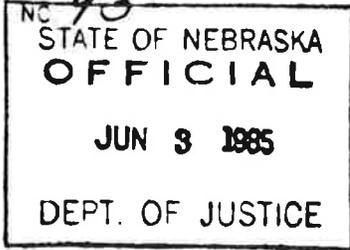


*Gen Weiss*

DEPARTMENT OF JUSTICE

STATE OF NEBRASKA

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Attorney General  
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June 3, 1985

Senator John W. DeCamp  
Nebraska State Legislature  
State Capitol, Room 1116  
Lincoln, Nebraska 68509

Dear Senator DeCamp:

You have requested us to clarify our response regarding the second question addressed in Attorney General Opinion No. 88, issued on May 29, 1985, dealing with the constitutionality of the Revenue Committee amendment to LB 717. You have asked whether the expense add back formula contained in the amendment unconstitutionally discriminates against municipal bond issues in violation of the Equal Protection Clause.

The Equal Protection Clause of the Fourteenth Amendment to the United States Constitution is applicable to state tax legislation, and operates to impose a restraint on the taxing power of the state. State ex rel. Douglas v. State Board of Equalization & Assessment, 205 Neb. 130, 286 N.W.2d 729 (1979). In Anderson v. Tiemann, 182 Neb. 393, 406, 155 N.W.2d 322, (1967), the Nebraska Supreme Court stated the following regarding the limitation imposed on the state taxing power under the Equal Protection Clause:

The power of a state to make reasonable and natural classifications for purposes of taxation is clear and unquestioned. "That a statute may discriminate in favor of a certain class does not render it arbitrary if the discrimination is founded upon a reasonable distinction, or difference in state policy. \* \* \* Similarly, it has long been settled that a classification, though discriminatory, is not arbitrary nor violative of the Equal Protection Clause of the Fourteenth Amendment if any state of facts reasonably can be conceived that would sustain it." Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 79 S.Ct. 437, 3 L.Ed 2d 480.

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Senator John DeCamp  
June 3, 1985  
Page -2-

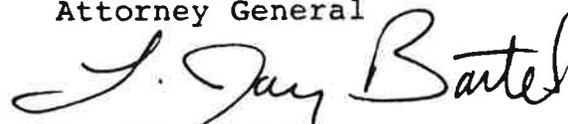
We do not believe the expense add back formula contained in the Revenue Committee amendment to LB 717 will unconstitutionally discriminate against municipal bond issues in violation of the Equal Protection Clause. The formula does not include municipal bonds alone in the calculation of the add back to taxable income. The amount of the add back is determined by dividing the corporation's average investment in all exempt securities by the corporation's average total assets, and multiplying this ratio by the corporation's total expenses. Furthermore, we believe a rational basis can be asserted for the add back formula. As was noted in our earlier opinion, the formula is designed to apportion a permissible exclusion or disallowance of expense deductions pertaining to the generation of nontaxable income.

While your letter refers only to the question of potential discrimination in violation of the Equal Protection Clause, we feel we should point out the distinction between the add back formula utilized in the Revenue Committee amendment to LB 717, and the discriminatory tax scheme invalidated by the U. S. Supreme Court in Memphis Bank & Trust Company v. Garner, 459 U.S. 392 (1983). In Memphis Bank, the Court held a Tennessee bank tax, under which the taxable net earnings of banks included interest earned on federal obligations, but excluded interest from obligations of the state and its political subdivisions, was discriminatory and therefore violated the immunity of federal obligations from state and local taxation provided under 31 U.S.C. §742.

The tax scheme held discriminatory in Memphis Bank differs from the add back formula provided under the Revenue Committee amendment to LB 717 in two key respects. First, the calculation employed in the add back formula does not discriminate between federal and state or local obligations. The ratio utilized is based on the total investment in all exempt securities, not solely investments in municipal bonds. This is the same ratio now employed under Neb.Rev.Stat. §77-2716(3) (Supp. 1984). Secondly, as we have pointed out previously, the add back formula does not subject interest income earned on such tax-exempt obligations to taxation as income. The formula operates to disallow or exclude a portion of expense deductions not incurred to generate taxable income.

Very truly yours,

ROBERT M. SPIRE  
Attorney General



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Assistant Attorney General

LJB:ejg  
cc Patrick J. O'Donnell  
Clerk of the Legislature