph 19).

JUDGMENT OF THE COURT

19 September 2000 (1)

(Aid granted to undertakings in the new German Länder - Tax provision favouring investment)

In Case C-156/98,

Federal Republic of Germany, represented by C.-D. Quassowski, Regierungsdirektor in the Federal Ministry of Economic Affairs, acting as Agent, assisted by K.A. Schroeter, Rechtsanwalt, Hamburg, Department E C2, 108 Graurheindorfer Strasse, D-53117 Bonn,

applicant,

v

Commission of the European Communities, represented by P.F. Nemitz and D. Triantafyllou of its Legal Service, acting as Agents, assisted by M. Hilf, Director of the Community Law Department of the University of Hamburg, with an address for service in Luxembourg at the office of C. Gómez de la Cruz, of its Legal Service, Wagner Centre, Kirchberg,

defendant,

APPLICATION for annulment of Commission Decision 98/476/EC of 21 January 1998 on tax concessions under Paragraph 52(8) of the German Income Tax Act (the Einkommensteuergesetz) (OJ 1998 L 212, p. 50),

THE COURT,

composed of: G.C. Rodríguez Iglesias, President, L. Sevón (President of Chamber), P.J.G. Kapteyn, C. Gulmann, J.-P. Puissochet, P. Jann, H. Ragnemalm, M. Wathelet (Rapporteur) and V. Skouris, Judges,

Advocate General: A. Saggio,

Registrar: D. Louterman-Hubeau, Principal Administrator,

having regard to the Report for the Hearing,

after hearing oral argument from the parties at the hearing on 9 November 1999

after hearing the Opinion of the Advocate General at the sitting on 27 January 2000,

gives the following

Judgment

1.
By application lodged at the Court Registry on 24 April 1998 the Federal Republic of Germany brought an action under the first paragraph of Article 173 of the EC Treaty (now, after amendment, Article 230 EC) for annulment of Commission Decision 98/476/EC of 21 January 1998 on tax concessions under Paragraph 52(8) of the German Income Tax Act (the Einkommensteuergesetz) (OJ 1998 L 212, p. 50, 'the contested decision).

The legal and factual background

The relevant Community legislation

2.
The first paragraph of Article 52 of the EC Treaty (now, after amendment, the first paragraph of Article 43 EC) provides:

'Within the framework of the provisions set out below, restrictions on the freedom of establishment of nationals of a Member State in the territory of another Member State shall be abolished by progressive stages in the course of the transitional period. Such progressive abolition shall also apply to restrictions on the setting-up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of any Member State.

3.
Article 92(1) of the Treaty (now, after amendment, Article 87(1) EC) provides:

'Save as otherwise provided in this Treaty, any aid granted by a Member State or through State resources in any form whatsoever which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods shall, in so far as it affects trade between Member States, be incompatible with the common market.

4.
In accordance with Article 92(2) of the Treaty:

'The following shall be compatible with the common market:

...

(c) aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division.

5.
According to Article 92(3) of the Treaty:

'The following may be considered compatible with the common market:

(a) aid to promote the economic development of areas where the standard of living is abnormally low or where there is serious underemployment;

...

(c) aid to facilitate the development of certain economic activities or of certain economic areas, where such aid does not adversely affect trading conditions to an extent contrary to the common interest ...

...

6.
According to paragraph 6 of Commission communication 88/C 212/02 on the method for the application of Article 92(3)(a) and (b) to regional aid (OJ 1988 C 212, p. 2,'the 1988 communication), it is only exceptionally and on certain conditions that operating aid may be granted in areas eligible under Article 92(3)(a) of the Treaty.

7.
According to Commission notice 96/C 68/06 on the de minimis rule for State aid (OJ 1996 C 68, p. 9, the 'de minimis notice), which amends the Community guidelines of 20 May 1992 on State aid for small and medium-sized enterprises as indicated in Commission notice 92/C 213/02 (OJ 1992 C 213, p. 2), Article 92(1) of the Treaty is to be considered as not applying to aid the amount of which is below the ceiling of ECU 100 000 over a three-year period beginning when the first de minimis aid is granted. That rule does not apply to the sectors covered by the ECSC Treaty, to shipbuilding, transport or to aid granted in respect of expenditure related to agriculture or fishing.

The relevant national legislation

8.
Paragraph 6b of the Einkommensteuergesetz ('the EStG) allows natural persons residing in Germany and legal persons having their registered office in that Member State to transfer into certain reinvestments hidden reserves formed over a period of at least six years in certain fixed capital assets which have been revealed on the assignment of those assets for valuable consideration. In the case of the sale of shares in capital companies forming part of working capital, the second sentence of Paragraph 6b(1) permits the deduction of any profit from such sale on, in particular, the purchase of shares in capital companies, on condition that the purchase is made by a holding company within the meaning of the German Law of 17 December 1986 on holding companies. Those holding companies may deduct from the cost of purchasing new shares in capital companies 100% of the profit made on the sale of shares in capital companies.

9.
The opportunities under Paragraph 6b of the EStG of carrying hidden reserves forward were increased in the 1996 annual Tax Act by the introduction into the EStG of Paragraph 52(8). This provision, which entered into force on 1 January 1996, broadens the tax concession in Paragraph 6b for the financial years 1996, 1997 and 1998. Up to 100% of the gain may be set off against the costs of purchasing new shares in capital companies, provided that the purchase is connected to an increase in capital, or the setting-up of new capital companies, and provided that such companies have both their registered office and their central administration in one of the new Länder or in Berlin, and that they have no more than 250 employees at the time the shares are acquired; the gain may also be offset where the companies are holding companies the sole object of which is, according to their own statutes, to acquire, administer or sell temporary holdings in companies which, at the time those holdings are acquired, employ no more than 250 persons and have both their registered office

and central administration in one of the new Länder or in Berlin.

The contested decision

10.
By letter of 13 October 1995 the German Government, in response to the Commission's express request, gave the Commission notice of the introduction of Paragraph 52(8) into the EStG.

11.
By decision of 26 February 1997 the Commission initiated the procedure provided for by Paragraph 93(2) of the EC Treaty (now Article 88(2) EC) with regard to the amendment of the tax rules set out in Paragraph 6b of the EStG made by Article 52(8) thereof. At the end of the procedure the Commission adopted the contested decision.

12.
It is clear from Part IV of the statement of the reasons on which the contested decision is based that the Commission considered that Article 52(8) of the EStG indirectly favoured the undertakings in the new Länder and West Berlin to which that provision applied. According to the sixth paragraph of Part IV of the contested decision, 'The economic advantage conferred is the greater demand for shares in the indirect beneficiary companies as compared with the legal situation which existed before Paragraph 52(8) entered into force; investors, the direct beneficiaries, will consequently be prepared to acquire holdings in east German and Berlin companies on terms more favourable to those companies than those which would have been obtained if the measure had not been introduced. As a result, the volume of holdings in those companies will rise, or the terms of the acquisition of the holding (price as compared with nominal value, duration of holding, return on holding, etc.) will be shifted in favour of those companies, or both.

13.
According to Article 1(1) of the contested decision:

'The tax concession provided for in Paragraph 52(8) of the Income Tax Act constitutes State aid to companies with no more than 250 employees and having their registered office and central administration in the new Länder or West Berlin and is incompatible with the common market pursuant to Article 92(1) of the EC Treaty and Article 61(1) of the EEA Agreement.

14.
Article 2(1) of the contested decision provides:

'Any aid already paid under the scheme referred to in Article 1(1) is unlawful, having been granted before the Commission decision.

15.
Article 2(2) requires the Federal Republic of Germany to ensure that any aid unlawfully granted is repaid.

The pleas in law put forward by the Federal Republic of Germany and the findings of the Court

16.
The German Government puts forward six pleas in law in support of its application for annulment. The first two allege infringement of Article 190 of the EC Treaty (nowArticle 253 EC) by the contested decision and an error in law by the Commission in applying Article 92(1) of the Treaty. In the alternative, the applicant alleges failure to observe the de minimis rule, failure to take into consideration Article 92(2)(c) of the Treaty, the improper exercise of the Commission's discretion in connection with Article 92(3)(a) and (c) of the Treaty, and misinterpretation by the Commission of Article 52 of the Treaty.

Application of Article 92(1) of the Treaty

17.
By its second plea in law, which it is appropriate to consider first, the German Government challenges the validity of the contested decision on the ground that the tax advantage created by Paragraph 52(8) of the EStG does not meet all the essential conditions laid down by Article 92(1) of the Treaty. In connection with this plea, the German Government considers how long the tax advantage granted lasts, the absence of any transfer of State resources, whether there is any distortion of competition and the effect of the provision of national law on trade between Member States.

18.
First of all, the German Government claims that the tax concession is merely temporary. Profit from the sale of shares can be set off against the cost of acquiring new financial assets only in so far as the actual cost of those assets exceeds the amount of the

profit which was offset. In its submission, the purchase of new financial assets of itself involves the creation of hidden reserves which must subsequently be disclosed and taxed.

19.
Second, the German Government maintains that the fact that an undertaking is granted a financial advantage is not sufficient, where there is no transfer of resources from the State, to establish the existence of aid. Paragraph 52(8) of the EStG does not entail any such transfer, since investors receiving the tax concession provided for by that provision have no reason to pass on any part of that advantage to the undertakings in which they invest.

20.
Furthermore, the German Government argues that this case may be distinguished from the situation considered in Joined Cases 67/85, 68/85 and 70/85 Van der Kooy and Others v Commission [1988] ECR 219, where the State or public bodies were able to direct the conduct of third parties until such time as the indirect beneficiary definitively received an advantage. In the present case the decision of private investors to reinvest the profit from their sales in the purchase of holdings in a capital or holding company is quite independent, even though the tax concession provided for by Paragraph 52(8) of the EStG encourages them to act in that way.

21.
Finally, the German Government claims that in the contested decision the Commission is wrong in confining itself to referring to the impossibility of excluding the risk of distortion of competition, on the one hand, and of an effect on trade between Member States, on the other.

22.
It should first be stressed that it is not disputed that the tax concession in favour of taxpayers who sell certain financial assets and can offset the resulting profit when they acquire other financial assets confers on them an advantage which, as a general measure applicable without distinction to all economically active persons, does not constitute aid to those taxpayers within the meaning of the relevant provisions of the Treaty.

23.
It should also be noted that the contested decision classifies the tax concession under Paragraph 52(8) of the EStG as State aid only in so far as it favours certain undertakings situated in the new Länder or West Berlin, which prevents its being a general measure of tax or economic policy.

24.
Irrespective of the fact that a mere postponement of taxation may also constitute State aid (see, to that effect, Case C-256/97 DM Transport [1999] ECR I-3913), it follows that the German Government's argument that the advantage conferred by the tax concession is only temporary cannot affect the validity of the contested decision since that argument refers only to the advantages given to investors and not to those given to the undertakings in question situated in the new Länder and West Berlin.

25.
Second, it is important to bear in mind that Article 92(1) of the Treaty provides that any aid granted by a Member State, or through State resources in any form whatsoever, which distorts or threatens to distort competition by favouring certain undertakings or the production of certain goods is incompatible with the common market. In particular, measures which, in various forms, mitigate the charges which are normally included in the budget of an undertaking and which, without therefore being subsidies in the strict meaning of the word, are similar in character and have the same effect are considered to constitute aid (Case C-387/92 Banco Exterior de España [1994] ECR I-877, paragraph 13, and Case C-75/97 Belgium v Commission [1999] ECR I-3671, paragraph 23).

26.
In the present case it must be observed that the origin of the advantage indirectly conferred on the undertakings referred to by Paragraph 52(8) of the EStG is the renunciation by the Member State of tax revenue which it would normally have received, inasmuch as it is this renunciation which has enabled investors to take up holdings in those undertakings on conditions which are in tax terms more advantageous.

27.
The fact that investors then take independent decisions does not mean that the connection between the tax concession and the advantage given to the undertakings in question has been eliminated since, in economic terms, the alteration of the market conditions which gives rise to the advantage is the consequence of the public authorities' loss of tax revenue.

28.
It follows that the Commission was right to consider that the tax concession entailed a transfer of State resources.

29.
Third, so far as concerns the risk of distortion of competition, it must be stated that the German Government has not demonstrated that the Commission erred in its determination that Paragraph 52(8) of the EStG had the effect of reducing the costs of certain financing charges for the undertakings in question.

30.
In principle, operating aid, that is to say aid which, like that provided for by Paragraph 52(8) of the EStG, is intended to release an undertaking from costs which it would normally have had to bear in its day-to-day management or normal activities, distorts the conditions of competition (see Case C-301/87 France v Commission [1990] ('Boussac Saint Frères) ECR I-307, and Case C-86/89 Italy v Commission [1990] ECR I-3891).

31.
The Commission therefore rightly considered that the aid provided for by the measure at issue threatened to distort competition.

32.
As regards the effects of the provision in question on trade between Member States, the Court has consistently held that the relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that intra-Community trade might be affected (Case C-142/87 Belgium v Commission [1990] ('Tubemeuse) ECR I-959, paragraph 43, and Joined Cases C-278/92, C-279/92 and C-280/92 Spain v Commission [1994] ECR I-4103, paragraphs 40 to 42).

33.
When aid granted by the State or through State resources strengthens the position of an undertaking compared with other undertakings competing in intra-Community trade the latter must be regarded as affected by that aid (Case 730/79 Philip Morris Holland v Commission [1980] ECR 2671, paragraph 11, and Case C-303/88 Italy v Commission [1991] ECR I-1433, paragraph 17).

34.
That is the case in this instance, since any undertaking other than those to which the measure in issue applies can increase its own resources only on less advantageous terms, whether it is established in Germany or in another Member State.

35.
It follows that the Commission rightly considered that the aid introduced by the measure at issue affected trade between Member States.

36.
In those circumstances the second plea put forward by the Federal Republic of Germany must be rejected.

The de minimis principle

37.
By its third plea in law the German Government claims, in the alternative, that the Commission acted contrary to Community law by failing to apply the 'de minimis principle in the case in question.

38.
The German Government maintains that because of the impossibility of quantifying the supposed financial benefit, it was not open to the Commission to exclude the application of the de minimis principle by relying on the fact that the Federal Republic of Germany had entered into no undertaking to apply the rules drawn up in the de minimis notice. In its submission, the measure in question does not lend itself to the application of the rules in that notice, which makes such an undertaking impossible. Moreover, the Commission ought to have considered that that notice was nothing more than the concrete expression of the general principle that aid of minimal importance is not to be regarded as aid incompatible with the common market.

39.
It should be borne in mind that the relatively small amount of aid or the relatively small size of the undertaking which receives it does not as such exclude the possibility that the aid, in so far as it satisfies the conditions laid down by Article 92(1) of the Treaty, may be incompatible with the common market (see Tubemeuse, cited above, paragraph 43).

40.
Furthermore, the aid introduced by the provision at issue does not comply with the requirements of the de minimis notice, in particular because there is no guarantee that the ECU 100 000 ceiling fixed by the notice will not be exceeded and because that provision does not exclude overlapping with other State aid.

41.

The Commission was therefore entitled to consider that, in the circumstances, it was impossible to apply the rule set out in the de minimis notice.

42.
It follows that the German Government's third plea must be rejected.

Application of Article 92(2)(c) of the Treaty

43.
By its fourth plea, the German Government claims, in the alternative, that even if Paragraph 52(8) of the EStG does constitute State aid it would fall within the scope of the derogation provided for by Article 92(2)(c) of the Treaty.

44.
It points out in that connection that that provision still applies even after the reunification of Germany. Under Article 92(2)(c) of the Treaty, a provision which confers no discretion on the Commission, the latter must confine itself to determining whether the conditions for the application of the derogation have been satisfied.

45.
The German Government maintains that Paragraph 52(8) of the EStG fulfils those conditions inasmuch as that provision is necessary in order to make good the economic disadvantages borne by small and medium-sized undertakings in the former East Germany as a result of the division of Germany. When Germany was reunited, the promoters of those companies in the new Länder were unable to find the capital required for their formation.

46.
It must be pointed out in this regard that under Article 92(2)(c) 'aid granted to the economy of certain areas of the Federal Republic of Germany affected by the division of Germany, in so far as such aid is required in order to compensate for the economic disadvantages caused by that division, is compatible with the common market.

47.
After the reunification of Germany that provision was not repealed either by the Treaty on European Union or by the Treaty of Amsterdam.

48.
In the light of the objective scope of the rules of Community law, the authority and effectiveness of which must be safeguarded, it cannot be presumed that that provision has been devoid of purpose since the reunification of Germany.

49.
It should, however, be noted that since it constitutes a derogation from the general principle, laid down in Article 92(1) of the Treaty, that State aid is incompatible with the common market, Article 92(2)(c) must be construed narrowly.

50.
Furthermore, as the Court has held in previous decisions, in interpreting a provision of Community law it is necessary to consider not only its wording but also the context in which it occurs and the objects of the rules of which it forms part (Case 292/82 Merck [1983] ECR 3781, paragraph 12, and Case 337/82 St Nikolaus Brennerei und Likörfabrik v Hauptzollamt Krefeld [1984] ECR 1051, paragraph 10).

51.
In addition, although, following the reunification of Germany, Article 92(2)(c) of the Treaty falls to be applied to the new Länder, such application is conceivable only on the same conditions as those applicable in the old Länder during the period preceding the date of that reunification.

52.
In this case, the phrase 'division of Germany refers historically to the establishment of the dividing line between the two occupied zones in 1948. Therefore, the 'economic disadvantages caused by that division can only mean the economic disadvantages caused in certain areas of Germany by the isolation which the establishment of that physical frontier entailed, such as the breaking of communication links or the loss of markets as a result of the breaking off of commercial relations between the two parts of German territory.

53.
By contrast, the conception advanced by the German Government, according to which Article 92(2)(c) of the Treaty permits full compensation for the undeniable economic backwardness suffered by the new Länder, disregards both the nature of that provision as a derogation and its context and aims.

54.
The economic disadvantages suffered by the new Länder as a whole have not been directly caused by the geographical division of Germany within the meaning of Article 92(2)(c) of the Treaty.

55.

It follows that the differences in development between the original and the new Länder are explained by causes other than the geographical rift caused by the division ofGermany and in particular by the different politico-economic systems set up in each part of Germany.

56.
Since the German Government has not established that the contested measure was necessary in order to make good an economic disadvantage caused by the division of Germany, in the sense defined in paragraph 52 above, no breach of Article 92(2)(c) has been established.

57.
In those circumstances, the German Government's fourth plea in law cannot be accepted.

Application of Article 92(3)(a) and (c) of the Treaty

58.
Again in the alternative, the German Government maintains by its fifth plea that, supposing that Paragraph 52(8) of the EStG were considered to be aid capable of affecting trade between Member States and not covered by the derogation provided for in Article 92(2)(c) of the Treaty, the aid would have to be declared compatible with the common market pursuant to Article 92(3)(a) and (c) of the Treaty. It complains that the Commission acted in excess of its powers in taking the view that the conditions laid down in Article 92(3)(a) and (c) of the Treaty were not satisfied by the contested measure.

59.
It points out that the Commission, while acknowledging that the five new Länder of Brandenburg, Mecklenburg-Western Pomerania, Saxony, Saxony-Anhalt and Thuringia were designated as assisted areas pursuant to Article 92(3)(a) of the Treaty until the end of 1999, considers that the contested measure is not compatible with the common market. By so doing, the Commission misinterprets the requirements of that provision.

60.
The German Government claims, first, that the Commission errs in law in classifying the contested measure as operating aid, which could only in exceptional circumstances be declared compatible with the common market, even in the case of the areas eligible under Article 92(3)(a) of the Treaty. Valuable consideration is always in fact given for the acquisition of shares in capital companies.

61.
Second, it submits that the Commission is wrong to claim that the aid scheme makes it impossible to prevent the capital thus made available from being deflected to the large undertakings to which the undertakings referred to in Paragraph 52(8) of the EStG belong or to undertakings established outside the assisted areas. In its view, the Commission is equally wrong to consider that it is not impossible that the scheme should be applied to undertakings in sensitive industries or to undertakings in difficulties.

62.
In that regard, the German Government maintains that an investor is hardly likely to take up a holding in a capital company belonging to a large undertaking whichgenerally possesses the capital necessary for its activities and has no interest in third parties' investing in its subsidiary. Furthermore, the Commission failed to ascertain, as it ought to have done, whether in the usual practice of such investments there was the slightest possibility that an investor might, in order to receive a tax concession, take up holdings in undertakings operating in sensitive economic sectors burdened with structural problems or overcapacity. The Commission is also wrong to consider that it is not inconceivable that an investor should take up a holding in an undertaking in difficulties. Finally, the argument put forward by the Commission in the contested decision that the recipient companies might invest outside the assisted areas seems wholly hypothetical. In any event, if the result were to be a widening of investment, that would be to the benefit of the area in which the undertakings were established; those undertakings would thereby be strengthened.

63.
As regards companies having their registered office and central administration in West Berlin, the German Government submits that the Commission has excluded the contested measure from the ambit of Article 92(3)(c) of the Treaty only by relying on the mistaken premiss that operating aid was in issue, which is permissible only in the areas eligible under Article 92(3)(a) of the Treaty, which West Berlin is not. According to the German Government, the advantage conferred on the undertakings covered by Paragraph 52(8) of the EStG cannot be classified as operating aid.

64.
As a preliminary point, it should be borne in mind that, as has been noted in paragraph 30 above, the aid scheme in issue must be regarded as granting

operating aid to the recipient undertakings and, in consequence, the German Government's argument that the shares are always acquired for valuable consideration cannot negate the favourable nature of the conditions under which those undertakings are financed.

65.
As regards West Berlin, an area covered by the aid scheme established by Paragraph 52(8) of the EStG, it is common ground that it has benefited from its status of assisted area by virtue of Article 92(3)(c) of the Treaty, in part until 1996 and wholly for 1997 to 1999. On the other hand, it is also common ground that during the material period West Berlin was not an assisted area for the purposes of Article 92(3)(a) of the Treaty.

66.
It follows that the Commission was entitled to consider that the disputed measure, as it was applied to undertakings established in West Berlin, cannot in the light of the derogation provided for by Article 92(3)(a) of the Treaty be regarded as compatible with the common market.

67.
So far as concerns the other areas covered by the aid scheme in issue, it should be noted that the Court has consistently held that as regards the application of Article 92(3) of the Treaty the Commission enjoys a wide discretion, the exercise of which involves assessments of an economic and social nature which must be made within a Community context (Case C-303/88 Italy v Commission, cited above, paragraph 34).

68.
As regards the exercise of the Commission's discretion, it is clear from paragraph 6 of the 1988 communication, the meaning of which has not been challenged by theGerman Government, that operating aid may only exceptionally be granted in areas assisted pursuant to Article 92(3)(a) of the Treaty, that is to say, where the aid is likely to promote a durable and balanced development of economic activity.

69.
As is clear from Part V of the contested decision, the Commission rightly considered in the circumstances of this case that application of the aid scheme in issue did not ensure that the recipient undertakings would use the capital provided for the development of economic activity in areas eligible under Article 92(3)(c) of the Treaty and that there was nothing to prevent the scheme from being applied to undertakings in difficulties or operating in sensitive industries for which specific State aid rules have been laid down.

70.
In those circumstances, the German Government has not adduced the evidence which would justify the conclusion that the Commission exceeded the bounds of its discretion when it considered that the aid scheme provided for by Paragraph 52(8) of the EStG did not satisfy the conditions which would enable it to fall within the scope of the derogation under Article 92(3)(a) of the Treaty.

71.
It follows that the Commission made no manifest error of assessment in considering that the aid scheme introduced by the contested measure did not fall within the scope of Article 92(3)(a) or (c) of the Treaty and consequently the plea in law alleging misinterpretation of that provision must also be rejected.

Article 52 of the Treaty

72.
By its sixth plea, the German Government challenges the Commission's finding that Paragraph 52(8) of the EStG infringes Article 52 of the Treaty.

73.
It claims that Paragraph 52(8) of the EStG contains neither overt nor covert discrimination liable to prejudice freedom of establishment, since that provision does not use the undertakings' nationality as a criterion for drawing distinctions, the tax advantage it introduces being limited to holdings in the capital of undertakings established in a certain part of Germany, with the result that undertakings established elsewhere in Germany do not receive that tax advantage.

74.
In addition, it argues that the Court's decisions, according to which Article 52 of the Treaty may also be infringed where there are non-discriminatory obstacles to the establishment in a Member State of Community nationals of other Member States, are not applicable in the circumstances of this case. Such obstacles are prohibited only where the host Member State either refuses to recognise diplomas obtained in another Member State or refuses to authorise a second establishment because the first is situated in

another Member State. The contested measure concerns neither of those two situations.

75.
The German Government adds that, in any event, the Commission cannot supply for a decision adopted pursuant to Article 93(2) of the Treaty alternative reasons based on Article 52 of the Treaty where the conditions under Article 92 for declaring the aid unlawful have not been satisfied. Inasmuch as there is no infringement of Article 92 of the Treaty, a decision adopted pursuant to Article 93(2) must be annulled, whether or not there is an infringement of Article 52.

76.
In this regard, the Court would observe that it is not disputed that if the Commission reaches the conclusion that a measure does not constitute aid within the meaning of Article 92 of the Treaty, it cannot have recourse to the procedure under Article 93 in order to decide that another provision of the Treaty, such as Article 52, has been infringed.

77.
That is not, however, the case in this instance since the Commission reached the conclusion that the disputed measure was indeed aid for the purposes of Article 92 of the Treaty and that it had, therefore, to consider whether the measure was compatible with the common market.

78.
As the Court has consistently held, it is clear from the general scheme of the Treaty that the procedure under Article 93 must never produce a result which is contrary to the specific provisions of the Treaty. State aid, certain conditions of which contravene other provisions of the Treaty, cannot therefore be declared by the Commission to be compatible with the common market (see, to that effect, Case 73/79 Commission v Italy [1980] ECR 1533, paragraph 11, and Case C-225/91 Matra v Commission [1993] ECR I-3203, paragraph 41).

79.
In those circumstances, the Commission was right to consider whether Paragraph 52(8) of the EStG infringed Article 52 of the Treaty.

80.
It must be borne in mind in this regard that, although direct taxation is a matter for the Member States, they must nevertheless exercise their direct taxation powers consistently with Community law (see Case C-107/94 Asscher v Staatssecretaris van Financiën [1996] ECR I-3089, paragraph 36, and Case C-264/96 ICI v Colmer (HMIT) [1998] ECR I-4695, paragraph 19).

81.
According to established case-law, the freedom of establishment which Article 52 grants to nationals of the Member States and which entails the right for them to take up and pursue activities as self-employed persons under the conditions laid down for its own nationals by the law of the Member State where such establishment is effected includes, pursuant to Article 58 of the Treaty, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community to pursue their activities in the Member States concerned through a subsidiary, branch or agency (see ICI, cited above, paragraph 20; Case C-254/97 Baxter and Others [1999] ECR I-4809, paragraph 9, and Case C-307/97 Saint-Gobain ZN v Finanzamt Aachen-Innenstadt [1999] ECR I-6161, paragraph 35).

82.
As far as companies or firms are concerned, their registered office, as indicated above, serves to determine, like nationality for natural persons, their connection to a Member State's legal order (Case C-307/97 Saint-Gobain, cited above, paragraph 36).

83.
It also follows from the case-law of the Court (see Case C-330/91 The Queen v Inland Revenue Commissioners, ex parte Commerzbank [1993] ECR I-4017, paragraph 14, and Case C-254/97 Baxter and Others, cited above, paragraph 10) that the rules regarding equal treatment prohibit not only overt discrimination by reason of nationality or, in the case of a company, its registered office, but all covert forms of discrimination which, by the application of other criteria of differentiation, lead in fact to the same result.

84.
It is admittedly true that, according to the Court's case-law, discrimination can arise only through the application of different rules to comparable situations or the application of the same rule to different situations and that, in relation to direct taxes, the situations of residents and non-residents are not, as a rule, comparable (Case C-279/93 Schumacker [1995] ECR I-225, paragraphs 30 and 31).

85.

It follows that if a Member State grants, even indirectly, a tax advantage to undertakings having their registered office on its territory, refusing to allow the undertakings having their registered office in another Member State to benefit from that advantage, the difference in treatment between the two categories will in principle be prohibited by the Treaty, provided that there is no objective difference in situation (Asscher, cited above, paragraph 42).

86.
There can, however, be no such objective difference of situation between a company established in a Member State other than the Federal Republic of Germany and carrying on economic activity in the new Länder through a branch, agency or fixed establishment, a company which cannot claim the benefit of the contested measure, and a company having its registered office on German territory, which does profit from the tax concession introduced by that measure.

87.
Since such a difference of treatment has been in no way justified, it is evident from the foregoing considerations that the Commission was right to reach the conclusion that Paragraph 52(8) of the EStG constituted discrimination prohibited by Article 52 of the Treaty.

88.
Having regard to the foregoing, and since the German Government's plea alleging breach of Article 92 of the Treaty has not been upheld, the plea alleging that there has been no breach of Article 52 cannot be upheld either.

The obligation to state reasons

89.
By its first plea, which it is appropriate to consider last, the German Government claims that the Commission did not give adequate reasons for the contested decision. This plea falls into five parts.

90.
In the first part of its first plea, the German Government submits that it is not possible to tell from the statement of reasons in the contested decision what constitutes the element of aid in the tax scheme in question or how that element should be quantified.

91.
It complains that the Commission used three different variations in its definition of the element of aid. First, the Commission relied on a comparison of the conditions under which an undertaking covered by Paragraph 52(8) of the EStG might obtain a contribution of capital depending on whether or not it receives the tax advantage in question. Next, the Commission asserts - an assertion which is not demonstrated in the contested decision - that an investor receiving the tax advantage transfers part of it to the undertaking in which it takes a holding. Finally, the Commission considers that the aid is quantified by the amount of capital made available to the undertaking by the investor when he takes up the holding, but does not explain how such an investment constitutes the grant of aid from State resources.

92.
By the second part of that plea, the German Government maintains that the Commission failed to give sufficient reasons for its allegation that there existed a risk of distortion of competition and obstacles to trade between Member States. First, it claims that the Commission merely alleges that there is such a risk of distortion of competition, relying only on the national tax scheme's character of State aid, instead of distinctly demonstrating the existence of such a risk, required by Article 92 if it is to be declared incompatible, whereas the fact is that that is an element constituting aid. Second, it claims that the Commission cannot merely, as in this instance, assert that the small amount of the aid is not sufficient to exclude the risk of effects on trade between Member States, without setting out the reasons for which it considers that the aid in issue would actually affect trade between Member States.

93.
In the third part of the same plea, the German Government submits that the Commission ought to have considered on its own initiative whether the conditions under which Paragraph 52(8) of the EStG might be covered by the scope of the derogation provided for by Article 92(2)(c) of the Treaty were satisfied, an obligation not fulfilled by the contested decision. In addition, the decision does not make it possible to understand why the Commission claims that the national tax scheme is not necessary in order to offset the economic disadvantages caused by the division of Germany. In any event, the Commission ought to have asked the German Government for further information since other facts would have been necessary in order to establish whether the tax concession was required for the purposes of Article 92(2)(c) of the Treaty.

94.
By the fourth part of its first plea, the German Government maintains that under Article 92(3) of the Treaty the Commission ought to have demonstrated in acomprehensible manner that it was realistic to believe that a prudent investor was liable to invest in sensitive industries or in undertakings in difficulties.

95.
By the last part of that plea, the German Government considers that the contested decision is inadequately reasoned, in that it calls for the repeal of the provisions rather than their amendment, which the Commission would have been justified in doing. If the amendment of aid were sufficient to make it compatible with the common market, the requirement that the aid should be totally abolished is a disproportionate measure.

96.
According to settled case-law, the reasoning required by Article 190 of the Treaty must show clearly and unequivocally the reasoning of the Community authority which adopted the contested measure so as to enable the persons concerned to ascertain the reasons for the measure and to enable the Court to exercise its power of review (Joined Cases 43/82 and 63/82 VBVB and VBBB v Commission [1984] ECR 19, paragraph 22).

97.
However, the reasoning is not required to go into every relevant point of fact and law, inasmuch as the question whether a statement of reasons satisfies those requirements must be assessed with reference not only to its wording but also to its context and the whole body of legal rules governing the matter in question (Case C-56/93 Belgium v Commission [1996] ECR I-723, paragraph 86, and Case C-278/95 P Siemens v Commission [1997] ECR I-2507, paragraph 17).

98.
That principle, applied to the categorisation of a measure as State aid, requires the Commission to state the reasons for which the measure in question falls within the ambit of Article 92(1) of the Treaty. Even where the very circumstances in which the aid has been granted show that it is liable to affect trade between Member States and to distort or threaten to distort competition, the Commission must at least set out those circumstances in the statement of reasons for its decision (Case 57/86 Greece v Commission [1988] ECR 2855, paragraph 15, and Joined Cases C-329/93, C-62/95 and C-63/95 Germany and Others v Commission [1996] ECR I-5151, paragraph 52).

99.
As regards the element of aid, in this instance the Commission declares in the first paragraph of Part IV of the reasons for the contested decision that Paragraph 52(8) of the EStG constitutes State aid within the meaning of Article 92(1) of the EC Treaty and Article 61(1) of the European Economic Area Agreement.

100.
As may be seen, from Part IV itself, the Commission clearly sets out and applies to the circumstances of the case the criteria to be satisfied if a State measure is to constitute State aid covered by Article 92(1) of the Treaty, namely that it is necessary that an economic advantage should be reserved to certain undertakings, that there should be a transfer of State resources and a risk of distorting competition or of affecting intra-Community trade.

101.
With regard to the Commission's assessment of the effects of the aid introduced by the contested decision on competition and intra-Community trade, it would appear that thecontested decision deduces logically from the characteristics of that measure, the purpose of which is to improve the contractual conditions under which holdings may be taken up in certain undertakings, that the application of this measure is liable to distort competition, since it makes other undertakings less attractive on the capital market, and to affect the intra-Community trade in which Community undertakings participate, whether they are recipients of or excluded from the advantage provided for by the measure in question.

102.
It is clear from the statement of reasons that the Commission considered whether or not the conditions for the application of Article 92(1) of the Treaty were satisfied. In so doing, it set out the facts and the legal considerations of essential importance in the general scheme of the contested decision. That statement of reasons enables the Federal Republic of Germany and the Community judicature to understand why the Commission considered that the conditions for the application of Article 92(1) of the Treaty were satisfied in the circumstances.

103.
It follows that the first and second parts of the first plea put forward by the Federal Republic of Germany must be rejected.

104.

As regards the third part of the plea, the contested decision contains admittedly only a brief résumé of the grounds on which the Commission refused to apply the derogation provided for by Article 92(2)(c) of the Treaty to the facts of the case.

105.
It should, however, be pointed out that the contested decision was adopted in a context well known to the German Government and that it fits into a well-established line of decisions, particularly in relation to that Government. In those circumstances, such a decision may be reasoned in a summary manner (Case 73/74 Groupement des Fabricants de Papiers Peints de Belgique and Others v Commission [1975] ECR 1491, paragraph 31).

106.
In its relations with the Commission, the German Government has referred to Article 92(2)(c) of the Treaty on various occasions since 1990, insisting on the importance of that provision to the revival of the new Länder.

107.
The arguments put forward in this connection by the German Government have been rejected by various decisions of the Commission, such as inter alia Commission Decision 94/266/EC of 21 December 1993 on the proposal to award aid to SST-Garngesellschaft mbH, Thüringen (OJ 1994 L 114, p. 21) and Commission Decision 94/1074/EC of 5 December 1994 on the German authorities' proposal to award aid to Textilwerke Deggendorf GmbH, Thüringen (OJ 1994 L 386, p. 13).

108.
It follows that the German Government is not justified in maintaining that the statement of reasons for the contested decision did not enable it to comprehend why Paragraph 52(8) of the EStG was not covered by the derogation provided for by Article 92(2)(c) of the Treaty and that, in the absence of any specific argument put forward by theGerman authorities, the Commission was not required to supply a more ample statement of the reasons for its contested decision.

109.
It follows that the third part of the first plea is not well founded.

110.
So far as concerns the argument that the statement of reasons is inadequate with regard to the application of Article 92(3) of the Treaty, it is sufficient to point out that, by recalling the criteria laid down in the 1988 communication and by finding, in the third, fifth and sixth paragraphs of Part V of the reasons for the contested decision that in the circumstances those criteria had not been satisfied, the Commission has given reasons for its decision to the requisite legal standard. The German Government and the Community judicature are perfectly capable of discerning the reasons for which in the circumstances the Commission refused to allow the benefit of the derogations provided for by Article 92(3)(a) or (c) of the Treaty.

111.
In consequence, the fourth part of the first plea is also unfounded.

112.
As regards the last part of the plea, relating to the allegedly insufficient reasons given in the contested decision for inviting the German authorities to repeal Paragraph 52(8) of the EStG, it should be pointed out that it follows from the Court's previous decisions that the termination of unlawful aid is the logical consequence of the finding that it is unlawful (see, to that effect, Tubemeuse, cited above, paragraph 66).

113.
In those circumstances, the Commission, which has properly found that a State measure constitutes State aid which, in the light of the derogations provided for by the Treaty, is incompatible with the common market, cannot be required to contemplate that aid's being amended instead of withdrawn.

114.
It follows that, by requiring the repeal rather than the amendment of Paragraph 52(8) of the EStG, the Commission has not infringed its obligation to state reasons.

115.
Since the fifth part of the first plea cannot be accepted either, the plea must be dismissed as unfounded.

116.
Since none of the pleas put forward by the German Government is well founded, the application must in consequence be dismissed.

Costs

117.

Under Article 69(2) of the Rules of Procedure, the unsuccessful party is to be ordered to pay the costs, if they have been applied for. Since the Commission has applied for costs and the Federal Republic of Germany has been unsuccessful, the latter must be ordered to pay the costs.

On those grounds,

THE COURT

hereby:

1. Dismisses the application;

2. Orders the Federal Republic of Germany to pay the costs.

Rodríguez Iglesias
Sevón
Kapteyn

Gulmann

Puissochet
Jann

Ragnemalm

Wathelet
Skouris

Delivered in open court in Luxembourg on 19 September 2000.

R. Grass

G.C. Rodríguez Iglesias
Registrar

President

1: Language of the case: German.

Supreme Court of Missouri,
En Banc.
GENERAL MOTORS CORPORATION and Subsidiaries, Appellants,
v.
DIRECTOR OF REVENUE, Respondent.
No. 80853.

Dec. 22, 1998.

ANN K. COVINGTON, Judge.

The principal issue in this case is whether General Motors Corporation and its subsidiaries have the right to file consolidated Missouri income tax returns for the years 1990, 1991, and 1992 pursuant to section 143.431.3(1), RSMo 1994. [FN1] Because construction of the revenue laws of the state is involved, this Court has exclusive appellate jurisdiction. *Mo. Const.* art. V, sec. 3. This Court reverses the decision of the Administrative Hearing Commission and remands for further proceedings, finding that section 143.431.3(1) violates the United States Constitution, article I, section 8, in that it discriminates against interstate commerce.

FN1. All statutory references are to RSMo 1994 unless otherwise noted.

General Motors Corporation (GM) is a Delaware Corporation domiciled in Detroit, Michigan. GM is parent to numerous subsidiaries. GM and its subsidiaries constitute GM Group, which engages in manufacturing automobiles, trucks, component parts, and accessories. GM Group is also involved in the financing of those products and in insurance and business management systems. GM and some of its subsidiaries conducted business in Missouri from 1990 through 1992.

GM Group, as an affiliated group of corporations, filed federal consolidated income tax returns for 1990, 1991, and 1992. Approximately 300 subsidiaries were part of the affiliated group. GM Group also filed Missouri consolidated income tax returns in 1990, 1991, and 1992. GM Group conducted substantial business in Missouri from 1990 ***563** through 1992. It had approximately $1.3 billion in property, $300 million in payroll, and $2.3 billion in gross receipts in Missouri for each of the three years. Because of its sizable commercial activities in other states, however, GM Group derived less than two percent of its income from sources within Missouri for each of the three years. On all three of its Missouri consolidated returns, GM Group reported zero tax liability. In 1990 and 1991, GM Group requested refunds in the amount of $3,651,703 and $1,172,400 respectively. GM Group did not claim a refund for 1992.

The Director of Revenue concluded that GM Group was not entitled to file consolidated returns for 1990, 1991, and 1992 because it did not derive at least fifty percent of its income from sources within Missouri pursuant to section 143.431.3(1). The director denied GM Group's refund claims for 1990 and 1991. The director further issued a notice of deficiency against GM in the amount of $12,533,176 for 1992.

GM Group appealed to the Administrative Hearing Commission, (AHC), claiming that section 143.431.3(1) is unconstitutional because it violates the Commerce Clause, *U.S. Const.* art. I, sec. 8; the Due Process Clause, *U.S. Const.* amends. V and XIV; the Equal Protection Clause, *U.S. Const.* amends. V and XIV; the Equal Rights and Opportunities Clause, *Mo. Const.* art. I, sec. 2; and the Uniformity Clause, *Mo. Const.* art. X, sec. 3. The AHC upheld the director's determination that GM Group did not meet the statutory requirements to file a Missouri consolidated income tax return in that it did not derive fifty percent of its income from sources within Missouri. Because GM Group did not meet the requirements for filing consolidated returns, it was not entitled to refunds for 1990 and 1991. The AHC further held that GM was not liable for Missouri income tax for 1992. The AHC did not reach the constitutional questions because it is without authority to decide constitutional issues. *State Tax Comm'n v. Administrative Hearing Comm'n,* 641 S.W.2d 69, 75-76 (Mo. banc 1982). This petition for review followed.

Missouri law permits the filing of a consolidated income tax return by an affiliated group of corporations under the conditions specified in section 143.431.3(1), which provides in pertinent part:

> If an affiliated group of corporations files a consolidated income tax return for the taxable year for federal income tax purposes and fifty percent or more of its income is derived from sources within

this state as determined in accordance with section 143.451, then it may elect to file a Missouri consolidated income tax return....

[1][2] The essential purpose of allowing corporations to file a consolidated return is to permit affiliated corporations, which may be separately incorporated for various business reasons, to be treated as if they were one corporation. *Mid-America Television Co. v. State Tax Comm'n*, 652 S.W.2d 674, 680 (Mo. banc 1983), *cert. denied*, 465 U.S. 1065, 104 S.Ct. 1413, 79 L.Ed.2d 740 (1984). If an affiliated group files a consolidated Missouri return, the individual corporations within the group will not be required to file separate corporate income tax returns for the taxable year. Section 143.431.3(3). It is undisputed that filing a consolidated return allows an affiliated group to offset the gains of one or more of its companies with the losses of one or more of its companies, which may result in lower tax. In addition, filing a consolidated return is administratively more convenient than filing separate returns. It is also undisputed that the right to file a Missouri consolidated income tax return confers a valuable tax benefit to an affiliated group.

[3] GM Group contends, among other arguments, that section 143.431.3(1) violates the Commerce Clause of the United States Constitution because the threshold requirement that an affiliated group derive fifty percent of its income from sources within Missouri discriminates against interstate commerce. GM Group claims that it is being denied specific tax benefits because of GM Group's corporate form and the geographic location of the group's business activities. Under section 143.431.3(1), only business groups that perform the majority of their business activities in Missouri may elect to file a Missouri consolidated income tax return. ***564** GM Group's Commerce Clause claim is dispositive.

In recent years, the United States Supreme Court has addressed challenges under the Commerce Clause that provide guidance in resolving the present case. In *American Trucking Ass'n, Inc. v. Scheiner*, 483 U.S. 266, 286, 107 S.Ct. 2829, 97 L.Ed.2d 226 (1987), the Court held that two Pennsylvania statutes that imposed lump-sum annual taxes on the operation of trucks and truck tractors plainly discriminated against interstate commerce. Because Pennsylvania provided a reduction in registration fees designed to offset the lump-sum tax for vehicles registered in Pennsylvania, the practical effect of the statute was to tax only vehicles registered out of state. *Id.* at 277-78, 107 S.Ct. 2829. The Commerce Clause prohibits state taxes that favor in-state businesses over out-of-state businesses for no reason other than the geographic location of the business. *Id.* at 286, 107 S.Ct. 2829.

In *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 567-68, 117 S.Ct. 1590, 137 L.Ed.2d 852 (1997), the Court scrutinized a Maine statute providing a general exemption from property taxes for charitable institutions that primarily served Maine residents. Institutions that principally served non-residents of Maine qualified for a limited tax benefit, if any. *Id.* at 568, 117 S.Ct. 1590. The Court held that:

> It is not necessary to look beyond the text of this statute to determine that it discriminates against interstate commerce. The Maine law expressly distinguishes between entities that serve a principally interstate clientele and those that primarily serve an intrastate market, singling out camps that serve mostly in-staters for beneficial tax treatment, and penalizing those camps that do a principally interstate business. As a practical matter, the statute encourages affected entities to limit their out-of-state clientele, and penalizes the principally non-resident customers of businesses catering to a primarily interstate market.

Id. at 575-76, 117 S.Ct. 1590. The Court further stated that the fact that the tax discrimination resulted from depriving certain institutions of an available tax benefit rather than from imposing a specific tax penalty had no effect on the determination of whether the statute discriminated against interstate commerce. *Id.* at 578-79, 117 S.Ct. 1590.

In the preceding year in *Fulton Corp. v. Faulkner*, 516 U.S. 325, 327-28, 116 S.Ct. 848, 133 L.Ed.2d 796 (1996), the Court examined a North Carolina statute that reduced the intangibles tax on the fair market value of corporate stock based upon the amount of business the corporation performed within the state. The tax scheme favored North Carolina corporations over out-of-state competitors because corporate stock was taxed only to the extent that the corporation conducted out-of-state business. *Id.* at 328, 116 S.Ct. 848. The Court held that "there is no doubt" that the intangibles tax facially discriminates against interstate commerce. *Id.* at 333, 116 S.Ct. 848. The Court further stated that state laws that discriminate against interstate commerce "on their face are 'virtually' *per se* invalid." [FN2] *Id.* at 331, 116 S.Ct. 848.

FN2. In *Fulton Corp.*, the Court went on to discuss whether the facially discriminatory tax at issue survived Commerce Clause scrutiny under the compensatory tax defense. 516 U.S. at 331, 116 S.Ct. 848.

In *Associated Indust. of Missouri v. Lohman,* 511 U.S. 641, 647, 114 S.Ct. 1815, 128 L.Ed.2d 639 (1994), the Court held that Missouri's use tax statute, which applied only to articles of personal property purchased outside the state, discriminated against interstate commerce. A use tax that does not exceed the state's sales tax is valid under the Commerce Clause. *Id.* at 648, 114 S.Ct. 1815. Missouri's use tax scheme discriminated against interstate commerce because the use tax exceeded the local sales tax in certain locations. *Id.* at 649, 114 S.Ct. 1815. Out-of-state goods brought into these locations were subject to taxes higher than the tax on local goods. *Id.* The Court noted that a state may not tax a transaction more heavily when it crosses state lines than when the transaction occurs entirely within the state. *Id.* at 647, 114 S.Ct. 1815. Finally, the ***565** Court stated that the scope and magnitude of actual discrimination has no bearing on the determination of whether discrimination has occurred. *Id.* at 650, 114 S.Ct. 1815. A court need not inquire into the purpose or motivation behind a law to determine that it actually discriminates against interstate commerce. *Id.* at 653, 114 S.Ct. 1815.

Soon after its decision in *Associated Indust. of Missouri,* the Court invalidated a Massachusetts pricing order on dairy products. *West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186, 194, 114 S.Ct. 2205, 129 L.Ed.2d 157 (1994). The pricing order was designed to enable Massachusetts dairy farmers to compete with out-of-state dairy producers. *Id.* All dairy dealers doing business in Massachusetts were required to pay a premium each month, which was then distributed to Massachusetts dairy farmers. *Id.* at 190-91, 114 S.Ct. 2205. The Court held that the premium payments were effectively a tax that discriminated against interstate commerce. *Id.* at 194, 114 S.Ct. 2205. The Court noted that the form by which a state erects barriers to commerce does not control the determination of whether the statute discriminates against interstate commerce. *Id.* at 201, 114 S.Ct. 2205. "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." *Id.*

In *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue,* 505 U.S. 71, 72-73, 112 S.Ct. 2365, 120 L.Ed.2d 59 (1992), the Court examined an Iowa statute that had the effect of taxing dividends received from foreign, but not domestic, subsidiaries. The Iowa Department of Revenue argued that the tax scheme was not unconstitutional because Kraft could have avoided the discriminatory tax by reorganizing its corporate structure. *Id.* at 77-78, 112 S.Ct. 2365. Iowa claimed that its tax scheme merely burdened a particular form of corporate organization, not foreign commerce. *Id.* The Court rejected these arguments, finding that the statute facially discriminated against foreign commerce. *Id.* at 82. The Court acknowledged that the Commerce Clause is not violated when two categories of corporations receive differential tax treatment because of differences in the nature of their businesses rather than the location of their business activities. *Id.* at 78, 112 S.Ct. 2365. The Court found no basis, however, "for the different proposition that a tax that does discriminate against foreign commerce may be upheld if a taxpayer could avoid that discrimination by changing the domicile of the corporations through which it conducts its business." *Id.*

[4][5][6][7][8][9][10] A reading of the foregoing cases reflects the guiding principles for determining whether a statute discriminates against interstate commerce. State laws that facially discriminate against interstate commerce are virtually *per se* unconstitutional. *Camps Newfound/Owatonna,* 520 U.S. at 575, 117 S.Ct. 1590; *Fulton Corp.,* 516 U.S. at 331, 116 S.Ct. 848; *Associated Indust. of Missouri,* 511 U.S. at 647, 114 S.Ct. 1815. A state statute may not favor in-state businesses over out-of-state businesses for no reason other than the geographic location of the businesses. *American Trucking Ass'n,* 483 U.S. at 286, 107 S.Ct. 2829. The scope and magnitude of the discrimination has no bearing on determining whether the discrimination has occurred. *Associated Indust. of Missouri,* 511 U.S. at 650, 114 S.Ct. 1815. A court need not inquire into the purpose or motivation behind a law to determine that it actually discriminates against interstate commerce. *Id.* at 653, 114 S.Ct. 1815. Nor does it matter whether the form of the tax discrimination is a tax penalty or a tax benefit. *Camps Newfound/Owatonna,* 520 U.S. at 578-79, 117 S.Ct. 1590; *West Lynn Creamery,* 512 U.S. at 201, 114 S.Ct. 2205. Any arguments that attempt to justify a discriminatory restriction on interstate commerce must pass the strictest scrutiny. *Fulton Corp.,* 516 U.S. at 345, 116 S.Ct. 848. The fact that a corporation could avoid a discriminatory tax by changing either the domicile of its business or its organizational form does not render that statute

constitutionally sound. *Kraft Gen. Foods,* 505 U.S. at 78, 82, 112 S.Ct. 2365.

[11] Applying these principles to the fifty-percent threshold requirement set forth in ***566** section 143.431.3(1) dictates a determination that the requirement facially discriminates against interstate commerce. An affiliated group must derive the majority of its income from within the state of Missouri before it may elect to file a Missouri consolidated income tax return. The statute expressly distinguishes between affiliated groups that perform the majority of their business activities in Missouri and groups that perform the majority of their business activities out of state. *See Camps Newfound/Owatonna,* 520 U.S. at 575-76, 117 S.Ct. 1590 (finding that a similar statute that expressly distinguished between charities based on in-state or out-of-state activities facially discriminated against interstate commerce). The fifty-percent threshold requirement of section 143.431.3(1) also penalizes groups, such as GM Group, that conduct substantial amounts of business in Missouri but do not qualify for consolidated returns because they perform the majority of their business out of state. *Id.* at 576, 117 S.Ct. 1590. *See also Westinghouse Elec. Corp. v. Tully,* 466 U.S. 388, 407, 104 S.Ct. 1856, 80 L.Ed.2d 388 (1984) (holding that a franchise tax that similarly provided positive incentives for increased in-state activity facially discriminated against interstate commerce). The difference in tax treatment under section 143.431.3(1) results in part from the geographic location of the majority of the affiliated group's business activities. *See Amerada Hess Corp. v. Director, Division of Taxation,* 490 U.S. 66, 77, 109 S.Ct. 1617, 104 L.Ed.2d 58 (1989) (finding that tax did not discriminate against interstate commerce because tax did not discriminate based on geographic location); *American Trucking Ass'n,* 483 U.S. at 286, 107 S.Ct. 2829. In addition, section 143.431.3(1) impermissibly treats GM Group differently because of its corporate structure. *See Kraft Gen. Foods,* 505 U.S. at 82, 112 S.Ct. 2365 (rejecting Iowa's argument that a discriminatory statute was rendered constitutionally sound because the taxpayer could have avoided the discriminatory tax by changing its corporate form). Disparate tax treatment based on an affiliated group's geographic location and corporate structure constitutes an impermissible burden on interstate commerce.

[12][13][14] This Court has not undertaken the foregoing analysis without being cognizant of the requirements to presume the validity of a statute unless it clearly contravenes a constitutional provision, *Mahoney v. Doerhoff Surgical Servs., Inc.,* 807 S.W.2d 503, 512 (Mo. banc 1991), to adopt any reasonable reading of the statute that will allow its validity, and to resolve any doubts in favor of constitutionality. *State ex rel. McClellan v. Godfrey,* 519 S.W.2d 4, 8 (Mo.1975). The director offers several arguments in support of the constitutionality of section 143.431.3(1).

*** [discussion of overturned Missouri precedent deleted]

[15] The director also claims that because section 143.431.3(1) neither imposes a tax nor grants a tax credit, the statute is constitutionally valid. Imposing a tax and granting a tax credit are not the exclusive means of discriminating against interstate commerce. The form by which a state erects barriers to commerce has no effect on the determination of whether discrimination exists. *West Lynn Creamery, Inc.,* 512 U.S. at 201, 114 S.Ct. 2205. The right to elect to file a consolidated return is a tax benefit. Based on its corporate form and its geographic location, GM Group is placed at a competitive disadvantage when it is denied the tax benefits that section 143.431.3(1) confers. This impermissibly discriminates against interstate commerce. *See Camps Newfound/Owatonna,* 520 U.S. at 578-79, 117 S.Ct. 1590.

*** Even if an affiliated group such as GM Group has substantial business activities with a nexus with Missouri, the group may not file a consolidated return unless it derives at least fifty percent of its total income from within the state. The fifty-percent threshold requirement of section 143.431.3(1) discriminates against interstate commerce in that it forecloses interstate commerce-neutral decisions and creates both an advantage for businesses that conduct the majority of their business in Missouri and a penalty for businesses that conduct the majority of their business outside Missouri. *Boston Stock Exch. v. State Tax Comm'n,* 429 U.S. 318, 331, 97 S.Ct. 599, 50 L.Ed.2d 514 (1977).

Finally, the director argues that the fifty-percent threshold requirement in section 143.431.3(1) passes the internal consistency test. The internal consistency test involves a determination of whether a state tax would impermissibly interfere with free trade if every jurisdiction enacted similar legislation. *American Trucking Ass'n,* 483 U.S. at 284, 107 S.Ct. 2829. The director claims that section 143.431.3(1) passes the internal consistency test because even if a group is not allowed to file a consolidated return, each individual corporation within the group would still have its tax liability fairly apportioned.

The director's argument fails to acknowledge that the portion of section 143.431.3(1) that discriminates against interstate commerce is the fifty-percent threshold requirement rather than the system of apportionment. If every state required affiliated groups to conduct a majority of their business within the state before the groups could qualify to file consolidated income tax returns, there would be interference with free trade. Affiliated groups would be unable to offset profits collectively earned by member corporations with the collective losses of the member corporations. The groups would not have the benefit of decreased tax liability or the administrative benefit of filing a single consolidated income tax return. If all states applied the fifty-percent threshold requirement, business groups would be encouraged ***568** to perform the majority of their business within a single state and would be penalized for engaging in free trade.

This Court holds that to the extent that section 143.431.3(1) requires an affiliated group to derive at least fifty percent of its income from sources within Missouri as a basis for filing a Missouri consolidated income tax return, section 143.431.3(1) violates the Commerce Clause of the United States Constitution, article I, section 8.

***

The fifty-percent threshold requirement of section 143.431.3(1) violates the Commerce Clause of the United States Constitution, article I, section 8, in that it discriminates against interstate commerce. The fifty-percent requirement of section 143.431.3(1) is ordered severed. GM Group is authorized to file Missouri consolidated income tax returns for 1990, 1991, and 1992.

The decision is reversed and remanded for further proceedings in accordance with this opinion.

All concur.

981 S.W.2d 561

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METALLGESELLSCHAFT LTD. AND OTHERS, HOECHST AG, HOECHST UK LTD. v. COMMISSIONERS OF INLAND REVENUE

2001 E.C.R. 1727

8 March 2001

Joined Cases C-397/98 and C-410/98

The High Court of Justice of England and Wales, Chancery Division, referred to the ECJ for preliminary ruling questions on the interpretation of (now) Articles 12, 43, 48, and 56 EC.

At the time the case arose, the United Kingdom subjected companies making dividend distributions to the advance corporate tax ("ACT"), which was paid by the distributing company and was creditable against the mainstream corporate tax ("MCT") payable by the company.[76] The ACT represented a prepayment of the MCT 8½ to 17½ months in advance. If no MCT was due in a given year, the ACT credit could be carried forward or back (paragraphs 8-10). However, a United Kingdom-resident company making a dividend distribution to a United Kingdom-resident parent did not have to pay the ACT if the parent and subsidiary filed a group income election. Group income election, and therefore the exemption from the ACT, was not available to British subsidiaries with parent companies resident in other Member States (paragraphs 21-22).

Metallgesellschaft Ltd., the Metal and Commodity Company Ltd., and Hoescht UK Ltd. were companies residing in the United Kingdom. They paid dividends subject to the ACT to their parent companies located in Germany. All three British subsidiaries were later able to offset the ACT paid against the MCT for which they were liable (paragraphs 26-28).

The German parent companies argued that because they could not make a group income election to avoid payment of ACT, their subsidiaries suffered a cash flow disadvantage that British subsidiaries of British parent companies did not suffer (paragraph 30). The disadvantage, they argued, amounted to nationality discrimination. As relief for this discrimination, the German parents sought interest for the ACT paid. In the alternative, they sought a tax credit in the amount of the ACT paid by their subsidiaries, modeled on the credits granted to non-resident parents established in Member States with which the United Kingdom had double tax reduction treaties (paragraphs 17-20 and 32). The double tax convention between the United

[76] The advance corporation tax was abolished in the United Kingdom, effective in 1999.

Kingdom and Germany did not call for such credits. Hoescht argued that granting such credits by tax treaty to parent companies established only in certain Member States was an unjustified discrimination (paragraph 32).

The High Court of Justice referred the following questions to the ECJ: (1) Does it violate Community law to limit group income election to cases where both the parent and subsidiary are resident in the Member State? (2) If such a limit violates EC law, does the Treaty grant a restitutionary right to the parent for interest on the ACT paid, particularly when the ACT has since been credited against MCT due? (3) Is it consistent with EC law to deny tax credits to parents resident in one Member State when it grants those credits to residents of other Member States by means of double tax treaties? (4) If the answer to 3 is no, is the United Kingdom obliged to make the tax credit available to all Member State companies on the same terms as companies resident in Member States with tax treaties providing for the credit? (5) Is it contrary to EC law to deny or reduce a claim because the taxpayers seeking restitution never applied for group relief even though it was clear under national law that such an application would be refused?

First Question: Legality

The ECJ first held that the Article 12 general prohibition on discrimination did not apply to this case because the specific freedom of establishment of Article 43 applied (paragraph 40). The Court then noted that for corporations, the freedom of establishment included the freedom to set up agencies, branches, or subsidiaries in other Member States (paragraph 42, *citing ICI*[77] and *Saint Gobain*[78]). The ECJ observed that the contested British legislation conditioned the ability to make a group income election on whether a British subsidiary's parent resided in the United Kingdom or another Member State (paragraph 43). The inability of British subsidiaries with foreign parents to file a group election resulted in a cash flow disadvantage to the subsidiaries (paragraph 44). The ECJ held that this restriction on the freedom of establishment could not be justified by the reasons proffered by the United Kingdom and other governments (paragraph 51).

First, the United Kingdom argued that subsidiaries with domestic and those with foreign parents were not in comparable situations. In the case of a domestic parent, the ACT was not waived; it was merely deferred until the time when the parent itself made a distribution subject to ACT (paragraph 47). In contrast, if subsidiaries with foreign parents were not assessed the ACT, then no ACT would ever be paid in the United Kingdom on those profits because

[77] Case C-264/96, Imperial Chemical Industries v. H.M. Inspector of Taxes, 1998 E.C.R. 4695.
[78] Case C-307/97, Saint-Gobain v. Finanzamt Aachen-Innenstadt, 1999 E.C.R. 6161.

foreign parents were not themselves subject to ACT (paragraph 48). Therefore, permitting non-resident companies to file a group election would result in tax avoidance (paragraph 49).

The ECJ held that allowing a non-resident parent to file a group election with its subsidiaries would not allow the subsidiary to avoid tax, since the subsidiary would still owe the full MCT on its profits (paragraphs 52-53). The only effect would be to allow the subsidiary to retain the sums that would have been paid as ACT until such time as the MCT fell due. This would merely put the subsidiaries in the same cash flow position as subsidiaries of British resident parents (paragraph 54). Finally, the fact that the non-resident parent company would not be liable for the ACT cannot justify limiting the ACT exemption to subsidiaries of domestic parents. The foreign parents should not have to make an advance payment of the British corporate tax (MCT), because they will never owe the MCT (paragraph 56). Moreover, even domestic parents whose subsidiaries received the ACT exemption may never be liable for the ACT, because they may never distribute profits. The ECJ concluded that the British parents' liability for MCT is not a prerequisite for the subsidiary's ACT exemption (paragraphs 57-58). Finally, a Member State's revenue concerns cannot justify a violation of a fundamental freedom (paragraph 59).

The United Kingdom also argued that the denial of the ACT exemption for foreign parents was essential to the cohesion of the tax system, but the ECJ found no direct link between the denial of the exemption and the fact that the non-British parents were not subject to corporate tax in the United Kingdom (paragraph 70). Moreover, the Court noted that the ACT has since been abolished in the United Kingdom, which suggests that it was not essential to the proper functioning of the corporate tax system (paragraph 74).

Having found the provision to violate the freedom of establishment, the Court did not find it necessary to consider the legislation's compatibility with the freedom of capital movement (paragraph 75).

Second Question: Remedy

Having held that the United Kingdom wrongfully deprived the German parents of a tax benefit, the Court next considered whether granting interest on the ACT wrongfully paid was an appropriate remedy. The Court observed that in the absence of Community rules on restitution, it is for each Member State to designate procedures and to settle ancillary questions relating to the reimbursement of charges, including the payment of interest (paragraphs 85-86).

However, in this case, the violation of EC law was not in levying the tax, but in levying it *prematurely* (paragraph 87). In such a case, the payment of interest is not an ancillary matter but is essential to restore the equal treatment guaranteed by Article 43 (paragraph 87). Resident subsidiaries and their non-resident parents must have an effective legal remedy to obtain reimbursement of their loss (paragraph 96).

Third and Fourth Questions: Double Tax Treaty Benefits

Not considered (paragraph 97).

Fifth Question: Procedure

The United Kingdom argued that the German parents and their British subsidiaries should have applied for group relief and that their failure to do so amounted to a failure to prosecute their claim diligently, a basis upon which their claim could be refused or reduced under British law (paragraphs 98-100). The United Kingdom conceded that it was clear under national law that the British subsidiaries and their German parents could not file as a group, and that their application would have been refused, if submitted (paragraph 103). The subsidiaries would have had to pay ACT, and had the taxpayers appealed, the ACT would not have been reimbursed (paragraph 104). The ECJ held that the exercise of rights of private persons conferred by the Treaty would be rendered impossible or excessively difficult if their claims for restitution were denied or reduced solely because they did not apply for an advantage that the law denied them. Therefore, no reduction of a claim could be made on that theory (paragraphs 106-107).

JUDGMENT OF THE COURT (Fifth Chamber)

8 March 2001 (1)

In Joined Cases C-397/98 and C-410/98,

REFERENCES to the Court under Article 177 of the EC Treaty (now Article 234 EC) by the High Court of Justice of England and Wales, Chancery Division, for a preliminary ruling in the proceedings pending before that court between

Metallgesellschaft Ltd and Others (C-397/98),
Hoechst AG,
Hoechst UK Ltd (C-410/98)

and

Commissioners of Inland Revenue,

H.M. Attorney General,

on the interpretation of Articles 6 and 52 of the EC Treaty (now, after amendment, Articles 12 EC and 43 EC), Article 58 of the EC Treaty (now Article 48 EC) and/or Article 73b of the EC Treaty (now Article 56 EC),

THE COURT (Fifth Chamber),

composed of: A. La Pergola, President of the Chamber, M. Wathelet (Rapporteur), D.A.O. Edward, P. Jann and L. Sevón, Judges,

Advocate General: N. Fennelly,

Registrar: L. Hewlett, Administrator,

after considering the written observations submitted on behalf of:

- Metallgesellschaft Ltd and Others, by J. Gardiner QC and F. Fitzpatrick, Barrister, instructed by Slaughter and May, Solicitors,

- Hoechst AG and Hoechst UK Ltd, by M. Barnes QC, instructed by Slaughter and May, Solicitors,

- the United Kingdom Government, by J.E. Collins, acting as Agent, D. Wyatt QC and R. Singh, Barrister,

- the Netherlands Government, by M.A. Fierstra, acting as Agent,

- the Finnish Government, by H. Rotkirch and T. Pynnä, acting as Agents,

- the Commission of the European Communities, by R. Lyal, H. Michard and M. Patakia, acting as Agents,

having regard to the Report for the Hearing,

after hearing the oral observations of Metallgesellschaft Ltd and Others, represented by J. Gardiner and F. Fitzpatrick; of Hoechst AG and Hoechst UK Ltd, represented by M. Barnes; of the United Kingdom Government, represented by G. Amodeo, acting as Agent, and D. Wyatt; of the German Government, represented by B. Muttelsee-Schön, acting as Agent; of the French Government, represented by S. Seam, acting as Agent; of the Netherlands Government, represented by M. Fierstra; and of the Commission, represented by R. Lyal and H. Michard, at the hearing on 25 May 2000,

after hearing the Opinion of the Advocate General at the sitting on 12 September 2000,
gives the following

Judgment

1.
By two orders of 2 October 1998, received at the Court Registry on 6 November 1998 (C-397/98) and 17 November 1998 (C-410/98) respectively, the High Court of Justice of England and Wales, Chancery Division, referred to the Court for a preliminary ruling under Article 177 of the EC Treaty (now Article 234 EC) five questions on the interpretation of Articles 6 and 52 of the EC Treaty (now, after amendment, Article 12 EC and Article 43 EC), Article 58 of the EC Treaty (now Article 48 EC) and/or Article 73b of the EC Treaty (now Article 56 EC).

2.
Those questions have been raised in proceedings between, on the one hand, in Case C-397/98, Metallgesellschaft Ltd, Metallgesellschaft AG, Metallgesellschaft Handel & Beteiligungen AG and The Metal and Commodity Company Ltd ('Metallgesellschaft and Others) and, on the other, in Case C-410/98, Hoechst AG and Hoechst UK Ltd ('Hoechst), and the Commissioners of Inland Revenue, concerning the obligation imposed on companies resident in the United Kingdom to pay

advance corporation tax in respect of dividends paid to their parent companies.

The relevant national provisions

3.
Under the provisions of Part I of the Income and Corporation Taxes Act 1988 ('ICTA), profits made during an accounting period by a company resident in the United Kingdom or by a company not so resident which is trading in the United Kingdom through a branch or agency are chargeable to corporation tax.

4.
In accordance with section 12 ICTA, an accounting period is generally 12 months. For accounting periods ending before 1 October 1993, corporation tax was payable either nine months after the end of the accounting period or one month after the issue of the notice of assessment relating to that accounting period, at the taxpayer's choice. For accounting periods ending after 1 October 1993, corporation tax is due and payable nine months and a day after the end of the accounting period.

Advance corporation tax

5.
Section 14 ICTA provides that a company resident in the United Kingdom which makes certain distributions, such as the payment of dividends to its shareholders, is liable to pay advance corporation tax ('ACT) calculated on an amount equal to the amount or value of the distribution made.

6.
It is important to bear in mind that ACT is not a sum withheld on a dividend, which is paid in full, but is rather corporation tax borne by the company distributing dividends, paid in advance and set off against the mainstream corporation tax ('MCT) payable in respect of each accounting period.

7.
A company is obliged to make a return, in principle every quarter, showing the amount of any distribution made during that period and the amount of ACT payable. ACT due in respect of a distribution must be paid within 14 days of the end of the quarter in which the distribution was made.

8.
Under sections 239 and 240 ICTA, the ACT paid by a company in respect of a distribution made during a given accounting period must, in principle, subject to that company's right of surrender, either be set off against the amount which that company must pay by way of MCT for that accounting period or be transferred to that company's subsidiaries, which can set it off against the amount of MCT for which they themselves are liable. If the company is not liable for any corporation tax for the accounting period in question (because, for example, its profits are insufficient), it may either set off the ACT against the corporation tax payable for subsequent accounting periods or claim to carry the set-off back to preceding accounting periods.

9.
Whereas MCT becomes payable nine months or nine months and a day after the end of the accounting period, depending on whether that period ended before or after 1 October 1993, ACT must be paid within 14 days of the end of the quarter during which the distribution was made. Consequently, ACT is always paid before the time at which MCT - against which it can generally be set off - becomes payable. The national court points out that the effect for a company distributing dividends is therefore to advance, by a period of from eight and a half months (in the case of a distribution made on the last day of an accounting period) to one year, five and a half months (where the distribution was made on the first day of the accounting period), the date for payment of corporation tax due in respect of dividends paid.

10.
Since, where no MCT is payable for the period in question, it is even possible to set off ACT against profits of subsequent accounting periods, the national court observes that in that case the advance will have been made for a longer period and even, in certain circumstances, for an indefinite period.

Tax credit

11.
A company resident in the United Kingdom is not liable to pay corporation tax in respect of dividends which it receives from another company resident in the UnitedKingdom (section 208 ICTA). Accordingly, any distribution of dividends subject to ACT made by one resident company to another gives rise to a tax credit for the company receiving the dividends (section 231(1) ICTA).

12.
That tax credit is equal to the amount of ACT paid by the distributing company on that distribution of dividends (section 231(1) ICTA).

13.

Where a company resident in the United Kingdom receives from its resident subsidiary a distribution entitling it to a tax credit, the parent company may deduct the amount of ACT paid by its subsidiary from the amount of ACT which it must itself pay when making distributions to its own shareholders, with the result that it pays ACT only on the excess.

14.
Where a company resident in the United Kingdom, but wholly exempt from MCT, receives a dividend from its resident subsidiary on which ACT has been paid, it is entitled to payment of an amount equal to the tax credit (section 231(2) ICTA).

15.
Companies that are not resident in the United Kingdom and do not trade there through a branch or agency are not subject to corporation tax in the United Kingdom. They are, however, in principle subject to United Kingdom income tax in respect of income having its source in that Member State, including dividends paid to them by their resident subsidiaries.

16.
However, under section 233(1) ICTA, where a non-resident parent company is not in principle entitled to a tax credit in the absence of a double taxation convention to that effect concluded between the United Kingdom and its State of residence, it is not subject to United Kingdom income tax on dividends paid by its resident subsidiary.

17.
Conversely, where a non-resident parent company is entitled to a tax credit under a double taxation convention concluded between the United Kingdom and its State of residence, it is subject to United Kingdom income tax on dividends received from its resident subsidiary.

18.
The double taxation convention concluded between the United Kingdom and the Federal Republic of Germany on 26 November 1964, as amended on 23 March 1970, does not grant a right to a tax credit to companies resident in Germany which hold shares in and receive dividends from companies resident in the United Kingdom.

19.
Consequently, a parent company with its seat in Germany and receiving a distribution subject to ACT from a subsidiary resident in the United Kingdom is not entitled in the United Kingdom to a tax credit corresponding to the ACT paid and, under United Kingdom tax law, is not taxable in the United Kingdom in respect of the dividends received from its resident subsidiary.

20.
Where a non-resident parent company is entitled to a tax credit pursuant to a double taxation convention concluded between the United Kingdom and its State of residence, that company may claim to set off that credit against the income tax for which it is then liable in the United Kingdom in respect of dividends received from its resident subsidiary and, where the amount of the tax credit exceeds the amount of the tax, to be repaid the difference. If the claim is rejected, the company which made it may appeal to the Special or General Commissioners and, if necessary, from them to the High Court.

Group Income Election

21.
Under section 247 ICTA, two companies resident in the United Kingdom, one of which holds at least 51% of the other, may make a group income election.

22.
The result of such election is that the subsidiary does not pay ACT on the dividends which it pays to its parent company, unless it gives notice that it does not wish the election to apply to a particular distribution of dividends.

23.
A request for group income election must be made to an Inspector of Taxes. If the request is rejected, the requesting company may appeal against that decision to the Special or General Commissioners and, as the case may be, may appeal from them on a point of law to the High Court.

24.
Where a dividend is paid under a group income election by a subsidiary resident in the United Kingdom to its parent company which is also resident in the United Kingdom, no ACT is payable by the subsidiary and the parent company is not entitled to a tax credit. A group of companies may not simultaneously benefit from a group income election and from a tax credit in respect of the same dividend.

25.
ACT was abolished by section 31 of the Finance Act 1998 with effect from 6 April 1999. The legal provisions described above in paragraphs 5 to 24 are those which were in force prior to that date.

The facts of the main proceedings

26.
In Case C-397/98, Metallgesellschaft Ltd and The Metal and Commodity Company Ltd, companies resident in the United Kingdom, paid dividends to their respective parent companies, Metallgesellschaft AG and Metallgesellschaft Handel & Beteiligungen AG, companies having their seat in Germany, and were therefore required to pay ACT. The two subsidiaries were subsequently able to set off that ACT against the MCT for which they were liable.

27.
Metallgesellschaft and Others instituted proceedings before the High Court of Justice of England and Wales, Chancery Division, against the Commissioners of InlandRevenue in which they sought a ruling that they had suffered loss by virtue of the fact that the distribution of dividends by the subsidiaries to their parent companies had been subject to ACT. The dispute in the main proceedings concerns the amounts of ACT paid between 16 April 1974 and 1 November 1995 by Metallgesellschaft Ltd and between 11 April 1991 and 13 October 1995 by The Metal and Commodity Company Ltd.

28.
In Case C-410/98, Hoechst UK Ltd, a company resident in the United Kingdom, distributed dividends to its parent company, Hoechst AG, which has its seat in Germany, and paid the ACT due on those dividends in the United Kingdom. It was subsequently able to set off that ACT against the MCT for which it was liable.

29.
Hoechst also brought proceedings before the High Court against the Commissioners of Inland Revenue in which they sought a ruling that they had suffered loss by virtue of the fact that the dividends distributed by Hoechst UK Ltd to Hoechst AG between 16 January 1989 and 26 April 1994 had been subject to ACT. The dispute in the main proceedings concerns the amounts of ACT paid between 14 April 1989 and 13 July 1994.

30.
In each of the cases in the main proceedings, the parent companies maintain that, because it was impossible for them and their subsidiaries to make a group income election, which would have enabled the subsidiaries to avoid payment of ACT, those subsidiaries suffered a cashflow disadvantage which subsidiaries of parent companies resident in the United Kingdom did not incur. By making a group income election, the latter were able to retain, until the date when the MCT to which they were liable fell due, the sums which they would otherwise have had to pay as ACT on the distribution of dividends to their parent companies. In their view, that disadvantage amounts to indirect discrimination on grounds of nationality contrary to the EC Treaty.

31.
In the alternative, Metallgesellschaft AG and Metallgesellschaft Handel & Beteiligungen AG maintain, in Case C-397/98, that they ought to receive a tax credit corresponding, at least in part, to the ACT paid by their resident subsidiaries, similar to that afforded to a parent company resident in the United Kingdom or to a parent company not resident in the United Kingdom but entitled to a tax credit under a double taxation convention.

32.
In Case C-410/98, if the Court were to find that Hoechst UK Ltd is not entitled to repayment of interest due in respect of the ACT paid, Hoechst AG claims, in the alternative, payment of tax credits corresponding to that ACT or a sum equivalent to the credits which a parent company resident in the Netherlands would have received. According to Hoechst AG, the fact that United Kingdom tax legislation authorises the grant of tax credits to parent companies which are not resident in the United Kingdom in respect of the ACT paid by their resident subsidiaries only where a double taxation convention so provides, which is the case with the convention concluded between the United Kingdom and the Kingdom of the Netherlands but not the case with theconvention concluded between the United Kingdom and the Federal Republic of Germany, amounts to unjustified discrimination between parent companies resident in different Member States, contrary to the Treaty.

The questions submitted for preliminary ruling

33.
As it took the view that the outcome of the cases pending before it depended on an interpretation of Community law, the High Court of Justice of England and Wales, Chancery Division, decided to stay proceedings and to refer the following questions, identically worded in each case, to the Court for a preliminary ruling:

'(1) In the circumstances set out in the orders for reference, is it consistent with Community law and, in particular, with Articles 6, 52, 58 and/or 73b of the

EC Treaty for the legislation of a Member State to permit a group income election (allowing distributions to be paid by a subsidiary to its parent without accounting for advance corporation tax (ACT)) only where both the subsidiary and parent are resident in that Member State?

(2) If the answer to Question 1 is no, do the abovementioned provisions of the EC Treaty give rise to a restitutionary right for a resident subsidiary of a parent company resident in another Member State and/or the said parent to claim a sum of money by way of interest on the ACT which the subsidiary paid on the basis that the national laws did not allow it to make a group income election, or can such a sum only be claimed, if at all, by way of an action for damages pursuant to the principles laid down by the Court of Justice in Joined Cases C-46/93 and C-48/93 Brasserie du Pêcheur SA v Federal Republic of Germany and R v Secretary of State for Transport, ex parte Factortame and Others [1996] ECR I-1029 and Case C-66/95 R v Secretary of State for Social Security, ex parte Eunice Sutton [1997] ECR I-2163, and in either case is the national court obliged to grant a remedy even if under national law interest cannot be awarded (whether directly or by way of restitution or damages) on principal sums which are no longer owing to the plaintiffs?

(3) In the circumstances set out in the orders for reference, is it consistent with the abovementioned provisions of the EC Treaty for the authorities of one Member State to deny any tax credit to a company resident in another Member State when it grants such credit to resident companies and to companies resident in certain other Member States by virtue of the terms of its double taxation conventions with those other Member States?

(4) If the answer to Question 3 above is no, is and was the first Member State at all material times obliged to make a tax credit available to such company on the same terms as to resident companies or as to companies resident in Member States with provision for such credits in their double- taxation conventions?

(5) Is a Member State entitled to plead in answer to such a claim for restitution, tax credit or damages, that the plaintiffs are not entitled to recover, or that the plaintiffs' claim should be reduced, on the grounds that, despite the terms of the national statute which prevented them from doing so, as a matter of national law they ought to have made a group income election, or claimed a tax credit and have appealed to the Commissioners and, if necessary, the courts, against the decision of the Inspector of Taxes refusing the election or claim, relying upon the primacy and direct effect of the provisions of Community law?

34.
By order of the President of the Court of 14 December 1998, Cases C-397/98 and C-410/98 were joined for the purposes of the written procedure, the oral procedure and the judgment.

The first question

35.
By its first question, the national court is in substance asking whether it is contrary to Articles 6, 52, 58 and/or 73b of the Treaty for the tax legislation of a Member State, such as that in issue in the main proceedings, to afford companies resident in that Member State the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that Member State but to deny them that possibility where their parent company has its seat in another Member State.

36.
According to Metallgesellschaft and Others and Hoechst, the national legislation in question tends to discourage companies resident in another Member State from establishing subsidiaries in the United Kingdom and therefore constitutes an unjustified restriction on freedom of establishment. Their subsidiary submission is that that legislation is likewise incompatible with the Treaty provisions on the free movement of capital.

37.
It should be remembered that, according to settled case-law, although direct taxation falls within their competence, Member States must none the less exercise that competence consistently with Community law and avoid any discrimination on grounds of nationality (Case C-80/94 Wielockx [1995] ECR I-2493, paragraph 16, Case C-107/94 Asscher [1996] ECR I-3089, paragraph 36, Case C-311/97 Royal Bank of Scotland [1999] ECR I-2651, paragraph 19, and Case C-251/98 Baars [2000] ECR I-2787, paragraph 17).

38.
It follows from the Court's case-law that the general prohibition of all discrimination on grounds of nationality laid down by Article 6 of the Treaty applies independently only to situations governed by

Community law for which the Treaty lays down no specific non-discrimination rules (Case 305/87 Commission v Greece [1989] ECR 1461, paragraphs 12 and 13, Case C-1/93 Halliburton Services [1994] ECR I-1137,paragraph 12, Royal Bank of Scotland, cited above, paragraph 20, and Baars, cited above, paragraph 23).

39.
It is common ground that, in relation to the right of establishment, the principle of non-discrimination was implemented and specifically laid down by Article 52 of the Treaty (Halliburton Services, cited above, paragraph 12, Case C-193/94 Skanavi and Chryssanthakopoulos [1996] ECR I-929, paragraph 21, and Baars, paragraph 24).

40.
Consequently, Article 6 of the Treaty is not applicable to the cases in the main proceedings. The question whether legislation such as that in question imposes an unwarranted restriction on freedom of establishment must therefore first of all be determined in the light of Article 52 of the Treaty.

41.
Article 52 of the Treaty constitutes one of the fundamental provisions of Community law and has been directly applicable in the Member States since the end of the transitional period. Under that provision, freedom of establishment for nationals of one Member State within the territory of another Member State includes the right to take up and pursue activities as self-employed persons and to set up and manage undertakings under the conditions laid down for its own nationals by the law of the country where such establishment is effected. The abolition of restrictions on freedom of establishment also applies to restrictions on the setting up of agencies, branches or subsidiaries by nationals of any Member State established in the territory of another Member State (Case 270/83 Commission v France [1986] ECR 273, paragraph 13, and Royal Bank of Scotland, paragraph 22).

42.
Freedom of establishment thus defined includes, pursuant to Article 58 of the Treaty, the right of companies or firms formed in accordance with the law of a Member State and having their registered office, central administration or principal place of business within the Community, to pursue their activities in the Member State concerned through a branch or agency (Case C-264/96 ICI [1998] ECR I-4695, paragraph 20, and the case-law cited therein, and Case C-307/97 Saint-Gobain ZN [1999] ECR I-6161, paragraph 34). With regard to companies, it should be noted in this context that it is their corporate seat in the above sense that serves as the connecting factor with the legal system of a particular State, like nationality in the case of natural persons (ICI, cited above, paragraph 20, and the case-law cited therein, and Saint-Gobain ZN, cited above, paragraph 35). Acceptance of the proposition that the Member State in which a company seeks to establish itself may freely apply to it a different treatment solely by reason of the fact that its registered office is situated in another Member State would thus deprive Article 52 of all meaning (Commission v France, cited above, paragraph 18).

43.
With regard to the right to make a group income election, the legislation in question creates a difference in treatment between subsidiaries resident in the United Kingdom depending on whether or not their parent company has its seat in the United Kingdom. Resident subsidiaries of companies having their seat in the United Kingdom may, subject to certain conditions, avail themselves of the group income election regime andthus be relieved of the obligation to pay ACT when distributing dividends to their parent companies. By contrast, that advantage is denied to the resident subsidiaries of companies not having their seat in the United Kingdom and which are therefore obliged to pay ACT whenever they distribute dividends to their parent companies.

44.
It is not disputed that this gives the subsidiary of a parent company resident in the United Kingdom a cashflow advantage inasmuch as it retains the sums which it would otherwise have had to pay by way of ACT until such time as MCT becomes payable, that is to say, for a period of between eight and a half months, at the least, and 17 and a half months, at the most, depending on the date of distribution. Where MCT is not payable at all for the accounting period in question, this entails an even longer period, since ACT can be set off against corporation tax due in respect of subsequent accounting periods.

45.
According to the United Kingdom, Finnish and Netherlands Governments, the difference in treatment for tax purposes between subsidiaries resident in the United Kingdom depending on whether or not their parent company is resident in that Member State is objectively justified.

46.

The first submission of the United Kingdom Government is that the situation of resident subsidiaries of resident parent companies is not comparable to that of resident subsidiaries of non-resident parent companies.

47.
So far as resident subsidiaries of resident parent companies are concerned, the United Kingdom Government claims that, even though making a group income election relieves the subsidiary of the obligation to pay ACT when paying dividends to its parent company, that payment is merely deferred, in that the parent company, being resident, is itself required to pay ACT when it makes distributions subject to that tax. The obligation to pay ACT when paying dividends is therefore transferred from the subsidiary to the parent company and the subsidiary's exemption from ACT is offset by the parent company's liability to ACT.

48.
By contrast, according to the United Kingdom Government, if resident subsidiaries and their non-resident parent companies were able to benefit from the group election regime, no ACT at all would be paid in the United Kingdom. The subsidiary would be exempt from payment of ACT when paying dividends to its parent company, but that exemption would not be offset by any subsequent payment of ACT by the non-resident parent company when it made distributions, in that it is not subject to United Kingdom corporation tax or, therefore, to ACT.

49.
The Netherlands Government maintains that the principle of territoriality allows a Member State to reserve to resident parent companies the possibility of opting for a regime such as group income election since even though, under such a regime, the State waives levying the tax on the subsidiary, it does not renounce its right to that tax, since the effect of that regime is simply to put back the charging of ACT to anotherlevel within the same group of companies. By contrast, if the exemption from ACT under a group income election were granted to subsidiaries of parent companies not resident in the United Kingdom, no ACT would be charged in the United Kingdom on transactions within the group since the other group companies are in another Member State and are not subject to corporation tax in the United Kingdom. That would be tantamount to tax avoidance.

50.
The Finnish Government also submits that affording subsidiaries of parent companies not resident in the United Kingdom the possibility of making a group income election would allow those subsidiaries to avoid taxation in the United Kingdom since their parent companies are not subject to tax in that Member State.

51.
Those arguments cannot be upheld.

52.
First, in so far as ACT is in no sense a tax on dividends but rather an advance payment of corporation tax, it is incorrect to suppose that affording resident subsidiaries of non-resident parent companies the possibility of making a group income election would allow the subsidiary to avoid paying any tax in the United Kingdom on profits distributed by way of dividends.

53.
The proportion of corporation tax which a resident subsidiary need not pay in advance when distributing dividends to its parent company under the group income election regime is in principle paid when the subsidiary's MCT liability falls due. It should be remembered that a resident subsidiary of a company resident in another Member State is liable to MCT in the United Kingdom in respect of its profits in the same way as a resident subsidiary of a resident parent company.

54.
Consequently, to afford resident subsidiaries of non-resident companies the possibility of making a group income election would do no more than allow them to retain the sums which would otherwise be payable by way of ACT until such time as MCT falls due. They would thus enjoy the same cashflow advantage as resident subsidiaries of resident parent companies, there being no other difference - assuming equal bases of assessment - between the amounts of MCT for which the two types of subsidiary are liable in respect of the same accounting period.

55.
Second, the fact that a non-resident parent company will, unlike a resident parent company, not be subject to ACT when it in turn pays out dividends cannot justify denying the resident subsidiary of the non-resident parent the possibility of exemption from payment of ACT when paying dividends to the parent.

56.

The fact that a non-resident parent company is not liable to ACT is attributable to its not being liable to corporation tax in the United Kingdom, since it is subject to that tax in its State of establishment. Logic therefore requires that a company should not have to make advance payment of a tax to which it will never be liable.

57.
Third, as regards the risk of tax avoidance, the Court has already held that the establishment of a company outside the United Kingdom does not, of itself, necessarily entail tax avoidance, since that company will in any event be subject to the tax legislation of the State of establishment (ICI, paragraph 26).

58.
Moreover, it would seem that it is acceptable to the tax law of the United Kingdom, so far as resident parent companies are concerned, for no ACT to be paid ultimately by companies which have made a group income election. In certain cases, the parent company to which dividends have been distributed under such a taxation regime will not itself pay any ACT. In particular, it may make no distribution liable to ACT or it may make distributions under the group income election which would otherwise have been liable to ACT. The liability of a resident parent of a resident subsidiary to pay ACT does not, therefore, even necessarily offset the release, arising from the group income election, of its subsidiary from the obligation to pay ACT.

59.
Fourth and finally, as regards the loss of revenue for the United Kingdom tax authorities which would result from affording resident subsidiaries of non-resident parent companies the possibility of making a group income election and thus to be exempted from paying ACT, suffice it to point out that it is settled case-law that diminution of tax revenue cannot be regarded as a matter of overriding general interest which may be relied upon in order to justify a measure which is, in principle, contrary to a fundamental freedom (see, in relation to Article 52 of the Treaty, ICI, paragraph 28).

60.
Consequently, as the Advocate General has pointed out in paragraph 25 of his Opinion, the difference in the tax treatment of parent companies depending on whether or not they are resident cannot justify denial of a tax advantage to subsidiaries, resident in the United Kingdom, of parent companies having their seat in another Member State where that advantage is available to subsidiaries, resident in the United Kingdom, of parent companies also resident in the United Kingdom, since all those subsidiaries are liable to MCT on their profits irrespective of the place of residence of their parent companies.

61.
The second submission of the United Kingdom Government is that the refusal to grant resident subsidiaries of non-resident parent companies the right to make a group income election is justified by the need to preserve the cohesion of the United Kingdom's tax system.

62.
The Government contends that the principle on which the United Kingdom's tax system is based is that companies should be liable to tax in respect of their profits and that their members should at the same time be liable to tax in respect of their share of those profits which the companies, in certain cases, pay out in the form of dividends. In order to mitigate that double taxation in economic terms, corporate shareholders resident in the United Kingdom are exempt from corporation tax on the dividendswhich they receive from their resident subsidiaries, as that exemption is offset by the ACT charge on the payment of dividends by subsidiaries to their parent companies.

63.
The United Kingdom Government submits that there is therefore a direct link between the exemption from corporation tax accorded to a parent company in respect of dividends received from its resident subsidiary and the liability of that subsidiary to ACT when it pays those dividends. The requirement that ACT be paid by the company distributing dividends is essential in order to ensure that, before the company receiving dividends is granted any exemption, the distributing company is taxed on those dividends, whether or not it is subject to corporation tax in respect of profits made during the accounting period in the course of which the dividends are paid.

64.
Where a resident subsidiary is not required to pay ACT when it distributes dividends, on the ground that it has, with its resident parent company, made a group income election, it is the ACT to be paid by the parent company when it in turn distributes dividends that will offset the exemption of the parent company from corporation tax in respect of the dividends which it has received.

65.

According to the United Kingdom Government, to authorise exemption from ACT where a resident subsidiary pays dividends to its non-resident parent company would mean that the tax exemption afforded to the parent company in respect of the dividends received would not be offset by any tax charged on the payment of those dividends, which would be incompatible with the cohesion of the United Kingdom tax system.

66.
That line of argument cannot be upheld.

67.
The Court of Justice has, it is true, held that the need to safeguard the cohesion of a tax system may justify rules that are liable to restrict fundamental freedoms (Case C-204/90 Bachmann [1992] ECR I-249 and Case C-300/90 Commission v Belgium [1992] ECR I-305).

68.
That is not, however, the case here.

69.
Whereas in the cases of Bachmann and Commission v Belgium, cited above, there was a direct link between the deductibility of contributions paid for old-age and life assurance contracts and the taxation of the sums paid out under those contracts, a link which had to be maintained in order to safeguard the cohesion of the tax system in question, there is no such direct link in the present cases between, on the one hand, the refusal to exempt subsidiaries in the United Kingdom of non-resident parent companies from payment of ACT under a group income election and, on the other, the fact that parent companies having their seat in another Member State and receiving dividends from their subsidiaries in the United Kingdom are not liable to corporation tax in the United Kingdom.

70.
Parent companies, whether resident or not, are exempt from corporation tax in the United Kingdom in respect of dividends received from their resident subsidiaries. Itis irrelevant for the purposes of granting a tax advantage such as exemption from ACT under the group income election regime that, for resident parent companies, such exemption is intended to prevent double taxation of the profits of subsidiaries in the United Kingdom and that, for non-resident parent companies, that exemption simply results from the fact that they are not in any event subject to corporation tax in that Member State, being subject to a comparable tax in the Member State in which they are established.

71.
Furthermore, the only tax to which a non-resident parent company is liable in the United Kingdom in respect of dividends received from its resident subsidiary is income tax, but that liability is linked to the grant, if any, of tax credits provided for by a double taxation convention concluded between the United Kingdom and the State of residence of the parent company.

72.
With regard to the plaintiffs in the main proceedings, parent companies resident in Germany are not liable to income tax in the United Kingdom on dividends received from their subsidiaries resident in the United Kingdom since the double taxation convention concluded between the United Kingdom and the Federal Republic of Germany does not provide for the grant of tax credits corresponding to the ACT paid by subsidiaries.

73.
Consequently, the refusal to allow subsidiaries, resident in the United Kingdom, of parent companies resident in another Member State to make a group income election cannot be justified on grounds relating to the need to preserve the cohesion of the United Kingdom's tax system.

74.
Moreover, the fact that ACT has in the meantime been abolished suggests that its payment was not essential to the proper functioning of the corporation tax system in the United Kingdom.

75.
Since legislation such as that in question runs counter to the Treaty provisions on freedom of establishment, it is unnecessary to consider whether it also runs counter to the Treaty provisions on the free movement of capital.

76.
The answer to the first question must therefore be that it is contrary to Article 52 of the Treaty for the tax legislation of a Member State, such as that in issue in the main proceedings, to afford companies resident in that Member State the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that Member State

but to deny them that possibility where their parent company has its seat in another Member State.

The second question

77.
Having regard to the answer given to the first question, the second question seeks in substance to ascertain whether, on a proper construction of Article 52 of the Treaty, where a subsidiary resident in the Member State concerned and its parent company having its seat in another Member State have been wrongfully deprived of the benefit of a taxation regime which would have enabled the subsidiary to pay dividends to its parent company without having to pay advance corporation tax, that subsidiary and/or its parent company are/is entitled to obtain a sum equal to the interest accrued on the advance payments made by the subsidiary from the date of those payments until the date on which the tax became chargeable, even when national law prohibits the payment of interest on a principal sum which is not due. The national court frames that question in two hypotheses: in the first alternative, where the claim by the subsidiary and/or parent company is made in an action for restitution of taxes levied in breach of Community law and, in the second, where the claim is made in an action for compensation for damage resulting from the breach of Community law.

78.
The United Kingdom Government maintains, first, that if it should be held that it was contrary to Community law to deny resident subsidiaries of parent companies not resident in the United Kingdom the benefit of the group income election regime, Community law would require that breach to be remedied, not through an action for restitution but through an action brought against the State for damages for loss occasioned by its breach of Community law. In its view, ACT is not a tax levied contrary to Community law, since subsidiaries are in any event bound to pay by way of MCT the sums paid by way of ACT. It is the fact that the United Kingdom legislature failed to provide for the possibility of a resident subsidiary and its non-resident parent making a group income election that is at the origin of the disputes in the main proceedings and that might cause the United Kingdom to incur non-contractual liability. In Sutton, cited above, the Court held, in particular, that in the case of damage arising out of breach of a directive, Community law does not require a Member State to pay a sum equivalent to the interest on a sum paid late, in that case arrears of social security benefits. From this the United Kingdom Government concludes that Community law does not require interest to be paid in respect of the loss of use of a sum of money for a certain period on account of the advance levying of a tax contrary to Community law.

79.
Second, the United Kingdom Government argues that, even if the plaintiffs' claims were to be treated as claims for recovery of sums paid in breach of Community law, such claims cannot be upheld inasmuch as settled case-law states that it is for national law to determine whether interest is payable in connection with reimbursement of charges improperly levied in the light of Community law. Under English law, entitlement to interest depends on whether or not proceedings were commenced before payment of the sum on which interest is claimed.

80.
In consequence, the United Kingdom Government submits that the plaintiffs in the main proceedings cannot claim interest under a claim for restitution or for damages inasmuch as the principal sums claimed were repaid by set-off of ACT against theamounts due by way of MCT payable by the subsidiaries before the proceedings were brought.

81.
It must be stressed that it is not for the Court to assign a legal classification to the actions brought by the plaintiffs before the national court. In the circumstances, it is for Metallgesellschaft and Others and Hoechst to specify the nature and basis of their actions (whether they are actions for restitution or actions for compensation for damage), subject to the supervision of the national court.

82.
First, on the assumption that the actions brought by the plaintiffs in the main proceedings are to be treated as claims for restitution of a charge levied in breach of Community law, the question is whether, in circumstances such as those in the main proceedings, a breach of Article 52 of the Treaty by a Member State entitles taxpayers to reimbursement of interest accrued on the tax they have paid from the date of its premature payment until the date on which it properly fell due.

83.
It is important to bear in mind in this regard that what is contrary to Community law, in the disputes in the main proceedings, is not the levying of a tax in the United Kingdom on the payment of dividends by a subsidiary to its parent company but the fact that subsidiaries, resident in the United Kingdom, of

parent companies having their seat in another Member State were required to pay that tax in advance whereas resident subsidiaries of resident parent companies were able to avoid that requirement.

84.
According to well-established case-law, the right to a refund of charges levied in a Member State in breach of rules of Community law is the consequence and complement of the rights conferred on individuals by Community provisions as interpreted by the Court (judgments in Case 199/82 San Giorgio [1983] ECR 3595, paragraph 12; Case 309/85 Barra [1988] ECR 355, paragraph 17; Case C-62/93 BP Supergas [1995] ECR I-1883, paragraph 40; Case C-343/96 Dilexport [1999] ECR I-579, paragraph 23; and judgment of 21 September 2000 in Joined Cases C-441/98 and C-442/98 Michailidis [2000] ECR I-0000, paragraph 30). The Member State is therefore required in principle to repay charges levied in breach of Community law (Joined Cases C-192/95 to C-218/95 Comateb and Others [1997] ECR I-165, paragraph 20, Dilexport, cited above, paragraph 23, and Michailidis, cited above, paragraph 30).

85.
In the absence of Community rules on the restitution of national charges that have been improperly levied, it is for the domestic legal system of each Member State to designate the courts and tribunals having jurisdiction and to lay down the detailed procedural rules governing actions for safeguarding rights which individuals derive from Community law, provided, first, that such rules are not less favourable than those governing similar domestic actions (principle of equivalence) and, second, that they do not render practically impossible or excessively difficult the exercise of rights conferred by Community law (principle of effectiveness) (see, in particular, Case C-231/96 Edis [1998] ECR I-4951, paragraphs 19 and 34, Case C-260/96 Spac [1998]ECR I-4997, paragraph 18, Case C-228/96 Aprile [1998] ECR I-7141, paragraph 18, and Dilexport, paragraph 25).

86.
It is likewise for national law to settle all ancillary questions relating to the reimbursement of charges improperly levied, such as the payment of interest, including the rate of interest and the date from which it must be calculated (Case 26/74 Roquette Frères v Commission [1976] ECR 677, paragraphs 11 and 12, and Case 130/79 Express Dairy Foods [1980] ECR 1887, paragraphs 16 and 17).

87.
In the main proceedings, however, the claim for payment of interest covering the cost of loss of the use of the sums paid by way of ACT is not ancillary, but is the very objective sought by the plaintiffs' actions in the main proceedings. In such circumstances, where the breach of Community law arises, not from the payment of the tax itself but from its being levied prematurely, the award of interest represents the 'reimbursement of that which was improperly paid and would appear to be essential in restoring the equal treatment guaranteed by Article 52 of the Treaty.

88.
The national court has said that it is in dispute whether English law provides for restitution in respect of damage arising from loss of the use of sums of money where no principal sum is due. It must be stressed that in an action for restitution the principal sum due is none other than the amount of interest which would have been generated by the sum, use of which was lost as a result of the premature levy of the tax.

89.
Consequently, Article 52 of the Treaty entitles a subsidiary resident in the United Kingdom and/or its parent company having its seat in another Member State to obtain interest accrued on the ACT paid by the subsidiary during the period between the payment of ACT and the date on which MCT became payable, and that sum may be claimed by way of restitution.

90.
Second, assuming that the plaintiffs' claims are to be treated as claims for compensation for damage caused by breach of Community law, the question is whether, in circumstances such as those in the main proceedings, breach of Article 52 of the Treaty by a Member State entitles the taxpayer to payment of damages in a sum equal to the interest accrued on the tax which they have paid from the date of premature payment until the date on which it properly fell due.

91.
In that regard, as the Court has already held in paragraph 87 of its judgment in Brasserie du Pêcheur and Factortame, cited above, total exclusion of loss of profit as a head of damage for which reparation may be awarded cannot be accepted in the case of a breach of Community law since, especially in the context of economic or commercial litigation, such a total exclusion of loss of profit would be such as to make reparation of damage practically impossible.

92.

In this regard, the United Kingdom Government's argument that the plaintiffs could not be awarded interest if they sought compensation in a claim for damages cannot be accepted.

93.
Admittedly, the Court ruled in Sutton that the Community directive at issue in that case conferred only the right to obtain the benefits to which the person concerned would have been entitled in the absence of discrimination and that the payment of interest on arrears of benefits could not be regarded as an essential component of the right as so defined. However, in the present cases, it is precisely the interest itself which represents what would have been available to the plaintiffs, had it not been for the inequality of treatment, and which constitutes the essential component of the right conferred on them.

94.
Moreover, in paragraphs 23 to 25 of Sutton, the Court distinguished the circumstances of that case from those of Case C-271/91 Marshall [1993] ECR I-4367 ('Marshall II). In the latter case, which concerned the award of interest on amounts payable by way of reparation for loss and damage sustained as a result of discriminatory dismissal, the Court ruled that full compensation for the loss and damage sustained cannot leave out of account factors, such as the effluxion of time, which may in fact reduce its value, and that the award of interest is an essential component of compensation for the purposes of restoring real equality of treatment (Marshall II, cited above, paragraphs 24 to 32). The award of interest was held in that case to be an essential component of the compensation which Community law required to be paid in the event of discriminatory dismissal.

95.
In circumstances such as those in the cases in the main proceedings, the award of interest would therefore seem to be essential if the damage caused by the breach of Article 52 of the Treaty is to be repaired.

96.
The answer to the second question referred must therefore be as follows:

- Where a subsidiary resident in one Member State has been obliged to pay advance corporation tax in respect of dividends paid to its parent company having its seat in another Member State even though, in similar circumstances, the subsidiaries of parent companies resident in the first Member State were entitled to opt for a taxation regime that allowed them to avoid that obligation, Article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained and from which the authorities of the Member State concerned have benefited as a result of the advance payment of tax by the subsidiaries.

- The mere fact that the sole object of such an action is the payment of interest equivalent to the financial loss suffered as a result of the loss of use of thesums paid prematurely does not constitute a ground for dismissing such an action.

- While, in the absence of Community rules, it is for the domestic legal system of the Member State concerned to lay down the detailed procedural rules governing such actions, including ancillary questions such as the payment of interest, those rules must not render practically impossible or excessively difficult the exercise of rights conferred by Community law.

The third and fourth questions

97.
In light of the answer given to the first question, it is unnecessary to reply to the third and fourth questions.

The fifth question

98.
By its fifth question, the national court is seeking in substance to ascertain whether it is contrary to Community law for a national court to refuse or reduce a claim brought before it by a resident subsidiary and its non-resident parent company for reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary, on the sole ground that they did not apply to the tax authorities in order to benefit from the taxation regime which would have exempted the subsidiary from making payments in advance and did not therefore make use of the legal remedies available to them to challenge the refusals of the tax authorities, by invoking the primacy and direct effect of the provisions of Community law, where upon any view national law denied resident subsidiaries and their non-resident parent companies the benefit of that taxation regime.

99.
According to the United Kingdom Government, were refusal to allow resident subsidiaries of non-resident parent companies the benefit of a group income

election to be held to be contrary to Community law, the appropriate legal recourse would be an action to establish State liability in accordance with the conditions laid down by the Court in Brasserie du Pêcheur and Factortame. It claims that it can plead, by way of defence to such actions for damages, that the claimants failed to act diligently, in that they did not at the outset apply to make a group income election, which would have enabled them to challenge the refusal of the tax authorities and to invoke the primacy and direct effect of Community law in order to obtain, in particular, a reference for a preliminary ruling at the earliest opportunity.

100.
That argument is not based on the existence in national law of any rule of limitation or time bar.

101.
The United Kingdom Government considers its position to be well founded, having regard in particular to paragraphs 84 and 85 of Brasserie du Pêcheur and Factortame,in which the Court ruled that, in accordance with a general principle common to the legal systems of the Member States, the injured party must show reasonable diligence in limiting the extent of the loss or damage, or risk having to bear the damage himself, and, therefore, that in order to determine the loss or damage for which reparation may be granted, the national court may inquire whether the injured person showed reasonable diligence in order to avoid the loss or damage or limit its extent and whether, in particular, he availed himself in time of all the legal remedies available to him.

102.
First of all, it must be borne in mind that actions such as those in the main proceedings are subject to national rules of procedure, which may in particular require plaintiffs to act with reasonable diligence in order to avoid loss or damage or to limit its extent.

103.
Next, it is not disputed that in the cases in the main proceedings the tax legislation of the United Kingdom clearly denied resident subsidiaries of non-resident parent companies the benefit of the group income election, with the result that the plaintiffs cannot be faulted for failure to indicate their intention to apply to make a group income election. According to the orders for reference, it is not disputed that, had the plaintiffs applied for that taxation regime, their application would have been refused by the Inspector of Taxes because the parent companies were not resident in the United Kingdom.

104.
Finally, the orders for reference make it clear that an appeal against such a refusal by the tax authorities could have been brought before the Special or General Commissioners and then, if necessary, before the High Court. According to the national court, before judgment could be given in such an appeal, the subsidiaries would still have had to pay ACT in respect of all the dividends which they had paid out and, furthermore, if the appeal had succeeded, they would not have obtained reimbursement of the ACT, since no such right to reimbursement exists under English law. If the subsidiaries had chosen not to pay ACT in respect of dividends paid before the determination of their appeals, they would nevertheless have been assessed to ACT, would have had to pay interest on those sums and would have laid themselves open to statutory penalties if they had been judged to have acted negligently and without reasonable cause.

105.
It therefore appears that, in the cases in the main proceedings, the United Kingdom Government is blaming the plaintiffs for lack of diligence and for not availing themselves earlier of legal remedies other than those which they took to challenge the compatibility with Community law of the national provisions denying a tax advantage to subsidiaries of non-resident parent companies. It is thus criticising the plaintiffs for complying with national legislation and for paying ACT without applying for the group income election regime or using the available legal remedies to challenge the refusal with which the tax authorities would inevitably have met their application.

106.
The exercise of rights conferred on private persons by directly applicable provisions of Community law would, however, be rendered impossible or excessively difficult if their claims for restitution or compensation based on Community law were rejected or reduced solely because the persons concerned had not applied for a tax advantage which national law denied them, with a view to challenging the refusal of the tax authorities by means of the legal remedies provided for that purpose, invoking the primacy and direct effect of Community law.

107.
The answer to the fifth question must therefore be that it is contrary to Community law for a national court to refuse or reduce a claim brought before it by a resident subsidiary and its non-resident parent

company for reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary, on the sole ground that they did not apply to the tax authorities in order to benefit from the taxation regime which would have exempted the subsidiary from making payments in advance and that they therefore did not make use of the legal remedies available to them to challenge the refusals of the tax authorities, by invoking the primacy and direct effect of the provisions of Community law, where upon any view national law denied resident subsidiaries and their non-resident parent companies the benefit of that taxation regime.

Costs

108.
The costs incurred by the United Kingdom, German, French, Netherlands and Finnish Governments and by the Commission, which have submitted observations to the Court, are not recoverable. Since these proceedings are, for the parties to the main proceedings, a step in the proceedings pending before the national court, the decision on costs is a matter for that court.

On those grounds,

THE COURT (Fifth Chamber),

in answer to the questions referred to it by the Court of Justice of England and Wales, Chancery Division, by orders of 2 October 1998, hereby rules:

1. It is contrary to Article 52 of the EC Treaty (now, after amendment, Article 43 EC) for the tax legislation of a Member State, such as that in issue in the main proceedings, to afford companies resident in that Member State the possibility of benefiting from a taxation regime allowing them to pay dividends to their parent company without having to pay advance corporation tax where their parent company is also resident in that Member State but to deny them that possibility where their parent company has its seat in another Member State.

2. Where a subsidiary resident in one Member State has been obliged to pay advance corporation tax in respect of dividends paid to its parent companyhaving its seat in another Member State even though, in similar circumstances, the subsidiaries of parent companies resident in the first Member State were entitled to opt for a taxation regime that allowed them to avoid that obligation, Article 52 of the Treaty requires that resident subsidiaries and their non-resident parent companies should have an effective legal remedy in order to obtain reimbursement or reparation of the financial loss which they have sustained and from which the authorities of the Member State concerned have benefited as a result of the advance payment of tax by the subsidiaries.

The mere fact that the sole object of such an action is the payment of interest equivalent to the financial loss suffered as a result of the loss of use of the sums paid prematurely does not constitute a ground for dismissing such an action.

While, in the absence of Community rules, it is for the domestic legal system of the Member State concerned to lay down the detailed procedural rules governing such actions, including ancillary questions such as the payment of interest, those rules must not render practically impossible or excessively difficult the exercise of rights conferred by Community law.

3. It is contrary to Community law for a national court to refuse or reduce a claim brought before it by a resident subsidiary and its non-resident parent company for reimbursement or reparation of the financial loss which they have suffered as a consequence of the advance payment of corporation tax by the subsidiary, on the sole ground that they did not apply to the tax authorities in order to benefit from the taxation regime which would have exempted the subsidiary from making payments in advance and that they therefore did not make use of the legal remedies available to them to challenge the refusals of the tax authorities, by invoking the primacy and direct effect of the provisions of Community law, where upon any view national law denied resident subsidiaries and their non-resident parent companies the benefit of that taxation regime.

La Pergola
Wathelet
Edward
Jann Sevón

Delivered in open court in Luxembourg on 8 March 2001.
R. Grass
A. La Pergola
Registrar
President of the Fifth Chamber

1: Language of the cases: English.

Supreme Court of the United States
BACCHUS IMPORTS, LTD. et al.
v.
Herbert H. DIAS, Director of Taxation of the State of Hawaii, et al.
No. 82-1565.

Argued Jan. 11, 1984.
Decided June 29, 1984.

Syllabus[1]

Hawaii imposes a 20% excise tax on sales of liquor at wholesale. But to encourage the development of the Hawaiian liquor industry, okolehao, a brandy distilled from the root of an indigenous shrub of Hawaii, and fruit wine manufactured in the State are exempted from the tax. Appellant liquor wholesalers, who sell to retailers at the wholesale price plus the tax, brought an action in the Hawaii Tax Appeal Court seeking a refund of taxes paid under protest and alleging that the tax is unconstitutional because it violates, inter alia, the Commerce Clause. The court rejected this constitutional claim, and the Hawaii Supreme Court affirmed, holding that the tax did not illegally discriminate against interstate commerce because the incidence of the tax is on the wholesalers and the ultimate burden is borne by consumers in Hawaii.

Held:

1. Appellants have standing to challenge the tax in this Court. Although they may pass the tax on to their customers, they are liable for it and must return it to the State whether or not their customers pay their bills. Moreover, even if the tax is passed on, it increases the price as compared to the exempted beverages, and appellants are entitled to litigate whether the tax has had an adverse competitive impact on their business. P. 3053.

2. The tax exemption for okolehao and fruit wine violates the Commerce Clause, because it has both the purpose and effect of discriminating in favor of local products. Pp. 3053-3056.

(a) Neither the fact that sales of the exempted beverages constitute only a small part of the total liquor sales in Hawaii nor the fact that the exempted beverages do not present a "competitive threat" to other liquors is dispositive of the question whether competition exists between the exempt beverages and foreign beverages but only goes to the extent of such competition. On the facts, it cannot be said that no competition exists. Pp. 3053-3054.

(b) As long as there is some competition between the exempt beverages and nonexempt products from outside the State, there is a discriminatory effect. The Commerce Clause limits the manner in which a State may legitimately compete for interstate trade, for in the process of competition no State may discriminatorily tax products manufactured in any other State. Here, it cannot properly be concluded that there was no ***264** improper discrimination against interstate commerce merely because the burden of the tax was borne by consumers in Hawaii. Nor does the propriety of economic protectionism hinge upon characterizing the industry in question as "thriving" or "struggling." And it is irrelevant to the Commerce Clause inquiry that the legislature's motivation was the desire to aid the makers of the locally produced beverages rather than to harm out-of-state producers. Pp. 3054-3056.

3. The tax exemption is not saved by the Twenty-first Amendment. The exemption violates a central tenet of the Commerce Clause but is not supported by any clear concern of that Amendment in combating the evils of an unrestricted traffic in ****3052** liquor. The central purpose of the Amendment was not to empower States to favor local liquor industry by erecting barriers to competition. Pp. 3056-3058.

4. This Court will not address the issues of whether, despite the unconstitutionality of the tax, appellants are entitled to tax refunds because the economic burden of the tax was passed on to their customers. These issues were not addressed by the state courts, federal constitutional issues may be intertwined with issues of state law, and resolution of the issues may necessitate more of a record than so far has been

[1] FNa1. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See United States v. Detroit Lumber Co., 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

made. Pp. 3058-3059.

65 Haw. 566, 656 P.2d 724, reversed and remanded.

[Description of counsel and amici deleted]

[OPINION]

***265** Justice WHITE delivered the opinion of the Court.

Appellants challenge the constitutionality of the Hawaii liquor tax, which is a 20% excise tax imposed on sales of liquor at wholesale. Specifically at issue are exemptions from the tax for certain locally produced alcoholic beverages. The Supreme Court of Hawaii upheld the tax against challenges based upon the Equal Protection Clause, the Import-Export Clause, and the Commerce Clause. In re Bacchus Imports, Ltd., 65 Haw. 566, 656 P.2d 724 (1982). We noted probable jurisdiction sub nom. Bacchus Imports, Ltd. v. Freitas,, 462 U.S. 1130, 103 S.Ct. 3109, 77 L.Ed.2d 1365 (1983), and now reverse.

I

The Hawaii liquor tax was originally enacted in 1939 to defray the costs of police and other governmental services that the Hawaii Legislature concluded had been increased due to the consumption of liquor. At its inception the statute contained no exemptions. However, because the legislature sought to encourage development of the Hawaiian liquor industry, it enacted an exemption for okolehao from May 17, 1971, until June 20, 1981, and an exemption for fruit wine from May 17, 1976, until June 30, 1981. [FN1] Haw.Rev.Stat. § § 244-4(6), (7) (Supp.1983). Okolehao is a brandy distilled from the root of the ti plant, an indigenous shrub of Hawaii. In re Bacchus Imports, Ltd., supra, 65 Haw. at 569, n. 7, 656 P.2d, at 727, n. 7. The only fruit wine manufactured in Hawaii during the relevant time was pineapple wine. Id., at 570, n. 8, 656 P.2d, at 727, n. 8. Locally produced sake and fruit liqueurs are not exempted from the tax.

FN1. ***

***266** Appellants-Bacchus Imports, Ltd., and Eagle Distributors, Inc.-are liquor wholesalers who sell to licensed retailers. They sell the liquor at their wholesale price plus the 20% excise tax imposed by § 244-4, plus a one-half percent tax imposed by Haw.Rev.Stat. § 237-13 (Supp.1983). Pursuant to Haw.Rev.Stat. § 40-35 (Supp.1983), which authorizes a taxpayer to pay taxes under protest and to commence an action in the Tax Appeal Court for the recovery of disputed sums, the wholesalers initiated protest proceedings and sought refunds of all taxes paid. Their complaint alleged that the Hawaii liquor tax was unconstitutional because it violates both the ****3053** Import-Export Clause and the Commerce Clause of the United States Constitution. The wholesalers sought a refund of approximately $45 million, representing all of the liquor tax paid by them for the years in question.

FN2 & 3. ***

FN4. Article I, § 10, cl. 2, of the Constitution provides in part:
"No State shall, without the Consent of the Congress, lay any Imposts or Duties on Imports or Exports...."

FN5 & 6. ***

***267** The Tax Appeal Court rejected both constitutional claims. On appeal, the Supreme Court of Hawaii affirmed the decision of the Tax Appeal Court and rejected an equal protection challenge as well. It held that the exemption was rationally related to the State's legitimate interest in promoting domestic industry and therefore did not violate the Equal Protection Clause. 65 Haw. at 573, 656 P.2d, at 730. It further held that there was no violation of the Import-Export Clause because the tax was imposed on all local sales and uses of liquor, whether the liquor was produced abroad, in sister States, or in Hawaii itself. Id., at 578-579, 656 P.2d, at 732-733. Moreover, it found no evidence that the tax was applied selectively to discourage imports in a manner inconsistent with federal foreign policy or that it had any substantial indirect effect on the demand for imported liquor. Ibid. Turning to the Commerce Clause challenge, the Hawaii court held that the tax did not illegally discriminate against interstate commerce because "incidence of the tax ... is on wholesalers of liquor in Hawaii and the ultimate burden is borne by consumers in Hawaii." Id., at 581, 656 P.2d, at 734.

II

***

The wholesalers plainly have standing to challenge the tax in this Court.

***

***268** III

[3] A cardinal rule of Commerce Clause jurisprudence is that "[n]o State, consistent with the Commerce Clause, may 'impose a tax which discriminates against interstate commerce ... by providing a direct commercial advantage to local business.' " Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 329, 97 S.Ct. 599, 607, 50 L.Ed.2d 514 (1977) (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959). Despite the fact that the tax exemption here at issue seems clearly to discriminate on its face against interstate commerce by bestowing a commercial advantage on okolehao and pineapple wine, the State argues-and the Hawaii Supreme Court held-that there is no improper discrimination.

A

[4][5] Much of the State's argument centers on its contention that okolehao and ****3054** pineapple wine do not compete with the other products sold by the wholesalers. The State relies in part on statistics showing that for the years in question sales of okolehao and pineapple wine constituted well under one percent of the total liquor sales in Hawaii. It also relies on the ***269** statement by the Hawaii Supreme Court that "[w]e believe we can safely assume these products pose no competitive threat to other liquors produced elsewhere and consumed in Hawaii," In re Bacchus Imports, Ltd., 65 Haw. at 582, n. 21, 656 P.2d, at 735, n. 21, as well as the court's comment that it had "good reason to believe neither okolehao nor pineapple wine is produced elsewhere." Id., at n. 20, 656 P.2d, at 735, n. 20. However, neither the small volume of sales of exempted liquor nor the fact that the exempted liquors do not constitute a present "competitive threat" to other liquors is dispositive of the question whether competition exists between the locally produced beverages and foreign beverages; instead, they go only to the extent of such competition. It is well settled that "[w]e need not know how unequal the Tax is before concluding that it unconstitutionally discriminates." Maryland v. Louisiana, 451 U.S. 725, 760, 101 S.Ct. 2114, 2136, 68 L.Ed.2d 576 (1981).

FN8-10 ***

[6] The State's position that there is no competition is belied by its purported justification of the exemption in the first place. The legislature originally exempted the locally produced beverages in order to foster the local industries by encouraging increased consumption of their product. Surely one way that the tax exemption might produce that result is that drinkers of other alcoholic beverages might give up or consume less of their customary drinks in favor of the exempted products because of the price differential that the exemption will permit. Similarly, nondrinkers, such as the maturing young, might be attracted by the low prices of okolehao and pineapple wine. On the stipulated facts in this case, we are unwilling to conclude that no competition exists between the exempted and the nonexempted liquors.

***270** B

The State contends that a more flexible approach, taking into account the practical effect and relative burden on commerce, must be employed in this case because (1) legitimate state objectives are credibly advanced, (2) there is no patent discrimination against interstate trade, and (3) the effect on interstate commerce is incidental. See Philadelphia v. New Jersey, 437 U.S. 617, 624, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978). On the other hand, it acknowledges that where simple economic protectionism is effected by state legislation, a stricter rule of invalidity has been erected. Ibid. See also Minnesota v. Clover Leaf Creamery Co., 449 U.S. 456, 471, 101 S.Ct. 715, 727, 66 L.Ed.2d 659 (1981); Lewis v. BT Investment Managers, Inc., 447 U.S. 27, 36-37, 100 S.Ct. 2009, 2015-2016, 64 L.Ed.2d 702 (1980).

[7][8][9] A finding that state legislation constitutes "economic protectionism" may be made on the basis of either discriminatory purpose, see Hunt v. Washington Apple Advertising Comm'n, 432 U.S. 333, 352-353, 97 S.Ct. 2434, at 2446-2447, 53 L.Ed.2d 383 (1977), or discriminatory effect,****3055** see Philadelphia v. New Jersey, supra. See also Minnesota v. Clover Leaf Creamery Co., supra, 449 U.S., at 471, n. 15, 101 S.Ct., at 727, n. 15. Examination of the State's purpose in this case is sufficient to demonstrate the State's lack of entitlement to a more flexible approach permitting inquiry into the balance between local benefits and the burden on interstate commerce. See Pike v. Bruce Church, Inc., 397 U.S. 137, 142, 90 S.Ct. 844, 847,

25 L.Ed.2d 174 (1970). The Hawaii Supreme Court described the legislature's motivation in enacting the exemptions as follows:
"The legislature's reason for exempting 'ti root okolehao' from the 'alcohol tax' was to 'encourage and promote the establishment of a new industry,' S.L.H. 1960, c. 26; Sen.Stand.Comm.Rep. No. 87, in 1960 Senate Journal, at 224, and the exemption of 'fruit wine manufactured in the State from products grown in the State' was intended 'to help' in stimulating 'the local fruit wine industry.' S.L.H.1976, c. 39; Sen.Stand.Comm.Rep. No. 408-76, in 1976 Senate Journal, at ***271** 1056." In re Bacchus Imports, Ltd., supra, 65 Haw., at 573-574, 656 P.2d, at 730.

Thus, we need not guess at the legislature's motivation, for it is undisputed that the purpose of the exemption was to aid Hawaiian industry. Likewise, the effect of the exemption is clearly discriminatory, in that it applies only to locally produced beverages, even though it does not apply to all such products. Consequently, as long as there is some competition between the locally produced exempt products and non-exempt products from outside the State, there is a discriminatory effect.

[10] No one disputes that a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry. However, the Commerce Clause stands as a limitation on the means by which a State can constitutionally seek to achieve that goal. One of the fundamental purposes of the Clause "was to insure ... against discriminating State legislation." Welton v. Missouri, 91 U.S. 275, 280, 23 L.Ed. 347 (1876). In Welton, the Court struck down a Missouri statute that "discriminat[ed] in favor of goods, wares, and merchandise which are the growth, product, or manufacture of the State, and against those which are the growth, product, or manufacture of other states or countries...." Id., 91 U.S., at 277. Similarly, in Walling v. Michigan, 116 U.S. 446, 455, 6 S.Ct. 454, 457, 29 L.Ed. 691 (1886), the Court struck down a law imposing a tax on the sale of alcoholic beverages produced outside the State, declaring:
"A discriminating tax imposed by a State operating to the disadvantage of the products of other States when introduced into the first mentioned State, is, in effect, a regulation in restraint of commerce among the States, and as such is a usurpation of the power conferred by the Constitution upon the Congress of the United States."

See also I.M. Darnell & Son Co. v. Memphis, 208 U.S. 113, 28 S.Ct. 247, 52 L.Ed. 413 (1908).

[11][12] ***272** More recently, in Boston Stock Exchange v. State Tax Comm'n, 429 U.S. 318, 97 S.Ct. 599, 50 L.Ed.2d 514 (1977), the Court struck down a New York law that imposed a higher tax on transfers of stock occurring outside the State than on transfers involving a sale within the State. We observed that competition among the States for a share of interstate commerce is a central element of our free-trade policy but held that a State may not tax interstate transactions in order to favor local businesses over out-of-state businesses. Thus, the Commerce Clause limits the manner in which States may legitimately compete for interstate trade, for "in the process of competition no State may discriminatorily tax the products manufactured or the business operations performed in any other State." Id., at 337, 97 S.Ct., at 610. It is therefore apparent that the Hawaii Supreme Court erred in concluding that there was no improper discrimination against interstate commerce merely because****3056** the burden of the tax was borne by consumers in Hawaii.

The State attempts to put aside this Court's cases that have invalidated discriminatory state statutes enacted for protectionist purposes. See Minnesota v. Clover Leaf Creamery Co., supra, 449 U.S., at 471, 101 S.Ct., at 727; Lewis v. BT Investment Managers, Inc., supra, 447 U.S., at 36-37, 100 S.Ct., at 2015-2016. The State would distinguish these cases because they all involved attempts "to enhance thriving and substantial business enterprises at the expense of any foreign competitors." Brief for Appellee Dias 30. Hawaii's attempt, on the other hand, was "to subsidize nonexistent (pineapple wine) and financially troubled (okolehao) liquor industries peculiar to Hawaii." Id., at 33. However, we perceive no principle of Commerce Clause jurisprudence supporting a distinction between thriving and struggling enterprises under these circumstances, and the State cites no authority for its proposed distinction. In either event, the legislation constitutes "economic protectionism" in every sense of the phrase. It has long been the law that States may not "build up [their] domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States." ***273**Guy v. Baltimore, 100 U.S. 434, 443, 25 L.Ed. 743 (1880). Were it otherwise, "the trade and business of the country [would be] at the mercy of local regulations, having for their object to secure exclusive benefits to the citizens and products of particular States." Id., 100 U.S., at 442. It was to prohibit such a "multiplication of preferential trade areas" that the Commerce Clause was adopted. Dean Milk Co. v. Madison, 340 U.S. 349, 356, 71 S.Ct. 295, 299, 95 L.Ed. 329 (1951). Consequently, the propriety of economic protectionism may not be allowed to hinge upon the State's-or this Court's-characterization of the industry as either "thriving" or "struggling."

[13] We also find unpersuasive the State's contention that there was no discriminatory intent on the part of the legislature because "the exemptions in question were not enacted to discriminate against foreign products, but rather, to promote a local industry." Brief for Appellee Dias 40. If we were to accept that justification, we would have little occasion ever to find a statute unconstitutionally discriminatory. Virtually 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. The determination of constitutionality does not depend upon whether one focuses upon the benefited or the burdened party. A discrimination claim, by its nature, requires a comparison of the two classifications, and it could always be said that there was no intent to impose a burden on one party, but rather the intent was to confer a benefit on the other. Consequently, it is 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.

We therefore conclude that the Hawaii liquor tax exemption for okolehao and pineapple wine violated the Commerce Clause because it had both the purpose and effect of discriminating in favor of local products.

> FN11. Because of our disposition of the Commerce Clause issue, we need not address the wholesalers' arguments based upon the Equal Protection Clause and the Import-Export Clause.

***274** IV

[Court's conclusion that 21st Amendment does not give states the right to enact discriminatory liquor taxes deleted.]

V

[Remand for remedy]

So ordered.

Justice BRENNAN took no part in the consideration or decision of this case.

***278** Justice STEVENS, with whom Justice REHNQUIST and Justice O'CONNOR, join, dissenting.

****3059**

*** I would affirm the judgment of the Supreme Court of Hawaii because the wholesalers' Commerce Clause claim is squarely foreclosed by the Twenty-first Amendment to the United States Constitution.

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III

***

As a matter of pure constitutional power, Hawaii may surely prohibit the importation of all intoxicating liquors. It seems clear to me that it may do so without prohibiting the local sale of liquors that are produced within the State. In other words, even though it seems unlikely that the okolehao lobby could persuade it to do so, the Hawaii Legislature surely has the power to create a local monopoly by prohibiting the sale of any other alcoholic beverage. If the State has the constitutional power to create a total local monopoly-thereby imposing the most severe form of discrimination on competing products originating elsewhere-I believe it may also engage in a less extreme form of discrimination that merely provides a special benefit, perhaps in the form of a subsidy or a tax exemption, for locally produced alcoholic beverages.

*** [A]ccording to the Court, that "state laws that constitute mere economic protectionism are not entitled to the same deference as laws enacted to combat the perceived evils of an unrestricted traffic in liquor." Ibid. This is a totally novel approach to ***287** the Twenty-first Amendment.****3064** The question is not one of "deference," nor one of "central purposes"; the question is whether the provision in this case is an exercise of a power expressly conferred upon the States by the Constitution. It plainly is.

***

Accordingly, I respectfully dissent.

U.S.,1984
Bacchus Imports, Ltd. v. Dias
468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200

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Briefs and Other Related Documents

Supreme Court of the United States
NEW ENERGY COMPANY OF INDIANA, Appellant,
v.
Joanne LIMBACH, Tax Commissioner of Ohio, et al.
No. 87-654.

Argued March 29, 1988.
Decided May 31, 1988.

****1805 *269** *Syllabus*[*]

An Ohio statute awards a tax credit against the Ohio motor vehicle fuel sales tax for each gallon of ethanol sold (as a component of gasohol) by fuel dealers, but only if the ethanol is produced in Ohio or, if produced in another State, to the extent that State grants similar tax advantages to ethanol produced in Ohio. Appellant, an Indiana limited partnership, manufactures ethanol in Indiana, which has no sales tax exemption for ethanol, wherefore appellant's ethanol sold in Ohio is ineligible for the Ohio tax credit. Appellant sought declaratory and injunctive relief in the Ohio Court of Common Pleas of Franklin County, alleging that the Ohio tax credit violates the Commerce Clause of the Federal Constitution by discriminating against out-of-state ethanol producers. The court denied relief; the Ohio Court of Appeals and the Ohio Supreme Court affirmed.

Held: The Ohio statute discriminates against interstate commerce in violation of the Commerce Clause. Pp. 1807-11.

(a) The Clause's “negative” aspect, directly limiting the States' power to discriminate against interstate commerce, prohibits economic protectionism-that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors. Thus, state statutes, such as Ohio's, that clearly discriminate against interstate commerce are invalid, unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism. There is no merit to appellees' argument that the availability of the Ohio tax credit to some out-of-state manufacturers (those in States that give tax advantages to Ohio-produced ethanol) shows that the Ohio provision is not discriminatory but, rather, is likely to promote interstate commerce by encouraging other States to enact similar tax advantages that will spur the interstate sale of ethanol. Discriminatory tax treatment for out-of-state goods is no more validated by the promise to remove it if reciprocity is accepted than would be the categorical exclusion of out-of-state goods. Nor is there any merit to appellees' argument that the Ohio statute should not be considered discrimination against interstate commerce because apparently only one Ohio ethanol manufacturer (appellee South Point Ethanol) is benefited by it and only one out-of-state manufacturer (appellant) is clearly disadvantaged. Where discrimination is patent, as ***270** it is here, neither a widespread advantage to in-state interests nor a widespread disadvantage to out-of-state competitors need be shown. Moreover, the “market participant” doctrine-under which the negative Commerce Clause's limitations apply only to a State's acting in its governmental capacity, not to its acting in the capacity of a market participant-has no application here. The state action at issue is not Ohio's purchase or sale of ethanol, but its assessment and computation of taxes. Although the tax credit scheme has the purpose and effect of subsidizing a particular industry, that does not transform it into a form of state participation in the free market. Pp. 1807-10.

(b) The clear discrimination in this case cannot be validated by the justifications advanced by appellees: health and commerce. Appellees argue that the Ohio statute****1806** encourages use of ethanol to reduce harmful exhaust emissions, both in Ohio and in surrounding States whose polluted atmosphere may reach Ohio. There is no reason to suppose, however, that ethanol produced in a State that does not offer tax advantages to ethanol produced in Ohio is less healthy, and thus should have its importation into Ohio suppressed by denial of the otherwise standard tax credit; and ethanol use outside Ohio is just as effectively fostered by other States' subsidizing ethanol production or sale in some fashion other than by giving a tax credit to Ohio-produced ethanol.

[*] FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

Thus, health is not the purpose of the Ohio provision, but is merely an occasional and accidental effect of achieving what is its purpose, favorable tax treatment for Ohio-produced ethanol. Essentially the same reasoning applies to the asserted justification that Ohio's reciprocity requirement is designed to increase commerce in ethanol by encouraging other States to enact ethanol subsidies. Pp. 1810-11.

32 Ohio St.3d 206, 513 N.E.2d 258, reversed.

[OPINION]

SCALIA, J., delivered the opinion for a unanimous Court.

[Counsel and amici information deleted]

***271** Justice SCALIA delivered the opinion of the Court.

Appellant New Energy Company of Indiana has challenged the constitutionality of Ohio Rev.Code Ann. § 5735.145(B) (1986), a provision that awards a tax credit against the Ohio motor vehicle fuel sales tax for each gallon of ethanol sold (as a component of gasohol) by fuel dealers, but only if the ethanol is produced in Ohio or in a State that grants similar tax advantages to ethanol produced in Ohio. The question presented is whether § 5735.145(B) discriminates against interstate commerce in violation of the Commerce Clause, U.S. Const., Art. I, § 8, cl. 3.

I

Ethanol, or ethyl alcohol, is usually made from corn. In the last decade it has come into widespread use as an automotive fuel, mixed with gasoline in a ratio of 1 to 9 to produce what is called gasohol. The interest in ethanol emerged in reaction to the petroleum market dislocations of the early 1970's. The product was originally promoted as a means of achieving energy independence while providing a market for surplus corn; more recently, emphasis has shifted to its environmental advantages as a replacement for lead in enhancing fuel octane. See United States Department of Agriculture, Ethanol: Economic and Policy Tradeoffs 1 (1988). Ethanol was, however (and continues to be), more expensive than gasoline, and the emergence of ethanol production on a commercial scale dates from enactment of the first federal subsidy, in the form of an exemption from federal motor fuel excise taxes, in 1978. See Energy Tax Act of 1978, Pub.L. 95-618, § 221, 92 Stat. 3185, codified, as amended, at 26 U.S.C. § § 4041, 4081 (1982 ed. and Supp. IV). Since then, many States, particularly ***272** those in the grain-producing areas of the country, have enacted their own ethanol subsidies. See United States General Accounting Office, Importance and Impact of Federal Alcohol Fuel Tax Incentives 5 (1984). Ohio first passed such a measure in 1981, providing Ohio gasohol dealers a credit of so many cents per gallon of ethanol used in their product against the Ohio motor vehicle fuel sales tax payable on both ethanol and gasoline. This credit was originally available without regard to the source of the ethanol. See Act of June 10, 1981, § 1, 1981-1982 Ohio Leg. Acts 1693, 1731-1732. In 1984, however, Ohio enacted ****1807** § 5735.145(B), which denies the credit to ethanol coming from States that do not grant a tax credit, exemption, or refund to ethanol from Ohio, or, if a State grants a smaller tax advantage than Ohio's, granting only an equivalent credit to ethanol from that State.

FN1. ***

Appellant is an Indiana limited partnership that manufactures ethanol in South Bend, Indiana, for sale in several States, including Ohio. Indiana repealed its tax exemption for ethanol, effective July 1, 1985, see Act of Mar. 5, 1984, § § 4, 5, 8, 1984 Ind. Acts 189, 194-195, at which time it also passed legislation providing a direct subsidy to Indiana ethanol producers (the sole one of which was appellant). See Ind.Code § § 4-4-10.1-1 to 4-4-10.1-8 (Supp.1987). Thus, by ***273** reason of Ohio's reciprocity provision, appellant's ethanol sold in Ohio became ineligible for the Ohio tax credit. Appellant sought declaratory and injunctive relief in the Court of Common Pleas of Franklin County, Ohio, alleging that § 5735.145(B) violated the Commerce Clause by discriminating against out-of-state ethanol producers to the advantage of in-state industry. The court denied relief, and the Ohio Court of Appeals affirmed. A divided Ohio Supreme Court initially reversed, finding that § 5735.145(B) discriminated without adequate justification against products of out-of-state origin, and shielded Ohio producers from out-of-state competition. The Ohio Supreme Court then granted appellees' motion for rehearing and reversed itself, a majority of the court finding that the provision was not protectionist or unreasonably burdensome. 32 Ohio St.3d 206, 513 N.E.2d 258 (1987). We noted probable jurisdiction. 484 U.S. 984, 108 S.Ct. 500, 98 L.Ed.2d 499 (1987).

FN2. ***

II

[1][2] It has long been accepted that the Commerce Clause not only grants Congress the authority to regulate commerce among the States, but also directly limits the power of the States to discriminate against interstate commerce. See, *e.g., Hughes v. Oklahoma,* 441 U.S. 322, 326, 99 S.Ct. 1727, 1731, 60 L.Ed.2d 250 (1979); *H.P. Hood & Sons, Inc. v. Du Mond,* 336 U.S. 525, 534-535, 69 S.Ct. 657, 663, 93 L.Ed. 865 (1949); *Welton v. Missouri,* 91 U.S. (1 Otto) 275, 23 L.Ed. 347 (1876). This "negative" aspect of the Commerce Clause prohibits economic protectionism-that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.***274** See, *e.g., Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 270-273, 104 S.Ct. 3049, 3054-3056, 82 L.Ed.2d 200 (1984); *H.P. Hood & Sons, supra,* 336 U.S., at 532-533, 69 S.Ct., at 662; *Guy v. Baltimore,* 100 U.S. (10 Otto) 434, 443, 25 L.Ed. 743 (1880). Thus, state statutes that clearly discriminate against interstate commerce are routinely struck down, see, *e.g., Sporhase v. Nebraska ex rel. Douglas,* 458 U.S. 941, 102 S.Ct. 3456, 73 L.Ed.2d 1254 (1982); ****1808***Lewis v. BT Investment Managers, Inc.,* 447 U.S. 27, 100 S.Ct. 2009, 64 L.Ed.2d 702 (1980); *Dean Milk Co. v. Madison,* 340 U.S. 349, 71 S.Ct. 295, 95 L.Ed. 329 (1951), unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism, see, *e.g., Maine v. Taylor,* 477 U.S. 131, 106 S.Ct. 2440, 91 L.Ed.2d 110 (1986).

[3] The Ohio provision at issue here explicitly deprives certain products of generally available beneficial tax treatment because they are made in certain other States, and thus on its face appears to violate the cardinal requirement of nondiscrimination. Appellees argue, however, that the availability of the tax credit to some out-of-state manufacturers (those in States that give tax advantages to Ohio-produced ethanol) shows that the Ohio provision, far from discriminating against interstate commerce, is likely to promote it, by encouraging other States to enact similar tax advantages that will spur the interstate sale of ethanol. We rejected a similar contention in an earlier "reciprocity" case, *Great Atlantic & Pacific Tea Co. v. Cottrell,* 424 U.S. 366, 96 S.Ct. 923, 47 L.Ed.2d 55 (1976). The regulation at issue there permitted milk from out of State to be sold in Mississippi only if the State of origin accepted Mississippi milk on a reciprocal basis. Mississippi put forward, among other arguments, the assertion that "the reciprocity requirement is in effect a free-trade provision, advancing the identical national interest that is served by the Commerce Clause." *Id.,* at 378, 96 S.Ct., at 932. In response, we said that "Mississippi may not use the threat of economic isolation as a weapon to force sister States to enter into even a desirable reciprocity agreement." *Id.,* at 379, 96 S.Ct., at 932. More recently, we characterized a Nebraska reciprocity requirement for the export of ground water from the State as "facially discriminatory legislation" ***275** which merited " 'strictest scrutiny.' " *Sporhase v. Nebraska ex rel. Douglas, supra,* 458 U.S., at 958, 102 S.Ct., at 3465, quoting *Hughes v. Oklahoma, supra,* 441 U.S., at 337, 99 S.Ct., at 1736.

It is true that in *Cottrell* and *Sporhase* the effect of a State's refusal to accept the offered reciprocity was total elimination of all transport of the subject product into or out of the offering State; whereas in the present case the only effect of refusal is that the out-of-state product is placed at a substantial commercial disadvantage through discriminatory tax treatment. That makes no difference for purposes of Commerce Clause analysis. In the leading case of *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 55 S.Ct. 497, 79 L.Ed. 1032 (1935), the New York law excluding out-of-state milk did not impose an absolute ban, but rather allowed importation and sale so long as the initial purchase from the dairy farmer was made at or above the New York State-mandated price. In other words, just as the appellant here, in order to sell its product in Ohio, only has to cut its profits by reducing its sales price below the market price sufficiently to compensate the Ohio purchaser-retailer for the forgone tax credit, so also the milk wholesaler-distributor in *Baldwin,* in order to sell its product in New York, only had to cut its profits by increasing its purchase price above the market price sufficiently to meet the New York-prescribed minimum. We viewed the New York law as "an economic barrier against competition" that was "equivalent to a rampart of customs duties." *Id.,* at 527, 55 S.Ct., at 502. Similarly, in *Hunt v. Washington Apple Advertising Comm'n,* 432 U.S. 333, 349-351, 97 S.Ct. 2434, 2444-2445, 53 L.Ed.2d 383 (1977), we found invalid under the Commerce Clause a North Carolina statute that did not exclude apples from other States, but merely imposed additional costs upon Washington sellers and deprived them of the commercial advantage of their distinctive grading system. The present law likewise imposes an economic disadvantage upon out-of-state sellers; and the promise to remove that if reciprocity is accepted no more justifies disparity of treatment than it would justify categorical exclusion. We ***276** have indicated that reciprocity requirements are not *per se* unlawful.****1809** See *Cottrell, supra,* 424 U.S., at 378, 96 S.Ct., at 931. But the case we cited for that proposition, *Kane v. New Jersey,* 242 U.S. 160, 167-168, 37 S.Ct. 30, 31-32, 61 L.Ed. 222 (1916), discussed a context in which, if a State offered the reciprocity did not accept it, the consequence was, to be sure, *less favored* treatment for its citizens, but nonetheless treatment that complied with the minimum requirements of the Commerce Clause. Here, quite to the contrary, the threat used to induce Indiana's acceptance is, in effect, taxing a product made by its manufacturers at a rate higher than the same product made by Ohio manufacturers, without (as we shall see) justification for the disparity.

[4] Appellees argue that § 5735.145(B) should not be considered discrimination against interstate commerce because its practical scope is so limited. Apparently only one Ohio ethanol manufacturer exists (appellee South Point Ethanol) and only one out-of-state manufacturer (appellant) is clearly disadvantaged by the provision. Our cases, however, indicate that where discrimination is patent, as it is here, neither a widespread advantage to in-state interests nor a widespread disadvantage to out-of-state competitors need be shown. For example, in *Bacchus Imports, Ltd. v. Dias, supra,* we held unconstitutional under the Commerce Clause a special exemption from Hawaii's liquor tax for certain locally produced alcoholic beverages (okolehao and fruit wine), even though other locally produced alcoholic beverages were subject to the tax. *Id.,* 468 U.S., at 265, 271, 104 S.Ct., at 3052, 3055. And in *Lewis v. BT Investment Managers, Inc., supra,* we held unconstitutional a Florida statute that excluded from certain business activities in Florida not all out-of-state entities, but only out-of-state bank holding companies, banks, or trust companies. In neither of these cases did we consider the size or number of the in-state businesses favored or the out-of-state businesses disfavored relevant to our determination. Varying the strength of the bar against economic protectionism according to the size and number of in-state and out-of-state firms affected would ***277** serve no purpose except the creation of new uncertainties in an already complex field.

[5] Appellees contend that even if § 5735.145(B) is discriminatory, the discrimination is not covered by the Commerce Clause because of the so-called market-participant doctrine. That doctrine differentiates between a State's acting in its distinctive governmental capacity, and a State's acting in the more general capacity of a market participant; only the former is subject to the limitations of the negative Commerce Clause. See *Hughes v. Alexandria Scrap Corp.,* 426 U.S. 794, 806-810, 96 S.Ct. 2488, 2496-2498, 49 L.Ed.2d 220 (1976). Thus, for example, when a State chooses to manufacture and sell cement, its business methods, including those that favor its residents, are of no greater constitutional concern than those of a private business. See *Reeves, Inc. v. Stake,* 447 U.S. 429, 438-439, 100 S.Ct. 2271, 2278, 65 L.Ed.2d 244 (1980).

[6] The market-participant doctrine has no application here. The Ohio action ultimately at issue is neither its purchase nor its sale of ethanol, but its assessment and computation of taxes-a primeval governmental activity. To be sure, the tax credit scheme has the purpose and effect of subsidizing a particular industry, as do many dispositions of the tax laws. That does not transform it into a form of state participation in the free market. Our opinion in *Alexandria Scrap, supra,* a case on which appellees place great reliance, does not remotely establish such a proposition. There we examined, and upheld against Commerce Clause attack on the basis of the market-participant doctrine, a Maryland cash subsidy program that discriminated in favor of in-state auto-hulk processors. The ****1810** purpose of the program was to achieve the removal of unsightly abandoned autos from the State, *id.,* 426 U.S., at 796-797, 96 S.Ct., at 2491, and the Court characterized it as proprietary rather than regulatory activity, based on the analogy of the State to a private purchaser of the auto hulks, *id.,* at 808-810, 96 S.Ct., at 2496-2498. We have subsequently observed that subsidy programs unlike that of *Alexandria Scrap* might not be characterized as proprietary. See *Reeves, Inc., supra,* 447 U.S., at 440, n. 14, 100 S.Ct., at 2279, n. 14. We think ***278** it clear that Ohio's assessment and computation of its fuel sales tax, regardless of whether it produces a subsidy, cannot plausibly be analogized to the activity of a private purchaser.

[7] It 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. To believe the Indiana

scheme is valid, however, is not to believe that the Ohio scheme must be valid as well. The Commerce Clause does not prohibit all state action designed to give its residents an advantage in the marketplace, but only action of that description *in connection with the State's regulation of interstate commerce.* Direct subsidization of domestic industry does not ordinarily run afoul of that prohibition; discriminatory taxation of out-of-state manufacturers does. Of course, even if the Indiana subsidy were invalid, retaliatory violation of the Commerce Clause by Ohio would not be acceptable. See *Cottrell*, 424 U.S., at 379-380, 96 S.Ct., at 931-932.

III

Our cases leave open the possibility that a State may validate a statute that discriminates against interstate commerce by showing that it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory alternatives. See, *e.g., Maine v. Taylor*, 477 U.S., at 138, 151, 106 S.Ct., at 2447, 2454; *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S., at 958; *Hughes v. Oklahoma*, 441 U.S., at 336-337, 99 S.Ct., at 1736; *Dean Milk Co. v. Madison*, 340 U.S., at 354, 71 S.Ct., at 297. This is perhaps just another way of saying that what may appear to be a "discriminatory" provision in the constitutionally prohibited sense-that is, a protectionist enactment-may on closer analysis not be so. However it be put, the standards for such justification are high. Cf. *Philadelphia v. New Jersey*, 437 U.S. 617, 624, 98 S.Ct. 2531, 2535, 57 L.Ed.2d 475 (1978) ("[W]here simple economic protectionism is ***279** effected by state legislation, a virtually *per se* rule of invalidity has been erected"); *Hughes v. Oklahoma, supra*, 441 U.S., at 337, 99 S.Ct., at 1737 ("[F]acial discrimination by itself may be a fatal defect" and "[a]t a minimum ... invokes the strictest scrutiny").

[8] Appellees advance two justifications for the clear discrimination in the present case: health and commerce. As to the first, they argue that the provision encourages use of ethanol (in replacement of lead as a gasoline octane-enhancer) to reduce harmful exhaust emissions, both in Ohio itself and in surrounding States whose polluted atmosphere may reach Ohio. Certainly the protection of health is a legitimate state goal, and we assume for purposes of this argument that use of ethanol generally furthers it. But § 5735.145(B) obviously does not, except perhaps by accident. As far as ethanol use in Ohio itself is concerned, there is no reason to suppose that ethanol produced in a State that does not offer tax advantages to ethanol produced in Ohio is less healthy, and thus should have its importation into Ohio suppressed by denial of the otherwise standard tax ****1811** credit. And as far as ethanol use outside Ohio is concerned, surely that is just as effectively fostered by other States' subsidizing ethanol production or sale in some fashion other than giving a tax credit to Ohio-produced ethanol; but these helpful expedients do not qualify for the tax credit. It could not be clearer that health is not the purpose of the provision, but is merely an occasional and accidental effect of achieving what is its purpose, favorable tax treatment for *Ohio* -produced ethanol. Essentially the same reasoning also responds to appellees' second (and related) justification for the discrimination, that the reciprocity ***280** requirement is designed to increase commerce in ethanol by encouraging other States to enact ethanol subsidies. What is encouraged is not ethanol subsidies in general, but only favorable treatment for Ohio-produced ethanol. In sum, appellees' health and commerce justifications amount to no more than implausible speculation, which does not suffice to validate this plain discrimination against products of out-of-state manufacture.

FN3. ***.
* * *

For the reasons stated, the judgment of the Ohio Supreme Court is

Reversed.

U.S.Ohio,1988.
New Energy Co. of Indiana v. Limbach
486 U.S. 269, 108 S.Ct. 1803, 56 USLW 4475, 100 L.Ed.2d 302

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Briefs and Other Related Documents

United States Court of Appeals,Sixth Circuit.
Charlotte CUNO, et al., Plaintiffs-Appellants,
v.
DAIMLERCHRYSLER, INC., et al., Defendants-Appellees.
No. 01-3960.

Argued: Feb. 4, 2003.
Decided and Filed: Oct. 19, 2004.
Rehearing En Banc Denied Jan. 18, 2005.

*740 [Counsel information deleted]

DAUGHTREY, Circuit Judge.
The plaintiffs initiated this litigation in state court, challenging the validity of certain state tax credits and local property tax abatements that were granted to DaimlerChrysler Corporation as an inducement to the company to expand its business operations in Toledo, Ohio. They contend that the tax scheme discriminates against interstate commerce by granting preferential treatment to in-state investment and activity, in violation of the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Ohio Constitution. After the defendants removed the action to federal court, the district court entered an order dismissing the complaint under Federal Rules of Civil Procedure 12(b)(1) and 12(b)(6) for failure to state a claim. Because we conclude that the investment tax credit runs afoul of the Commerce Clause, we can affirm only part of the district court's judgment.

I. *FACTUAL AND PROCEDURAL BACKGROUND*

In 1998, DaimlerChrysler entered into an agreement with the City of Toledo to construct a new vehicle-assembly plant near the company's existing facility in exchange for various tax incentives. DaimlerChrysler estimated that it would invest approximately $1.2 billion in this project, which would provide the region with several thousand new jobs. In return, the City and two local school districts agreed to give DaimlerChrysler a ten-year 100 percent property tax exemption, as well as an investment tax credit of 13.5 percent against the state corporate franchise tax for certain qualifying investments. The total value of the tax incentives was estimated to be $280 million.

Ohio's investment tax credit grants a taxpayer a non-refundable credit against the state's corporate franchise tax if the taxpayer "purchases new manufacturing machinery and equipment during the qualifying period, provided that the new manufacturing machinery and equipment are installed in [Ohio]." Ohio Rev.Code Ann. § 5733.33(B)(1). The investment tax credit is generally 7.5 percent "of the excess of the cost of the new manufacturing machinery and equipment purchased during the calendar year for use in a county over the county average new manufacturing machinery and equipment investment for that county." *See* Ohio Rev.Code Ann. § 5733.33(C)(1). The rate increases to 13.5 percent of the cost of the new investment if it is purchased for use in specific economically depressed areas. *See* Ohio Rev.Code Ann. § 5733.33(C)(2), (A)(8)-(13). The credit may not exceed $1 million unless the taxpayer has increased its overall ownership of manufacturing equipment in the state during the year for which the credit is claimed. *See* Ohio Rev.Code Ann. § 5733.33(B)(2)(a). To the extent that the credit exceeds the corporation's total Ohio franchise tax liability in a particular year, the balance of the credit is carried forward and can be used to reduce its liability in any of the three following years. *See* Ohio Rev.Code Ann. § 5733.33(D).

The personal property tax exemption is authorized under § § 5709.62 and 5709.631; it permits 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. Ohio Rev.Code Ann. § 5709.62(C)(1). An exemption may be granted "for a specified number of years, ***742** not to exceed ten, of a specified portion, up to seventy-five per cent, of the assessed value of tangible personal property first used in business at the project site as a result of the agreement." Ohio Rev.Code Ann. § 5709.62(C)(1)(a). The exemption may exceed 75 percent with consent of the affected school districts. *See* Ohio Rev.Code Ann. § 5709.62(D)(1).

The district court held that the investment tax credit and the property tax exemption do not violate the Commerce Clause because, although "an increase in activity in Ohio could increase the credit and exemption amount" under the two statutes, an increase in activity *outside* the state would not *decrease* the amount of the tax credit or exemption and therefore would not run afoul of the United States Supreme Court's ruling in *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 400-01, 104 S.Ct. 1856, 80 L.Ed.2d 388 (1984). From that decision, the plaintiffs now appeal.

II. *ANALYSIS*

We review *de novo* a district court's order granting a motion to dismiss for failure to state a claim upon which relief may be granted. *See Inge v. Rock Fin. Corp.*, 281 F.3d 613, 619 (6th Cir.2002). In considering a motion to dismiss pursuant to Rule 12(b)(6), all well-pleaded factual allegations of the complaint must be accepted as true and the complaint construed in the light most favorable to the plaintiffs. *Id.* It is well-settled that dismissal of a complaint is proper "only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." *Hishon v. King & Spalding*, 467 U.S. 69, 73, 104 S.Ct. 2229, 81 L.Ed.2d 59 (1984)(citing *Conley v. Gibson*, 355 U.S. 41, 45-46, 78 S.Ct. 99, 2 L.Ed.2d 80 (1957)).

On appeal, the plaintiffs' primary contention is that the Ohio statutes authorizing the investment tax credit and personal property tax exemption violate the Commerce Clause of the United States Constitution. Secondarily, the plaintiffs claim that the tax incentives violate Ohio's Equal Protection Clause.

A. Commerce Clause Claim

[1] The United States Constitution expressly authorizes Congress to "regulate Commerce with foreign Nations, and among the several States," U.S. Const. art. I, § 8, cl. 3, and the "negative" or "dormant" aspect of the Commerce Clause implicitly limits the State's right to tax interstate commerce. A tax provision satisfies the requirements of the Commerce Clause if (1) the activity taxed has a substantial nexus with the taxing State; (2) the tax is fairly apportioned to reflect the degree of activity that occurs within the State; (3) the tax does not discriminate against interstate commerce; and (4) the tax is fairly related to benefits provided by the state. *See Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279, 97 S.Ct. 1076, 51 L.Ed.2d 326 (1977).

The parties do not dispute that the tax provisions at issue have a sufficient nexus with the state, are fairly apportioned, and are related to benefits provided by the state. Nor do the parties dispute that it is legitimate for Ohio to structure its tax system to encourage new intrastate economic activity. Indeed, the United States Supreme Court has indicated that the Commerce Clause "does not prevent the States from structuring their tax systems to encourage the growth and development of intrastate commerce and industry," nor does it prevent a state from "compet[ing] with other States for a share of interstate commerce" so long as "no State [ ] discriminatorily tax [es] the products manufactured***743** or the business operations performed in any other State." *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336-37, 97 S.Ct. 599, 50 L.Ed.2d 514 (1977); *see also Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 272, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984) (the federal Commerce Clause "limits the manner in which States may legitimately compete for interstate trade"). Rather, the parties dispute whether Ohio's method for encouraging new economic investment-conferring investment tax incentives and property tax exemptions-discriminates against interstate commerce.

The United States Supreme Court has never precisely delineated the scope of the doctrine that bars discriminatory taxes. The Court has made clear, however, that a tax statute's "constitutionality does not depend upon whether one focuses upon the benefited or the burdened party." *Bacchus Imports,* 468 U.S. at 273, 104 S.Ct. 3049. The fact that a statute "discriminates against business carried on outside the State by disallowing a tax credit rather than by imposing a higher tax" is therefore legally irrelevant. *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 404, 104 S.Ct. 1856, 80 L.Ed.2d 388 (1984).

[2][3] In general, a challenged credit or exemption will fail Commerce Clause scrutiny if it discriminates on its face or if, on the basis of "a sensitive, case-by-case analysis of purposes and effects," the provision "will in its practical operation work discrimination against interstate commerce," *West Lynn Creamery v. Healy*, 512 U.S. 186, 201, 114 S.Ct. 2205, 129 L.Ed.2d 157 (1994) (citations omitted), by "providing

a direct commercial advantage to local business." *Bacchus Imports*, 468 U.S. at 268, 104 S.Ct. 3049 (citations omitted). " '[D]iscrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc. v. Dep't. of Envtl. Quality*, 511 U.S. 93, 99, 114 S.Ct. 1345, 128 L.Ed.2d 13 (1994). 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." *Id.* at 101, 114 S.Ct. 1345 (quoting *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278, 108 S.Ct. 1803, 100 L.Ed.2d 302 (1988)).

1. Investment Tax Credit

[4] Although the investment tax credit at issue here is equally available to in-state and out-of-state businesses, the plaintiffs nevertheless maintain that it discriminates against interstate economic activity by coercing businesses already subject to the Ohio franchise tax to expand locally rather than out-of-state. Specifically, any corporation currently doing business in Ohio, and therefore paying the state's corporate franchise tax in Ohio, can reduce its existing tax liability by locating significant new machinery and equipment within the state, but it will receive no such reduction in tax liability if it locates a comparable plant and equipment elsewhere. Moreover, 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, while a competitor that invests out-of-state will face a comparatively higher tax burden because it will be ineligible for any credit against its Ohio tax.

The plaintiffs' argument principally relies on the Supreme Court's own explanation of its Commerce Clause jurisprudence in cases invalidating tax schemes that encourage the development of local industry by imposing greater burdens on economic activity taking place outside the state. In ***744** *Boston Stock Exchange*, for example, the Supreme Court held unconstitutional amendments to New York's securities transfer tax that aimed to offset the competitive advantage that the transfer tax otherwise created for out-of-state exchanges that did not tax transfers. *See* *Boston Stock Exchange*, 429 U.S. at 323-24, 97 S.Ct. 599. Prior to the amendment, New York uniformly taxed in-state transfers of securities without regard to the place of sale. *See* *id.* at 322, 97 S.Ct. 599. The amendment created a 50 percent reduction in the tax rate on transfers by nonresidents and limited liability on transfers of large blocks of shares as long as the sales were made in New York. *See* *id.* at 324, 97 S.Ct. 599. As a result, the amendment caused transactions involving out-of-state sales to be taxed more heavily than transactions involving in-state sales. *See* *id.* at 330-31, 97 S.Ct. 599. The Court held that the reduction offended the Commerce Clause's anti-discrimination principle by converting a tax that was previously "neutral as to in-state and out-of-state sales" into one that which would induce a seller to trade through a New York broker in order to reduce its tax liability. *See* *id.* at 330-32, 97 S.Ct. 599. In doing so, New York effectively "foreclose[d] tax-neutral decisions" and "creat [ed] both an advantage for the exchanges in New York and a discriminatory burden on commerce to its sister States." *Id.* at 331, 97 S.Ct. 599. The diversion of interstate commerce from the most economically efficient channels that resulted from New York's use of "its power to tax an in-state operation as a means of 'requiring [other] business operations to be performed in the home state,' " *id.* at 336, 97 S.Ct. 599 (quoting *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 145, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970)), was seen by the Court as "wholly inconsistent with the free trade purpose of the Commerce Clause."

Shortly thereafter, in *Maryland v. Louisiana*, 451 U.S. 725, 101 S.Ct. 2114, 68 L.Ed.2d 576 (1981), the Supreme Court reviewed a Louisiana statute that imposed a first-use tax on natural gas extracted from the continental shelf in an amount equivalent to the severance tax imposed on natural gas extracted in Louisiana. *See* *id.* at 731, 101 S.Ct. 2114. Taxpayers subject to the first-use tax were entitled to a direct tax credit on any Louisiana Severance Tax owed in connection with the extraction of natural resources within the state. *See* *id.* at 732, 101 S.Ct. 2114. Most Louisiana consumers of offshore gas were eligible for tax credits and exemptions, but the tax applied in full to offshore gas moving through and out of state. *See* *id.* at 733, 101 S.Ct. 2114. Noting that the state severance tax credit "favor[ed] those who both own [offshore] gas and engage in Louisiana production" and that the "obvious economic effect of this Severance Tax Credit [was] to encourage natural gas owners involved in the production of [offshore] gas to invest in mineral exploration and development within Louisiana rather than to invest in further [offshore] development or in production in other States," the Court held that the statute "unquestionably discriminate[d] against interstate commerce in favor of local interests." *Id.* at 756-57, 101 S.Ct. 2114.

In *Westinghouse Electric Corp. v. Tully,* 466 U.S. 388, 104 S.Ct. 1856, 80 L.Ed.2d 388 (1984), the Supreme Court invalidated a New York franchise tax that gave corporations an income tax credit based on the portion of their exports shipped from New York. Under the law, income from a subsidiary engaged exclusively in exports was to be combined with the income of its parent company for state tax purposes. *See id.* at 393, 104 S.Ct. 1856. In an effort to provide an incentive to increase export activity in New York, the parent company ***745** was given a partially offsetting credit against income tax attributable to the subsidiary's income generated from New York exports. *See id.* Because the credit was based on the ratio of the subsidiary's New York exports to its income from all export shipments, a company's overall New York tax liability would decrease as exports from New York increased relative to exports from other states. Conversely, a company's New York tax liability increased when exports from New York decreased relative to exports from other states. *See id.* at 401, 104 S.Ct. 1856. The Court found that the tax scheme "penalize[d] increases in the [export] shipping activities in other states," *id.* at 401, 104 S.Ct. 1856, and that it was therefore a discriminatory tax that advantaged New York firms "by placing 'a discriminatory burden on commerce to its sister *States.*' " *Id.* at 406, 104 S.Ct. 1856 (quoting *Boston Stock Exchange,* 429 U.S. at 331, 97 S.Ct. 599).

Analogizing to the provisions considered in *Boston Stock Exchange, Maryland v. Louisiana,* and *Westinghouse,* the plaintiffs argue that the investment tax credit at issue here encourages the development of local business through the use of Ohio's "power to tax an in-state operation as a means of 'requiring [other] business operations to be performed in the home State.' " *Boston Stock Exch.,* 429 U.S. at 336, 97 S.Ct. 599 (quoting *Bruce Church,* 397 U.S. at 145, 90 S.Ct. 844). Thus, they contend that like the tax credit in *Maryland v. Louisiana,* the economic effect of the Ohio investment tax credit is to encourage further investment in-state at the expense of development in other states and that the result is to hinder free trade among the states. *Cf. Boston Stock Exch.,* 429 U.S. at 336, 97 S.Ct. 599.

The defendants maintain that the Supreme Court's opinions should be read narrowly to hold that tax incentives, like the Ohio tax credit, are permissible as long as they do not penalize out-of-state economic activity, citing Philip M. Tatarowicz & Rebecca F. Mims-Velarde, *An Analytical Approach to State Tax Discrimination Under the Commerce Clause,* 39 Vand. L.Rev. 879, 929 (1986) (elaborating upon and applying this distinction to the Court's precedents). In their view, the Commerce Clause is primarily concerned with preventing economic protectionism-that is, regulatory measures designed to benefit local interests by burdening out-of-state commerce. According to their theory, the only tax credits and exemptions that would run afoul of the Commerce Clause fall into two categories: those that function like a tariff by placing a higher tax upon out-of-state business or products and those that penalize out-of-state economic activity by relying on both the taxpayer's in-state and out-of-state activities to determine the taxpayer's effective tax rate.

Although it is arguably possible to fit certain of the Supreme Court's cases into this framework, it is clear that the Court itself has not adopted this approach in analyzing dormant Commerce Clause cases, undoubtedly because it rests on the distinction between laws that benefit in-state activity and laws that burden out-of-state activity. Such a distinction is tenuous in light of the Court's acknowledgment that "[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." *Bacchus Imports,* 468 U.S. at 273, 104 S.Ct. 3049. Indeed, economically speaking, the effect of a tax benefit or burden is the same. Moreover, the Court's command to examine the practical effect of challenged tax schemes suggests that "constitutionality [should] not depend ***746** upon whether one focuses upon the benefited or the burdened party." *Id.; see also Westinghouse,* 466 U.S. at 404, 104 S.Ct. 1856 ("Nor is it relevant that New York discriminates against business carried on outside the State by disallowing a tax credit rather than by imposing a higher tax.").

Although the defendants liken the investment tax credit to a direct subsidy, which would no doubt have the same economic effect, the Court has intimated that attempts to create location incentives through the state's power to tax are to be treated differently from direct subsidies despite their similarity in terms of end-result economic impact. The majority in *New Energy* noted in dicta that subsidies do not "ordinarily run afoul of [the Commerce Clause]" because they are not generally "connect[ed] with the State's regulation of interstate commerce." *New*

Energy Co., 486 U.S. at 278, 108 S.Ct. 1803; *see also* *West Lynn Creamery*, 512 U.S. at 199 n. 15, 114 S.Ct. 2205 ("We have never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that '[d]irect subsidization of domestic industry does not ordinarily run afoul' of the negative Commerce Clause." (quoting *New Energy Co.*, 486 U.S. at 278, 108 S.Ct. 1803)). Thus, 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.

FN1. For further discussion of the constitutionality of coercive and non-coercive state regulation of interstate commerce through the state power to tax, see Walter Hellerstein and Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 Cornell L.Rev. 789, 806-09 (1996) (explaining the non-coercive nature of a similar tax exemption.)

In short, while we may be sympathetic to efforts by the City of Toledo to attract industry into its economically depressed areas, we conclude that Ohio's investment tax credit cannot be upheld under the Commerce Clause of the United States Constitution.

2. Personal Property Tax Exemption

The plaintiffs maintain that the discriminatory characteristic of the City's personal property tax exemption rests not on the fact that only in-state property is eligible for exemption, but rather on the conditions that Ohio places on eligibility-conditions that require beneficiaries of the exemptions to agree to maintain a specified level of employment and investment in the state. The effect, they argue, is to subject two similarly situated owners of Ohio personal property to differential tax rates. A taxpayer who agrees to focus his employment or investment in Ohio receives preferential treatment in the form of a tax break, while a taxpayer who prefers to preserve the freedom to hire or invest elsewhere does not.

[5] Although conditions imposed on property tax exemptions may independently violate the Commerce Clause, conditional exemptions raise no constitutional issues when the conditions for obtaining the favorable tax treatment are related to the use or location of the property itself. Stated differently, an exemption may be discriminatory if it requires the beneficiary to engage in another form of business in order to receive the benefit or is limited to businesses with a specified economic presence. *Cf.* *Maryland*, 451 U.S. at 756-57, 101 S.Ct. 2114 (finding unconstitutional a tax benefit that encouraged natural gas owners to invest in other forms of mineral exploration and development within Louisiana rather than investing further in natural***747** gas development outside the state). However, if the conditions imposed on the exemption do not discriminate based on an independent form of commerce, they are permissible.

[6] Contrary to the plaintiffs' assertions, the conditions imposed on the receipt of the Ohio property tax exemption are minor collateral requirements and are directly linked to the use of the exempted personal property. The authorizing statute requires only an investment in new or existing property within an enterprise zone and maintenance of employees. *See* Ohio Rev.Code Ann. § 5709.62(C)(1). The statute does not impose specific monetary requirements, require the creation of new jobs, or encourage a beneficiary to engage in an additional form of commerce independent of the newly acquired property. As a consequence, the conditions placed on eligibility for the exemption do not independently burden interstate commerce.

FN2. Plaintiffs' assertion that the exemption, once received, coerces business into continual re-investment in Ohio in order to preserve the tax exemption is not persuasive. The exemption is project-specific and, therefore, a business does not lose its existing exemption by deciding to make its next investment elsewhere.

The cases on which the plaintiffs rely are inapplicable here, because they fail to address the question of whether conditions attached to the receipt of an exemption violate the anti-discrimination principle where the conditions themselves do not impose independent burdens upon commerce. In *Camps Newfound/Owatonna,Inc. v. Town of Harrison*, 520 U.S. 564, 117 S.Ct. 1590, 137 L.Ed.2d 852 (1997), the Supreme Court reviewed a property tax exemption for charitable organizations that excluded organizations operated principally for the benefits of nonresidents and found the exemption unconstitutionally discriminatory because the effect of the statute was to "distinguish[ ] between entities that serve a principally interstate clientele and those that primarily serve an intrastate market, singling out [entities] that serve mostly in-staters for beneficial tax treatment, and penalizing those camps that do a principally interstate business." *Id.* at 576, 117 S.Ct. 1590. Similarly, the Fifth Circuit in *Pelican Chapter, Associated Builders & Contractors, Inc. v. Edwards*, 128 F.3d 910 (5th Cir.1997), invalidated a tax exemption because it required beneficiaries to give a preference to in-state manufacturers, suppliers, and laborers. The Ohio provision at issue contains no restriction on the individuals employed or served. Therefore, the conditional character of the Ohio property tax exemption does not resemble characteristics of property tax exemptions found unconstitutional by previous courts.

Finally, the plaintiffs' argument regarding the effect of the exemption overlooks fundamental differences between tax credits and exemptions. Unlike an investment tax credit that reduces pre-existing income tax liability, the personal property exemption does not reduce any existing property tax liability. The exemption merely allows a taxpayer to avoid tax liability for new personal property put into first use in conjunction with a qualified new investment. Thus, a taxpayer's failure to locate new investments within Ohio simply means that the taxpayer is not subject to the state's property tax at all, and any discriminatory treatment between a company that invests in Ohio and one that invests out-of-state cannot be attributed the Ohio tax regime or its failure to reduce current property taxes. *See* Walter Hellerstein and Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 Cornell L.Rev. 789, 806-09 (1996) (explaining the non-coercive nature ***748** of a similar tax exemption.) Additionally, the personal property tax exemption is internally consistent because, if universally applied, the new property would escape tax liability irrespective of location. Every new investment, no matter where undertaken, would be exempt from a tax. Thus, businesses that desire to expand are neither discriminated against nor pressured into investing in Ohio. Accordingly, we hold that the Ohio personal property tax exemption does not violate the dormant Commerce Clause.

B. State Equal Protection Claim

The plaintiffs also challenged the investment tax credit and property tax exemption under the Equal Protection Clause of the Ohio Constitution ***.

[7][8][9] The Equal Protection Clauses of the Ohio and United States Constitutions impose identical limitations on government classification. *** Because the tax credit and the exemption provision classify on the basis of locality, a classification that is not inherently suspect, the tax incentives need only satisfy rational basis review.

[10][11] Under rational basis review, a classification "must be upheld against equal protection challenge if there is any reasonably conceivable state of facts that could provide a rational basis for the classification." *Cent. State Univ.*, 717 N.E.2d at 290 (quoting *FCC v. Beach Communications, Inc.*, 508 U.S. 307, 313, 113 S.Ct. 2096, 124 L.Ed.2d 211 (1993)). A rational relationship exists so long as "the relationship of the classification to its goal is not so attenuated as to render the distinction arbitrary or irrational." *PICA Corp., Inc. v. Tracy*, 97 Ohio App.3d 42, 646 N.E.2d 206, 209 (Ohio Ct.App.1994). The state, moreover, has no duty to produce legislative facts to sustain the rationality of a statutory classification. *Cent. State Univ.*, 717 N.E.2d at 290. A statute is presumed constitutional, and the "burden is on the one attacking the legislative arrangement to negative every conceivable basis which might support it." *Id.* (quoting *Heller v. Doe*, 509 U.S. 312, 320, 113 S.Ct. 2637, 125 L.Ed.2d 257 (1993) (citation omitted)).

[12] The courts have recognized a state's legitimate interest in revitalizing economically troubled areas in order to eliminate problems frequently associated with urban blight. *See, e.g.*, *Desenco, Inc. v. Akron*, 84 Ohio St.3d 535, 706 N.E.2d 323, 332 (1999) (statutes that created economic development districts were rationally related to the state's legitimate interest in facilitating economic development, creating or preserving jobs, and improving the economic welfare of citizens); *Nordlinger v. Hahn*, 505 U.S. 1, 12, 112 S.Ct. 2326, 120 L.Ed.2d 1 (1992) ("[T]he State has a legitimate interest in local neighborhood preservation, continuity, and stability.") (citing *Village of Euclid v. Ambler Realty Co.*, 272 U.S. 365, 47 S.Ct. 114, 71 L.Ed. 303 (1926)). The benefits conferred ***749** by the investment tax credit and property tax exemption are rationally related to this interest, given that their objective is to encourage businesses to relocate or expand existing facilities in central cities or areas that have high unemployment rates, significant low-income populations, or deteriorating buildings.

The plaintiffs argue nonetheless that granting tax incentives to a new domestic business but not nonresident businesses is not a legitimate purpose under Ohio's Equal Protection Clause. However, the cases cited in support of this argument lend little or no weight to the plaintiffs' position. In *Metropolitan Life Insurance Co. v. Ward*, 470 U.S. 869, 880, 105 S.Ct. 1676, 84 L.Ed.2d 751 (1985), for example, the Court invalidated an Alabama statute that imposed a higher tax rate on insurance companies that were incorporated or maintained their principal place of business outside of Alabama, on the ground that the difference in treatment failed to advance a legitimate state interest. In so ruling, the Court held "that promotion of domestic business within a State, by discriminating against foreign corporations that wish to compete by doing business there, is not a legitimate state purpose." *Id.* Thus, *Metropolitan Life* holds that a state may not impose a discriminatory tax in order to promote domestic industry solely based on nonresident status. The tax benefits under the Ohio statutes, however, are equally available to domestic and foreign corporations and classify corporations on the basis of new investment in economically depressed areas.

Likewise inapplicable are the cited opinions in *Allegheny Pittsburgh Coal Co. v. County Commission of Webster County*, 488 U.S. 336, 109 S.Ct. 633, 102 L.Ed.2d 688 (1989), and *Hooper v. Bernalillo County Assessor*, 472 U.S. 612, 105 S.Ct. 2862, 86 L.Ed.2d 487 (1985). In both cases, the Supreme Court struck down a county property tax assessment scheme that could not reasonably support the state's asserted legislative purpose. In *Allegheny*, the county tax assessor valued property based on the last sale price regardless of when it was last sold, providing only a modest increase in assessed value for properties that had not been recently transferred. *See id.* at 343, 109 S.Ct. 633. This practice resulted in gross disparities in the assessed value of comparable properties. The Court acknowledged that a "[s]tate may divide different kinds of property into classes and assign to each class a different tax burden so long as those divisions and burdens are reasonable," but it found no rational basis for the county's tax scheme whose asserted purpose was to "assess [ ] properties at true current value." *Id.* at 343-44, 109 S.Ct. 633. Similarly, the Court held in *Hooper* that a tax exemption classifying military veterans based solely on their period of residency within the state could not be rationalized by the state's interest in encouraging veterans to relocate to the state or in repaying veterans for their military service. 472 U.S. at 620-22, 105 S.Ct. 2862.

By contrast, the classification in this case is clearly supported by facts that give rise to a legitimate state interest. In the equal protection context, a tax statute withstands constitutional scrutiny as long as the burden it imposes is found to be rationally related to that purpose. The purpose of the Ohio statutes-to encourage industrial development and economic stimulation of the state's economically troubled areas-clearly has a reasonable nexus to the tax provisions. Hence, we conclude that the plaintiffs have failed to demonstrate that the challenged tax incentives violate the Equal Protection Clause of the Ohio Constitution.

*750 III. *CONCLUSION*

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. We AFFIRM the remaining portions of the district court's judgment.

C.A.6 (Ohio),2004.
Cuno v. DaimlerChrysler, Inc.
386 F.3d 738, 2004 Fed.App. 0356A

Briefs and Other Related Documents (Back to top)

• 01-3960 (Docket) (Sep. 12, 2001)

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Supreme Court of the United States
WEST LYNN CREAMERY, INC., et al., Petitioners,
v.
Jonathan HEALY, Commissioner of Massachusetts Department of Food and Agriculture.
No. 93-141.

Argued March 2, 1994.
Decided June 17, 1994.

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****2207** *Syllabus* [*]

A Massachusetts pricing order subjects all fluid milk sold by dealers to Massachusetts retailers to an assessment. Although most of that milk is produced out of State, the entire assessment is distributed to Massachusetts dairy farmers. Petitioners--licensed dealers who purchase milk produced by out-of-state farmers and sell it within Massachusetts--sued to enjoin enforcement of the order on the ground that it violated the Federal Commerce Clause, but the state court denied relief. The Supreme Judicial Court of Massachusetts affirmed, concluding that the order was not facially discriminatory, applied evenhandedly, and only incidentally burdened interstate commerce, and that ****2208** such burden was outweighed by the "local benefits" to the dairy industry.

Held: The pricing order unconstitutionally discriminates against interstate commerce. Pp. 2211-2218.

(a) The order is clearly unconstitutional under this Court's decisions invalidating state laws designed to benefit local producers of goods by creating tariff-like barriers that neutralized the competitive and economic advantages possessed by lower cost out-of-state producers. See, *e.g., Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200. The "premium payments" are effectively a tax making milk produced out of State more expensive. Although that tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely (indeed more than) offset by the subsidy provided exclusively to Massachusetts dairy farmers, who are thereby empowered to sell at or below the price charged by lower cost out-of-state producers. Pp. 2211-2213.

(b) Respondent's principal argument--that, because both the local-subsidy and nondiscriminatory-tax components of the order are valid, the combination of the two is equally valid--is rejected. Even granting respondent's assertion that both components of the pricing order would be constitutional standing alone, the order must still fall because it is funded principally from taxes on the sale of milk produced in other States and therefore burdens interstate commerce. More fundamentally, the argument is logically flawed in its assumption that the lawfulness of each of two acts establishes the legality of their combination. ***187** Indeed, by conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone: The Commonwealth's political processes cannot be relied on to prevent legislative abuse where dairy farmers, one of the powerful in-state interests that would ordinarily be expected to lobby against the order premium as a tax raising milk prices, have been mollified by the subsidy. Pp. 2214- 2216.

(c) Respondent's second argument--that the order is not discriminatory because the dealers who pay premiums are not competitors of the farmers who receive disbursements--cannot withstand scrutiny. The imposition of a differential burden on any part of the stream of commerce--from wholesaler to retailer to consumer--is invalid because a burden placed at any point will result in a disadvantage to the out-of-state producer. P. 2216.

(d) If accepted, respondent's third argument--that the order is not protectionist because the program's costs are borne only by Massachusetts dealers and consumers and its benefits are distributed exclusively to Massachusetts farmers--would undermine almost every discriminatory tax case. State taxes are ordinarily paid by in-state businesses and consumers,

[*] FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.,* 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

yet if they discriminate against out-of-state products they are unconstitutional. More fundamentally, the argument ignores the fact that Massachusetts dairy farmers are part of an integrated interstate market. The obvious impact of the order on out-of-state production demonstrates that it is simply wrong to assume that it burdens only in-state consumers and dealers. Pp. 2216-2217.

(e) Acceptance of respondent's final argument--that the order's incidental burden on commerce is justified by the local benefit of saving the financially distressed dairy industry--would make a virtue of the vice that the rule against discrimination condemns. Preservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits. Pp. 2217-2218.

415 Mass. 8, 611 N.E.2d 239, reversed.

STEVENS, J., delivered the opinion of the Court, in which O'CONNOR, KENNEDY, SOUTER, and GINSBURG, JJ., joined. SCALIA, J., filed an opinion concurring in the judgment, in which THOMAS, J., joined, *post,* p. 2218. REHNQUIST, C.J., filed a dissenting ****2209** opinion, in which BLACKMUN, J., joined, *post,* p. 2221.

Steven J. Rosenbaum, Washington, DC, for the petitioners.

***188** Douglas H. Wilkins, Boston, MA, for the respondent.

Justice STEVENS delivered the opinion of the Court.

A Massachusetts pricing order imposes an assessment on all fluid milk sold by dealers to Massachusetts retailers. About two-thirds of that milk is produced out of State. The entire assessment, however, is distributed to Massachusetts dairy farmers. The question presented is whether the pricing order unconstitutionally discriminates against interstate commerce. We hold that it does.

I

Petitioner West Lynn Creamery, Inc., is a milk dealer licensed to do business in Massachusetts. It purchases raw milk, which it processes, packages, and sells to wholesalers, retailers, and other milk dealers. About 97% of the raw milk it purchases is produced by out-of-state farmers. Petitioner LeComte's Dairy, Inc., is also a licensed Massachusetts milk dealer. It purchases all of its milk from West Lynn and distributes it to retail outlets in Massachusetts.

Since 1937, the Agricultural Marketing Agreement Act, 50 Stat. 246, as amended, 7 U.S.C. § 601 *et seq.,* has authorized the Secretary of Agriculture to regulate the minimum prices ***189** paid to producers of raw milk by issuing marketing orders for particular geographic areas. [FN1] While the Federal Government sets minimum prices based on local conditions, those prices have not been so high as to prevent substantial competition among producers in different States. In the 1980's and early 1990's, Massachusetts dairy farmers began to lose market share to lower cost producers in neighboring States. In response, the Governor of Massachusetts appointed a Special Commission to study the dairy industry. The commission found that many producers had sold their dairy farms during the past decade and that if prices paid to farmers for their milk were not significantly increased, a majority of the remaining farmers in Massachusetts would be "forced out of business within the year." App. 13. On January 28, 1992, relying on the commission's report, the Commissioner of the Massachusetts Department of Food and Agriculture (respondent) declared a State of Emergency. ***190** In his declaration he noted that the average federal blend price [FN2] had declined from $14.67 per hundred pounds (cwt) of raw milk in 1990 to $12.64/cwt in 1991, while costs of production for Massachusetts farmers had risen to an estimated average of $15.50/cwt. *Id.,* at 27. He concluded:

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> "Regionally, the industry is in serious trouble and ultimately, a federal solution will ****2210** be required. In the meantime, we must act on the state level to preserve our local industry, maintain reasonable minimum prices for the dairy farmers, thereby ensure a continuous and adequate supply of fresh milk for our market, and protect the public health." *Id.,* at 31.

Promptly after his declaration of emergency, respondent issued the pricing order that is challenged in this proceeding. [FN3]

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The order requires every "dealer" [FN4] in Massachusetts to make a monthly "premium payment" into the "Massachusetts Dairy Equalization Fund." The amount of those payments is computed in two steps. First, the monthly "order premium" is determined by subtracting the federal blend price for that month from $15 and dividing the difference by three; thus if the federal price is $12/cwt, the order premium is $1/cwt. [FN5] Second, the premium is multiplied by the amount ***191** in pounds) of the dealer's Class I [FN6] sales in Massachusetts. Each month the fund is distributed to Massachusetts producers. [FN7] Each Massachusetts producer receives a share of the total fund equal to his proportionate contribution to the State's total production of raw milk. [FN8]

FN4. A "dealer" is defined as "any person who is engaged within the Commonwealth in the business of receiving, purchasing, pasteurizing, bottling, processing, distributing, or otherwise handling milk, purchases or receives milk for sale as the consignee or agent of a producer, and shall include a producer-dealer, dealer-retailer, and sub-dealer." App. 32-33.

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FN7. A "producer" is defined as "any person producing milk from dairy cattle." App. 33.

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Petitioners West Lynn and LeComte's complied with the pricing order for two months, paying almost $200,000 into the Massachusetts Dairy Equalization Fund. *Id.,* at 100, 105. Starting in July 1992, however, petitioners refused to make the premium payments, and respondent commenced license revocation proceedings. Petitioners then filed an action in state court seeking an injunction against enforcement of the order on the ground that it violated the Commerce Clause of the Federal Constitution. The state court denied relief and respondent conditionally revoked their licenses.

The parties agreed to an expedited appellate procedure, and the Supreme Judicial Court of Massachusetts transferred the cases to its own docket. It affirmed, because it concluded that "the pricing order does not discriminate on its face, is evenhanded in its application, and only incidentally ***192** burdens interstate commerce." *West Lynn Creamery, Inc. v. Commissioner of Dept. of Food and Agriculture*, 415 Mass. 8, 15, 611 N.E.2d 239, 243 (1993). The court noted that the "pricing order was designed to aid only Massachusetts producers." *Id.*, at 16, 611 N.E.2d, at 244. It conceded that "[c]ommon sense" indicated that the plan has an "adverse ****2211** impact on interstate commerce" and that "[t]he fund distribution scheme does burden out-of-State producers." *Id.*, at 17, 611 N.E.2d, at 244. Nevertheless, the court asserted that "the burden is incidental given the purpose and design of the program." *Id.*, at 18, 611 N.E.2d, at 244. Because it found that the "local benefits" provided to the Commonwealth's dairy industry "outweigh any incidental burden on interstate commerce," it sustained the constitutionality of the pricing order. *Id.*, at 19, 611 N.E.2d, at 245. We granted certiorari, 510 U.S. 811, 114 S.Ct. 56, 126 L.Ed.2d 26 (1993), and now reverse.

II

[1][2] The Commerce Clause vests Congress with ample power to enact legislation providing for the regulation of prices paid to farmers for their products. *United States v. Darby*, 312 U.S. 100, 61 S.Ct. 451, 85 L.Ed. 609 (1941); *Wickard v. Filburn*, 317 U.S. 111, 63 S.Ct. 82, 87 L.Ed. 122 (1942); *Mandeville Island Farms, Inc. v. American Crystal Sugar Co.*, 334 U.S. 219, 68 S.Ct. 996, 92 L.Ed. 1328 (1948). An affirmative exercise of that power led to the promulgation of the federal order setting minimum milk prices. The Commerce Clause also limits the power of the Commonwealth of Massachusetts to adopt regulations that discriminate against interstate commerce. "This 'negative' aspect of the Commerce Clause prohibits economic protectionism--that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors.... Thus, state statutes that clearly discriminate against interstate commerce are routinely struck down ... unless the discrimination is demonstrably justified by a valid factor unrelated to economic protectionism. ..." ***193** *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 273-274, 108 S.Ct. 1803, 1807, 100 L.Ed.2d 302 (1988). [FN9]

FN9. The "negative" aspect of the Commerce Clause was considered the more important by the "father of the Constitution," James Madison. In one of his letters, Madison wrote that the Commerce Clause "grew out of the abuse of the power by the importing States in taxing the non-importing, and was intended as a negative and preventive provision against injustice among the States themselves, rather than as a power to be used for the positive purposes of the General Government." 3 M. Farrand, Records of the Federal Convention of 1787, p. 478 (1911).

[3] The paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State. A tariff is an attractive measure because it simultaneously raises revenue and benefits local producers by burdening their out-of-state competitors. Nevertheless, it violates the principle of the unitary national market by handicapping out-of-state competitors, thus artificially encouraging in-state production even when the same goods could be produced at lower cost in other States.

[4] Because of their distorting effects on the geography of production, tariffs have long been recognized as violative of the Commerce Clause. In fact, tariffs against the products of other States are so patently unconstitutional that our cases reveal not a single attempt by any State to enact one. Instead, the cases are filled with state laws that aspire to reap some of the benefits of tariffs by other means. In *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 55 S.Ct. 497, 79 L.Ed. 1032 (1935), the State of New York attempted to protect its dairy farmers from the adverse effects of Vermont competition by establishing a single minimum price for all milk, whether produced in New York or elsewhere. This Court did not hesitate, however, to strike it down. Writing for a unanimous Court, Justice Cardozo reasoned:

> ***194** "Neither the power to tax nor the police power may be used by the state of destination with the aim and effect of establishing an economic barrier against competition with the products of another state or the labor of its residents. Restrictions so contrived are an unreasonable clog upon the mobility of commerce. They set up what is equivalent to a rampart of customs duties designed to neutralize advantages ****2212** belonging to the place of origin." *Id.*, at 527, 55 S.Ct. at 502.

Thus, because the minimum price regulation had the same effect as a tariff or customs duty--neutralizing the advantage possessed by lower cost out-of-state producers--it was held unconstitutional. Similarly, in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984), this Court invalidated a law which advantaged local production by granting a tax exemption to certain liquors produced in Hawaii. Other cases of this kind are legion. *Welton v. Missouri*, 91 U.S. 275, 23 L.Ed. 347 (1876); *Guy v. Baltimore*, 100 U.S. 434, 25 L.Ed. 743 (1880); *Toomer v. Witsell*, 334 U.S. 385, 68 S.Ct. 1156, 92 L.Ed. 1460 (1948); *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361, 84 S.Ct. 378, 11 L.Ed.2d 389 (1964); *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334, 112 S.Ct. 2009, 119 L.Ed.2d 121 (1992); see also *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 351, 97 S.Ct. 2434, 2445, 53 L.Ed.2d 383 (1977) (invalidating statute, because it "has the effect of stripping away from the Washington apple industry the competitive and economic advantages it has earned").

[5][6] Under these cases, Massachusetts' pricing order is clearly unconstitutional. Its avowed purpose and its undisputed effect are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States. The "premium payments" are effectively a tax which makes milk produced out of State more expensive. Although the tax also applies to milk produced in Massachusetts, its effect on Massachusetts producers is entirely (indeed more than) offset by the subsidy provided exclusively to Massachusetts dairy farmers. Like an ordinary tariff, the tax is thus effectively imposed only on out-of-state products. The pricing ***195** order thus allows Massachusetts dairy farmers who produce at higher cost to sell at or below the price charged by lower cost out-of-state producers. [FN10] If there were no federal minimum prices for milk, out-of-state producers might still be able to retain their market share by lowering their prices. Nevertheless, out-of-staters' ability to remain competitive by lowering their prices would not immunize a discriminatory measure. *New Energy Co. of Ind. v. Limbach*, 486 U.S., at 275, 108 S.Ct., at 1808. [FN11] In this ****2213** case, because the Federal Government sets ***196** minimum prices, out-of-state producers may not even have the option of reducing prices in order to retain market share. The Massachusetts pricing order thus will almost certainly "cause local goods to constitute a larger share, and goods with an out-of-state source to constitute a smaller share, of the total sales in the market." [FN12] *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 126, n. 16, 98 S.Ct. 2207, 2214, n. 16, 57 L.Ed.2d 91 (1978). In fact, this effect was the motive behind the promulgation of the pricing order. This effect renders the program unconstitutional, because it, like a tariff, "neutraliz[es] advantages belonging to the place of origin." *Baldwin*, 294 U.S., at 527, 55 S.Ct., at 502.

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In some ways, the Massachusetts pricing order is most similar to the law at issue in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984). Both involve a broad-based tax on a single kind of good and special provisions for in-state producers. ***197** *Bacchus* involved a 20% excise tax on all liquor sales, coupled with an exemption for fruit wine manufactured in Hawaii and for okolehao, a brandy distilled from the root of a shrub indigenous to Hawaii. The Court held that Hawaii's law was unconstitutional because it "had both the purpose and effect of discriminating in favor of local products." *Id.*, at 273, 104 S.Ct., at 3056. See also *I.M. Darnell & Son Co. v. Memphis*, 208 U.S. 113, 28 S.Ct. 247, 52 L.Ed. 413 (1908) (invalidating property tax exemption favoring local manufacturers). By granting a tax exemption for local products, Hawaii in effect created a protective tariff. Goods produced out of State were taxed, but those produced in State were subject to no net tax. It is obvious that the result in *Bacchus* would have been the same if instead of exempting certain Hawaiian liquors from tax, Hawaii had rebated the amount of tax collected from the sale of those liquors. See *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 108 S.Ct. 1803, 100 L.Ed.2d 302 (1988) (discriminatory tax credit). And if a discriminatory tax rebate is unconstitutional, Massachusetts' pricing order is surely invalid; for Massachusetts not only rebates to domestic milk producers the tax paid on the sale of Massachusetts milk, but also the tax paid on the sale of milk produced elsewhere. [FN13] The additional rebate of the tax paid on the sale of milk produced elsewhere in no way reduces the danger to the national market posed by tariff-like barriers, but instead exacerbates the danger by giving domestic producers an additional tool with which to shore up their competitive position. [FN14]

FN13. Indeed, it is this aspect of the pricing order which allows it to give Massachusetts farmers a benefit three times as valuable per cwt as the tax (order premium) imposed. See n. 5, *supra.*

FN14. One might attempt to distinguish *Bacchus* by noting that the rebate in this case goes not to the entity which pays the tax (milk dealers) but to the dairy farmers themselves. Rebating the taxes directly to producers rather than to the dealers, however, merely reinforces the conclusion that the pricing order will favor local producers. If the taxes were refunded only to the dealers, there might be no impact on interstate commerce, because the dealers might not use the funds to increase the price or quantity of milk purchased from Massachusetts dairy farmers. The refund to the dealers might, therefore, result in no advantage to in-state producers. On the other hand, by refunding moneys directly to the dairy farmers, the pricing order ensures that Massachusetts producers will benefit.

****2214 *198** III

Respondent advances four arguments against the conclusion that its pricing order imposes an unconstitutional burden on interstate commerce: (A) Because each component of the program--a local subsidy and a nondiscriminatory tax--is valid, the combination of the two is equally valid; (B) The dealers who pay the order premiums (the tax) are not competitors of the farmers who receive disbursements from the Dairy Equalization Fund, so the pricing order is not discriminatory; (C) The pricing order is not protectionist, because the costs of the program are borne only by Massachusetts dealers and consumers, and the benefits are distributed exclusively to Massachusetts farmers; and (D) The order's incidental burden on commerce is justified by the local benefit of saving the dairy industry from collapse. We discuss each of these arguments in turn.

A

[7] Respondent's principal argument is that, because "the milk order achieves its goals through lawful means," the order as a whole is constitutional. Brief for Respondent 20. He argues that the payments to Massachusetts dairy farmers from the Dairy Equalization Fund are valid, because subsidies are constitutional exercises of state power, and that the order premium which provides money for the fund is valid, because it is a nondiscriminatory tax. Therefore the pricing order is constitutional, because it is merely the combination of two independently lawful regulations. In effect, respondent argues, if the State may impose a valid tax on dealers, it is free to use the proceeds of the tax as it chooses; and ***199** if it may independently subsidize its farmers, it is free to finance the subsidy by means of any legitimate tax.

[8][9][10] Even granting respondent's assertion that both components of the pricing order would be constitutional standing alone, [FN15] the pricing order nevertheless must fall. A pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business. The pricing order in this case, however, is funded principally from taxes on the sale of milk

produced in other States. [FN16] By so funding the subsidy, respondent not only assists local farmers, but burdens interstate commerce. The pricing order thus violates the cardinal principle that a State may not "benefit in-state economic interests by burdening out-of-state competitors." *New Energy Co. of Ind. v. Limbach*, 486 U.S., at 273-274, 108 S.Ct., at 1807-1808; see also *Bacchus Imports, Ltd. v. Dias*, 468 U.S., at 272, 104 S.Ct., at 3055; *Guy v. Baltimore*, 100 U.S., at 443, 25 L.Ed. 743.

FN15. We have never squarely confronted the constitutionality of subsidies, and we need not do so now. We have, however, noted that "[d]irect subsidization of domestic industry does not ordinarily run afoul" of the negative Commerce Clause. *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278, 108 S.Ct. 1803, 1810, 100 L.Ed.2d 302 (1988); see also *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 815, 96 S.Ct. 2488, 2500, 49 L.Ed.2d 220 (1976) (STEVENS, J., concurring). In addition, it is undisputed that States may try to attract business by creating an environment conducive to economic activity, as by maintaining good roads, sound public education, or low taxes. *Zobel v. Williams*, 457 U.S. 55, 67, 102 S.Ct. 2309, 2316, 72 L.Ed.2d 672 (1982) (Brennan, J., concurring); *Bacchus Imports, Ltd. v. Dias*, 468 U.S., at 271, 104 S.Ct., at 3055; *Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 876- 878, 105 S.Ct. 1676, 1680-1681, 84 L.Ed.2d 751 (1985).

FN16. It is undisputed that an overwhelming majority of the milk sold in Massachusetts is produced elsewhere. Thus, even though the tax is applied even-handedly to milk produced in State and out of State, most of the tax collected comes from taxes on milk from other States. In addition, the tax on in-state milk, unlike that imposed on out-of-state milk, does not impose any burden on in-state producers, because in-state dairy farmers can be confident that the taxes paid on their milk will be returned to them via the Dairy Equalization Fund.

[11] More fundamentally, respondent errs in assuming that the constitutionality of the pricing order follows logically from the constitutionality of its component parts. By conjoining ***200** a tax and a subsidy, Massachusetts ****2215** has created a program more dangerous to interstate commerce than either part alone. Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "[t]he existence of major in-state interests adversely affected ... is a powerful safeguard against legislative abuse." *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 473, n. 17, 101 S.Ct. 715, 728, n. 17, 66 L.Ed.2d 659 (1981); see also *Raymond Motor Transp., Inc. v. Rice*, 434 U.S. 429, 444, n. 18, 98 S.Ct. 787, 795, n. 18, 54 L.Ed.2d 664 (1978) (special deference to state highway regulations because "their burden usually falls on local economic interests as well as other States' economic interests, thus insuring that a State's own political processes will serve as a check against unduly burdensome regulations"); *South Carolina Highway Dept. v. Barnwell Brothers, Inc.*, 303 U.S. 177, 187, 58 S.Ct. 510, 514, 82 L.Ed. 734 (1938); *Goldberg v. Sweet*, 488 U.S. 252, 266, 109 S.Ct. 582, 591, 102 L.Ed.2d 607 (1989). [FN17] However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a State's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy. So, in this case, one would ordinarily have expected at least three groups to lobby against the order premium, which, as a tax, raises the price (and hence lowers demand) for milk: dairy farmers, milk dealers, and consumers. But because the tax was coupled with a subsidy, one of the most powerful of these groups, Massachusetts dairy ***201** farmers, instead of exerting their influence against the tax, were in fact its primary supporters. [FN18]

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[12] Respondent's argument would require us to analyze separately two parts of an integrated regulation, but we cannot divorce the premium payments from the use to which the payments are put. It is the entire program--not just the contributions to the fund or the distributions from that fund--that simultaneously burdens interstate commerce and discriminates in favor of local producers. The choice of constitutional means--nondiscriminatory tax and local subsidy--cannot guarantee the constitutionality of the program as a whole. New York's minimum price order also used constitutional means--a State's power to regulate prices--but was held unconstitutional because of its deleterious effects. *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 55 S.Ct. 497, 79 L.Ed. 1032 (1935).

Similarly, the law held unconstitutional in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984), involved the exercise of Hawaii's undisputed power to tax and to grant tax exemptions.

[13] Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce. Rather our cases have eschewed formalism for a sensitive, case-by-case analysis of purposes and effects. As the Court declared over 50 years ago: "The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under ****2216** attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce." *Best & Co. v. Maxwell*, 311 U.S. 454, 455-456, 61 S.Ct. 334, 335, 85 L.Ed. 275 (1940); *Maryland v. Louisiana*, 451 U.S. 725, 756, 101 S.Ct. 2114, 2134, 68 L.Ed.2d 576 (1981); ***202** *Exxon Corp. v. Governor of Maryland*, 437 U.S., at 147, 98 S.Ct., at 2224; see also *Guy v. Baltimore*, 100 U.S., at 430, 25 L.Ed. 743 (invalidating discriminatory wharfage fees which were "mere expedient or device to accomplish, by indirection, what the State could not accomplish by a direct tax, viz., build up its domestic commerce by means of unequal and oppressive burdens upon the industry and business of other States"); *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S., at 527, 55 S.Ct., at 502 ("What is ultimate is the principle that one state in its dealings with another may not put itself in a position of economic isolation. Formulas and catchwords are subordinate to this overmastering requirement"); *Dean Milk Co. v. Madison*, 340 U.S. 349, 354, 71 S.Ct. 295, 297, 95 L.Ed. 329 (1951); *New Energy Co. of Ind. v. Limbach*, 486 U.S., at 275, 276, 108 S.Ct., at 1808, 1809 (invalidating reciprocal tax credit because it, "in effect, tax[es] a product made by [Indiana] manufacturers at a rate higher than the same product made by Ohio manufacturers").

B

[14][15] Respondent also argues that since the Massachusetts milk dealers who pay the order premiums are not competitors of the Massachusetts farmers, the pricing order imposes no discriminatory burden on commerce. Brief for Respondent 28-29. This argument cannot withstand scrutiny. Is it possible to doubt that if Massachusetts imposed a higher sales tax on milk produced in Maine than milk produced in Massachusetts that the tax would be struck down, in spite of the fact that the sales tax was imposed on consumers, and consumers do not compete with dairy farmers? For over 150 years, our cases have rightly concluded that the imposition of a differential burden on any part of the stream of commerce--from wholesaler to retailer to consumer--is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer. *Brown v. Maryland*, 12 Wheat. 419, 444, 448, 6 L.Ed. 678 (1827) ("So, a tax on the occupation of an importer is, in like manner, a tax on importation. It must add to the price of the article, and be paid by the consumer, or by the ***203** importer himself, in like manner as a direct duty on the article itself would be made." "The distinction between a tax on the thing imported, and on the person of the importer, can have no influence on this part of the subject. It is too obvious for controversy, that they interfere equally with the power to regulate commerce"); *I.M. Darnell & Son Co. v. Memphis*, 208 U.S. 113, 28 S.Ct. 247, 52 L.Ed. 413 (1908) (differential burden on intermediate stage manufacturer); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 104 S.Ct. 3049, 82 L.Ed.2d 200 (1984) (differential burden on wholesaler); *Webber v. Virginia*, 103 U.S. 344, 350, 26 L.Ed. 565 (1881) (differential burden on sales agent); *New Energy Co. of Ind. v. Limbach*, 486 U.S., at 273-274, 108 S.Ct., at 1807-1808 (differential burden on retailer).

C

[16][17] Respondent also argues that "the operation of the Order disproves any claim of protectionism," because "*only* in-state consumers feel the effect of any retail price increase ... [and] [t]he dealers themselves ... have a substantial in-state presence." Brief for Respondent 17 (emphasis in original). This argument, if accepted, would undermine almost every discriminatory tax case. State taxes are ordinarily paid by in-state businesses and consumers, yet if they discriminate against out-of-state products, they are unconstitutional. The idea that a discriminatory tax does not interfere with interstate commerce "merely because the burden of the tax was borne by consumers" in the taxing State was thoroughly repudiated in *Bacchus Imports, Ltd. v. Dias*, 468 U.S., at 272, 104 S.Ct., at 3055. The cost of a ****2217** tariff is also borne primarily by local consumers, yet a tariff is the paradigmatic Commerce Clause violation.

More fundamentally, respondent ignores the fact that Massachusetts dairy farmers are part of an integrated interstate market. As noted *supra*, at 2212-2213, the purpose and effect of the pricing order are to divert market share to Massachusetts dairy farmers. This diversion necessarily injures the dairy farmers in neighboring States. Furthermore, ***204** the

Massachusetts order regulates a portion of the same interstate market in milk that is more broadly regulated by a federal milk marketing order which covers most of New England. 7 CFR § 1001.2 (1993). The Massachusetts producers who deliver milk to dealers in that regulated market are participants in the same interstate milk market as the out-of-state producers who sell in the same market and are guaranteed the same minimum blend price by the federal order. The fact that the Massachusetts order imposes assessments only on Massachusetts sales and distributes them only to Massachusetts producers does not exclude either the assessments or the payments from the interstate market. To the extent that those assessments affect the relative volume of Class I milk products sold in the marketing area as compared to other classes of milk products, they necessarily affect the blend price payable even to out-of-state producers who sell only in non-Massachusetts markets. [FN19] The obvious impact of the order on out-of-state production demonstrates that it is simply wrong to assume that the pricing order burdens only Massachusetts consumers and dealers.

FN19. On the way changing the demand for Class I milk products changes the blend price for producers in the entire area covered by the marketing order, see n. 1, *supra.*

D

[18][19][20] Finally, respondent argues that any incidental burden on interstate commerce "is outweighed by the 'local benefits' of preserving the Massachusetts dairy industry." [FN20] Brief for ***205** Respondent 42. In a closely related argument, respondent urges that "the purpose of the order, to save an industry from collapse, is not protectionist." *Id.*, at 16. If we were to accept these arguments, we would make a virtue of the vice that the rule against discrimination condemns. Preservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits. In *Bacchus Imports, Ltd. v. Dias,* 468 U.S., at 272, 104 S.Ct., at 3055, we explicitly rejected any distinction "between thriving and struggling enterprises." Whether a State is attempting to " 'enhance thriving and substantial business enterprises' " or to " 'subsidize ... financially troubled' " ones is irrelevant to Commerce Clause analysis. ****2218** *Ibid.* With his characteristic eloquence, Justice Cardozo responded to an argument that respondent echoes today:

FN20. Among the "local benefits" that respondent identifies is "protecting unique open space and related benefits." Brief for Respondent 40.

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"The argument is pressed upon us, however, that the end to be served by the Milk Control Act is something more than the economic welfare of the farmers or of any other class or classes. The end to be served is the maintenance of a regular and adequate supply of pure and wholesome milk, the supply being put in jeopardy when ***206** the farmers of the state are unable to earn a living income. *Nebbia v. New York,* ... [291 U.S. 502, 54 S.Ct. 505, 78 L.Ed. 940 (1934)]. Let such an exception be admitted, and all that a state will have to do in times of stress and strain is to say that its farmers and merchants and workmen must be protected against competition from without, lest they go upon the poor relief lists or perish altogether. To give entrance to that excuse would be to invite a speedy end of our national solidarity. The Constitution was framed under the dominion of a political philosophy less parochial in range. It was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division." *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S., at 522-523, 55 S.Ct., at 500. [FN21]

FN21. "This distinction between the power of the State to shelter its people from menaces to their health or safety and from fraud, even when those dangers emanate from interstate commerce, and its lack of power to retard, burden or constrict the flow of such commerce for their economic advantage, is one deeply rooted in both our history and our law." *H.P. Hood & Sons, Inc. v. Du Mond,* 336 U.S. 525, 533, 69 S.Ct. 657, 662, 93 L.Ed. 865 (1949); see also *Bacchus Imports, Ltd. v. Dias,* 468 U.S., at 272-273, 104 S.Ct., at 3055-3056.

In a later case, also involving the welfare of Massachusetts dairy farmers, [FN22] Justice Jackson described the same overriding interest in the free flow of commerce across state lines:

FN22. A surprisingly large number of our Commerce Clause cases arose out of attempts to protect local dairy farmers.

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> "Our system, fostered by the Commerce Clause, is that every farmer and every craftsman shall be encouraged ***207** to produce by the certainty that he will have free access to every market in the Nation, that no home embargoes will withhold his exports, and no foreign state will by customs duties or regulations exclude them. Likewise, every consumer may look to the free competition from every producing area in the Nation to protect him from exploitation by any. Such was the vision of the Founders; such has been the doctrine of this Court which has given it reality." *H.P. Hood & Sons, Inc. v. Du Mond,* 336 U.S. 525, 539, 69 S.Ct. 657, 665, 93 L.Ed. 865 (1949).

The judgment of the Supreme Judicial Court of Massachusetts is reversed.

It is so ordered.

Justice SCALIA, with whom Justice THOMAS joins, concurring in the judgment.

In my view the challenged Massachusetts pricing order is invalid under our negative-Commerce-Clause jurisprudence, for the reasons explained in Part II below. I do not agree with the reasons assigned by the Court, which seem to me, as explained in Part I, a broad expansion of current law. Accordingly, I concur only in the judgment of the Court.

I

The purpose of the negative Commerce Clause, we have often said, is to create a ****2219** national market. It does not follow from that, however, and we have never held, that every state law which obstructs a national market violates the Commerce Clause. Yet that is what the Court says today. It seems to have canvassed the entire corpus of negative-Commerce-Clause opinions, culled out every free-market snippet of reasoning, and melded them into the sweeping principle that the Constitution is violated by any state law or regulation that "artificially encourag[es] in-state production even when the same goods could be produced at lower cost in other States." *Ante,* at 2211. See also *ante,* at 2212 (the ***208** law here is unconstitutional because it "neutraliz[es] the advantage possessed by lower cost out-of-state producers"); *ante,* at 2212 (price order is unconstitutional because it allows in-state producers "who produce at higher cost to sell at or below the price charged by lower cost out-of-state producers"); *ante,* at 2213 (a state program is unconstitutional where it " 'neutralizes advantages belonging to the place of origin' ") (quoting *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 527, 55 S.Ct. 497, 502, 79 L.Ed. 1032 (1935)); *ante,* at 2217 ("Preservation of local industry by protecting it from the rigors of interstate competition is the hallmark of the economic protectionism that the Commerce Clause prohibits").

As the Court seems to appreciate by its eagerness expressly to reserve the question of the constitutionality of subsidies for in-state industry, *ante,* at 2214, and n. 15, this expansive view of the Commerce Clause calls into question a wide variety of state laws that have hitherto been thought permissible. It seems to me that a state subsidy would *clearly* be invalid under any formulation of the Court's guiding principle identified above. The Court guardedly asserts that a "pure subsidy funded out of general revenue *ordinarily* imposes no burden on interstate commerce, but merely assists local business," *ante,* at 2214 (emphasis added), but under its analysis that must be taken to be true only because most local businesses (*e.g.,* the local hardware store) are not competing with businesses out of State. The Court notes that, in funding this subsidy, Massachusetts has taxed milk produced in other States, and thus "not only assists local farmers, but burdens interstate commerce." *Ibid.* But the same could be said of almost all subsidies funded from general state revenues, which almost invariably include moneys from use taxes on out-of-state products. And even where the funding does not come in any part from taxes on out-of-state goods, "merely assist[ing]" in-State businesses, *ibid.,* unquestionably neutralizes advantages possessed by out-of-state enterprises. Such subsidies, particularly where ***209** they are in the form of cash or (what comes to the same thing) tax forgiveness, are often admitted to have as their purpose--*indeed, are nationally advertised as having as their purpose*--making it more profitable to conduct business in-state than elsewhere, *i.e.,* distorting normal market incentives.

The Court's guiding principle also appears to call into question many garden-variety state laws heretofore permissible under the negative Commerce Clause. A state law, for example, which requires, contrary to the industry practice, the use of recyclable packaging materials, favors local nonexporting producers, who do not have to establish an additional, separate packaging operation for in-state sales. If the Court's analysis is to be believed, such a law would be unconstitutional without regard to whether disruption of the "national market" is the real purpose of the restriction, and without the need to "balance" the importance of the state interests thereby pursued, see *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 90 S.Ct. 844, 25 L.Ed.2d 174 (1970). These results would greatly extend the negative Commerce Clause beyond its current scope. If the Court does not intend these consequences, and does not want to foster needless litigation concerning them, it should not have adopted its expansive rationale. Another basis for deciding the case is available, which I proceed to discuss.

II

"The historical record provides no grounds for reading the Commerce Clause to be other ****2220** than what it says--an authorization for Congress to regulate commerce." *Tyler Pipe Industries, Inc. v. Washington State Dept. of Revenue*, 483 U.S. 232, 263, 107 S.Ct. 2810, 2828, 97 L.Ed.2d 199 (1987) (SCALIA, J., concurring in part and dissenting in part). Nonetheless, we formally adopted the doctrine of the negative Commerce Clause 121 years ago, see *Case of the State Freight Tax*, 15 Wall. 232, 21 L.Ed. 146 (1873), and since then have decided a vast number of negative-Commerce-Clause cases, engendering considerable reliance interests. ***210** As a result, I will, on *stare decisis* grounds, enforce a self-executing "negative" Commerce Clause in two situations: (1) against a state law that facially discriminates against interstate commerce, and (2) against a state law that is indistinguishable from a type of law previously held unconstitutional by this Court. See *Itel Containers Int'l Corp. v. Huddleston*, 507 U.S. 60, 78-79, and nn. 1, 2, 113 S.Ct. 1095, 1106-1107, and nn. 1, 2, 122 L.Ed.2d 421 (1993) (SCALIA, J., concurring in judgment) (collecting cases). Applying this approach--or at least the second part of it--is not always easy, since once one gets beyond facial discrimination our negative-Commerce-Clause jurisprudence becomes (and long has been) a "quagmire." *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450, 458, 79 S.Ct. 357, 362, 3 L.Ed.2d 421 (1959). See generally D. Currie, The Constitution in the Supreme Court: The First Hundred Years 1789-1888, pp. 168-181, 222-236, 330-342, 403-416 (1985). The object should be, however, to produce a clear rule that honors the holdings of our past decisions but declines to extend the rationale that produced those decisions any further. See *American Trucking Assns., Inc. v. Scheiner*, 483 U.S. 266, 305-306, 107 S.Ct. 2829, 2851-2852, 97 L.Ed.2d 226 (1987) (SCALIA, J., dissenting).

There are at least four possible devices that would enable a State to produce the economic effect that Massachusetts has produced here: (1) a discriminatory tax upon the industry, imposing a higher liability on out-of-state members than on their in-state competitors; (2) a tax upon the industry that is nondiscriminatory in its assessment, but that has an "exemption" or "credit" for in-state members; (3) a nondiscriminatory tax upon the industry, the revenues from which are placed into a segregated fund, which fund is disbursed as "rebates" or "subsidies" to in-state members of the industry (the situation at issue in this case); and (4) with or without nondiscriminatory taxation of the industry, a subsidy for the in-state members of the industry, funded from the State's general revenues. It is long settled that the first of these methodologies is unconstitutional under the negative Commerce ***211** Clause. See, *e.g.*, *Guy v. Baltimore*, 100 U.S. 434, 443, 25 L.Ed. 743 (1880). The second of them, "exemption" from or "credit" against a "neutral" tax, is no different in principle from the first, and has likewise been held invalid. See *Maryland v. Louisiana*, 451 U.S. 725, 756, 101 S.Ct. 2114, 2134, 68 L.Ed.2d 576 (1981); *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 399- 400, and n. 9, 104 S.Ct. 1856, 1865, & n. 9, 80 L.Ed.2d 388 (1984). The fourth methodology, application of a state subsidy from general revenues, is so far removed from what we have hitherto held to be unconstitutional, that prohibiting it must be regarded as an extension of our negative-Commerce-Clause jurisprudence and therefore, to me, unacceptable. See *New Energy Co. of Ind. v. Limbach*, 486 U.S. 269, 278, 108 S.Ct. 1803, 1810, 100 L.Ed.2d 302 (1988). Indeed, in my view our negative-Commerce-Clause cases have already approved the use of such subsidies. See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 809-810, 96 S.Ct. 2488, 2497-2498, 49 L.Ed.2d 220 (1976).

The issue before us in the present case is whether the third of these methodologies must fall. Although the question is close, I conclude it would not be a principled point at which to disembark from the negative-Commerce-Clause train. The only difference between methodology (2) (discriminatory "exemption" from nondiscriminatory tax) and methodology (3) (discriminatory refund of nondiscriminatory tax) is that the money is taken and returned rather than simply left ****2221** with the favored in-state taxpayer in the first place. The difference between (3) and (4), on the other hand, is the difference between assisting in-state industry through discriminatory taxation and assisting in-state industry by other means.

I would therefore allow a State to subsidize its domestic industry so long as it does so from nondiscriminatory taxes that go into the State's general revenue fund. Perhaps, as some commentators contend, that line comports with an important economic reality: A State is less likely to maintain a subsidy when its citizens perceive that the money (in the general fund) is available for any number of competing, ***212** nonprotectionist, purposes. See Coenen, Untangling the Market-Participant Exemption to the Dormant Commerce Clause, 88 Mich.L.Rev. 395, 479 (1989); Collins, Economic Union as a Constitutional Value, 63 N.Y.U.L.Rev. 43, 103 (1988); Gergen, The Selfish State and the Market, 66 Texas L.Rev. 1097, 1138 (1988); see also *ante*, at 2215, and n. 17. That is not, however, the basis for my position, for as THE CHIEF JUSTICE explains, "[a]nalysis of interest group participation in the political process may serve many useful purposes, but serving as a basis for interpreting the dormant Commerce Clause is not one of them." *Post*, at 2222 (dissenting opinion). Instead, I draw the line where I do because it is a clear, rational line at the limits of our extant negative-Commerce-Clause jurisprudence.

Chief Justice REHNQUIST, with whom Justice BLACKMUN joins, dissenting.

The Court is less than just in its description of the reasons which lay behind the Massachusetts law which it strikes down. The law undoubtedly sought to aid struggling Massachusetts dairy farmers, beset by steady or declining prices and escalating costs. This situation is apparently not unique to Massachusetts; New Jersey has filed an *amicus* brief in support of respondent because New Jersey has enacted a similar law. Both States lie in the northeastern metropolitan corridor, which is the most urbanized area in the United States, and has every prospect of becoming more so. The value of agricultural land located near metropolitan areas is driven up by the demand for housing and similar urban uses; distressed farmers eventually sell out to developers. Not merely farm produce is lost, as is the milk production in this case, but, as the Massachusetts Special Commission whose report was the basis for the order in question here found:

> "Without the continued existence of dairy farmers, the Commonwealth will lose its supply of locally produced fresh milk, together with the open lands that are used as ***213** wildlife refuges, for recreation, hunting, fishing, tourism, and education." App. 13.

Massachusetts has dealt with this problem by providing a subsidy to aid its beleaguered dairy farmers. In case after case, we have approved the validity under the Commerce Clause of such enactments. "No one disputes that a State may enact laws pursuant to its police powers that have the purpose and effect of encouraging domestic industry." *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263, 271, 104 S.Ct. 3049, 3055, 82 L.Ed.2d 200 (1984). "Direct subsidization of domestic industry does not ordinarily run afoul of [the dormant Commerce Clause]; discriminatory taxation of out-of-state manufacturers does." *New Energy Co. of Ind. v. Limbach,* 486 U.S. 269, 278, 108 S.Ct. 1803, 1810, 100 L.Ed.2d 302 (1988). But today the Court relegates these well-established principles to a footnote and, at the same time, gratuitously casts doubt on the validity of state subsidies, observing that "[w]e have never squarely confronted" their constitutionality. *Ante,* at 2214, n. 15.

But in *Milk Control Bd. v. Eisenberg Farm Products,* 306 U.S. 346, 59 S.Ct. 528, 83 L.Ed. 752 (1939), the Court upheld a Pennsylvania statute establishing minimum prices to be paid to Pennsylvania dairy farmers against a Commerce Clause challenge by a Pennsylvania milk dealer that shipped all of its milk purchased in Pennsylvania to New York to be sold there. The Court observed that "[t]he purpose of the statute ... is to ****2222** reach a domestic situation in the interest of the welfare of the producers and consumers of milk in Pennsylvania." *Id.,* at 352, 59 S.Ct., at 531. It went on to say:

> "One of the commonest forms of state action is the exercise of police power directed to the control of local conditions and exerted in the interest of the welfare of the state's citizens. Every state police statute necessarily will affect interstate commerce in some degree, but such a statute does not run counter to the grant of Congressional power merely because it incidentally or ***214** indirectly involves or burdens interstate commerce.... These principles have guided judicial decision for more than a century." *Id.,* at 351-352, 59 S.Ct., at 530-531.

The Massachusetts subsidy under consideration is similar in many respects to the Pennsylvania statute described in *Eisenberg, supra.* Massachusetts taxes all dealers of milk within its borders. The tax is even-handed on its face, *i.e.,* it affects all dealers regardless of the point of origin of the milk. *Ante,* at 2212 ("the tax also applies to milk produced in Massachusetts"); *ante,* at 2215 ("the evenhanded tax at issue here"). The State has not acted to strong-arm sister States as in *Limbach;* rather, its motives are purely local. As the Supreme Judicial Court of Massachusetts aptly described it: "[T]he premiums represent one of the costs of doing business in the Commonwealth, a cost all milk dealers must pay." *West Lynn Creamery, Inc. v. Commissioner of Dept. of Food and Agriculture,* 415 Mass. 8, 19, 611 N.E.2d 239, 245 (1993).

Consistent with precedent, the Court observes: "A pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business." *Ante,* at 2214. And the Court correctly recognizes that "[n]ondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld" due to the deference normally accorded to a State's political process in passing legislation in light of various competing interest groups. *Ante,* at 2215, citing *Minnesota v. Clover Leaf Creamery Co.,* 449 U.S. 456, 473, n. 17, 101 S.Ct. 715, 728, n. 17, 66 L.Ed.2d 659 (1981), and *Raymond Motor Transp., Inc. v. Rice,* 434 U.S. 429, 444, n. 18, 98 S.Ct. 787, 795, n. 18, 54 L.Ed.2d 664 (1978). But the Court strikes down this method of state subsidization because the nondiscriminatory tax levied against all milk *dealers* is coupled with a subsidy to milk *producers. Ante,* at 2215. The Court does this because of its view that the method of imposing the tax and subsidy distorts the State's political process: The dairy farmers, who would otherwise lobby against the tax, have been mollified by the subsidy. *Ante,* at 2214-2215. But as the Court itself points out, there are still at least two ***215** strong interest groups opposed to the milk order--consumers and milk dealers. More importantly, nothing in the dormant Commerce Clause suggests that the fate of state regulation should turn upon the particular lawful manner in which the state subsidy is enacted or promulgated. Analysis of interest group participation in the political process may serve many useful purposes, but serving as a basis for interpreting the dormant Commerce Clause is not one of them.

The Court concludes that the combined effect of the milk order "simultaneously burdens interstate commerce and discriminates in favor of local producers." *Ante,* at 2215. In support of this conclusion, the Court cites *Baldwin v. G.A.F. Seelig, Inc.,* 294 U.S. 511, 55 S.Ct. 497, 79 L.Ed. 1032 (1935), and *Bacchus Imports, Ltd. v. Dias, supra,* as two examples in which constitutional means were held to have unconstitutional effects on interstate commerce. But both *Baldwin* and *Bacchus* are a far cry from this case.

In *Baldwin, supra,* in order to sell bottled milk in New York, milk dealers were required to pay a minimum price for milk, even though they could have purchased milk from Vermont farmers at a lower price. This scheme was found to be an effort to prevent Vermont milk producers from selling to New York dealers at their lower market price. As Justice Cardozo explained, under the New York statute, "the importer ... may keep his ****2223** milk or drink it, but sell it he may not." 294 U.S., at 521, 55 S.Ct., at 499. Such a scheme clearly made it less attractive for New York dealers to purchase milk from Vermont farmers, for the disputed law negated any economic advantage in so doing. Under the Massachusetts milk order, there is no such adverse effect. Milk dealers have the same incentives to purchase lower priced milk from out-of-state farmers; dealers of all milk are taxed equally. To borrow Justice Cardozo's description, milk dealers in Massachusetts are free to keep their milk, drink their milk, and sell it--on equal terms as local milk.

***216** In *Bacchus,* the State of Hawaii combined its undisputed power to tax and grant exemptions in a manner that the Court found violative of the Commerce Clause. There, the State exempted a local wine from the burdens of an excise tax levied on all other liquor sales. Despite the Court's strained attempt to compare the scheme in *Bacchus* to the milk order in this case, *ante,* at 2213, it is clear that the milk order does not produce the same effect on interstate commerce as the tax exemption in *Bacchus.* I agree with the Court's statement that *Bacchus* can be distinguished "by noting that the rebate in this case goes not to the entity which pays the tax (milk dealers) but to the dairy farmers themselves." *Ante,* at 2213, n. 14. This is not only a distinction, but a significant difference. No decided case supports the Court's conclusion that the negative Commerce Clause prohibits the State from using money that it has lawfully obtained through a neutral tax on milk dealers and distributing it as a subsidy to dairy farmers. Indeed, the case which comes closest to supporting the result the Court reaches is the ill-starred opinion in *United States v. Butler,* 297 U.S. 1, 56 S.Ct. 312, 80 L.Ed. 477 (1936), in which the Court held unconstitutional what would have been an otherwise valid tax on the processing of agricultural products because of the use to which the revenue raised by the tax was put.

More than half a century ago, Justice Brandeis said in his dissenting opinion in *New State Ice Co. v. Liebmann,* 285 U.S. 262, 311, 52 S.Ct. 371, 386, 76 L.Ed. 747 (1932):

"To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."

***217** Justice Brandeis' statement has been cited more than once in subsequent majority opinions of the Court. See, *e.g., Reeves, Inc. v. Stake,* 447 U.S. 429, 441, 100 S.Ct. 2271, 2279, 65 L.Ed.2d 244 (1980). His observation bears heeding today, as it did when he made it. The wisdom of a messianic insistence on a grim sink-or-swim policy of laissez-faire economics would be debatable had Congress chosen to enact it; but Congress has done nothing of the kind. It is the Court which has imposed the policy under the dormant Commerce Clause, a policy which bodes ill for the values of federalism which have long animated our constitutional jurisprudence.

512 U.S. 186, 114 S.Ct. 2205, 129 L.Ed.2d 157, 62 USLW 4518, 73 A.F.T.R.2d 94-2263

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