

Syllabus

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. 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.

SUPREME COURT OF THE UNITED STATES

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DEPARTMENT OF REVENUE OF KENTUCKY ET AL. *v.*
DAVIS ET UX.

CERTIORARI TO THE COURT OF APPEALS OF KENTUCKY

No. 06–666. Argued November 5, 2007—Decided May 19, 2008

Kentucky exempts from state income taxes interest on bonds issued by it or its political subdivisions but not on bonds issued by other States and their subdivisions. After paying state income tax on out-of-state municipal bonds, respondents sued petitioners (hereinafter Kentucky) for a refund, claiming that Kentucky’s differential tax impermissibly discriminated against interstate commerce. The trial court ruled for Kentucky, relying in part on a “market-participation” exception to the dormant Commerce Clause limit on state regulation. The State Court of Appeals reversed, finding that Kentucky’s scheme ran afoul of the Commerce Clause.

Held: The judgment is reversed, and the case is remanded.

197 S. W. 3d 557, reversed and remanded.

JUSTICE SOUTER delivered the opinion of the Court, except as to Part III–B, concluding that Kentucky’s differential tax scheme does not offend the Commerce Clause. Pp. 7–13, 20–28.

(a) Modern dormant Commerce Clause law is driven by concern about “economic protectionism—that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors,” *New Energy Co. of Ind. v. Limbach*, 486 U. S. 269, 273–274—but that concern is limited by federalism favoring a degree of local autonomy. Under the resulting analysis, a discriminatory law is “virtually *per se* invalid.” *Oregon Waste Systems, Inc. v. Department of Environmental Quality of Ore.*, 511 U. S. 93, 99. An exception covers States that go beyond regulation and themselves “participat[e] in the market” to “exercis[e] the right to favor [their] own citizens over others,” *Hughes v. Alexandria Scrap Corp.*, 426 U. S. 794, 810, reflecting a “basic distinction . . . between States as market

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participants and States as market regulators,” *Reeves, Inc. v. Stake*, 447 U. S. 429, 436. Last Term, in a case decided independently of the market participant exception, this Court upheld an ordinance requiring trash haulers to deliver solid waste to a public authority’s processing plant, finding that it addressed what was “both typically and traditionally a local government function,” and did “not discriminate against interstate commerce for purposes of the dormant Commerce Clause,” *United Haulers Assn., Inc. v. Oneida-Herkimer Solid Waste Management Authority*, 550 U. S. ___, ___. Pp. 7–10.

(b) *United Haulers* provides a firm basis for reversal here. The logic that a government function is not susceptible to standard dormant Commerce Clause scrutiny because it is likely motivated by legitimate objectives distinct from simple economic protectionism applies with even greater force to laws favoring a State’s municipal bonds, since issuing debt securities to pay for public projects is a quintessentially public function, with a venerable history. Bond proceeds are a way to shoulder the cardinal civic responsibilities listed in *United Haulers*: protecting citizens’ health, safety, and welfare. And *United Haulers*’ apprehension about “unprecedented . . . interference” with a traditional government function is warranted here, where respondents would have this Court invalidate a century-old taxing practice presently employed by 41 States and supported by all. In fact, emphasizing an enterprise’s public character is just one step in addressing the fundamental element of dormant Commerce Clause jurisprudence that “any notion of discrimination assumes a comparison of substantially similar entities,” *id.*, at ___. Viewed through the lens of *Bonaparte v. Tax Court*, 104 U. S. 592, there is no forbidden discrimination because Kentucky, as a public entity, does not have to treat itself as being “substantially similar” to other bond issuers in the market. Pp. 11–13.

(c) A look at the specific markets in which the exemption’s effects are felt confirms that no traditionally forbidden discrimination is underway and points to the tax policy’s distinctive character. In both the interstate market as most broadly conceived—issuers and holders of all fixed-income securities—and the more specialized market—commerce solely in federally tax-exempt municipal bonds, often conducted through interstate municipal bond funds—nearly every taxing State believes its public interests are served by the same tax-and-exemption feature which is supported in this Court by every State. These facts suggest that no State perceives any local advantage or disadvantage beyond the permissible ones open to a government and to those who deal with that government when it enters the market. An equally significant perception emerges from examining the market for municipal bonds within the issuing State, a large proportion

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of which market is managed by one or more single-state funds. An important feature of such markets is that intrastate funds absorb securities issued by smaller or lesser known municipalities that interstate markets tend to ignore. Many single-state funds would likely disappear if the current differential tax schemes were upset, and there is no suggestion that the interstate markets would welcome the weaker municipal issues that would lose their local market homes after a Davis victory. Financing for long-term municipal improvements would thus change radically if the differential tax feature disappeared. The fact that the differential tax scheme is critical to the operation of an identifiable segment of the current municipal financial market demonstrates that the States' unanimous desire to preserve the scheme is a far cry from the private protectionism that has driven the dormant Commerce Clause's development. Pp. 20–23.

(e) The Court generally applies the rule in *Pike v. Bruce Church, Inc.*, 397 U. S. 137, 142, that even nondiscriminatory burdens on commerce may be struck down on a showing that they clearly outweigh the benefits of a state or local practice. But the current record and scholarly material show that the Judicial Branch is not institutionally suited to draw reliable conclusions of the kind that would be necessary for the Davises to satisfy a *Pike* burden in this particular case. Pp. 23–27.

SOUTER, J., announced the judgment of the Court and delivered the opinion of the Court, except as to Part III–B. STEVENS and BREYER, JJ., joined that opinion in full; ROBERTS, C. J., and GINSBURG, J., joined all but Part III–B; and SCALIA, J., joined all but Parts III–B and IV. STEVENS, J., filed a concurring opinion. ROBERTS, C. J., and SCALIA, J., filed opinions concurring in part. THOMAS, J., filed an opinion concurring in the judgment. KENNEDY, J., filed a dissenting opinion, in which ALITO, J., joined. ALITO, J., filed a dissenting opinion.