DEPARTMENT OF JUSTICE
STATE OF NEBRASKA • STATE CAPITOL
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STATE OF NEBRASKA
OFFICIAL
MAR 22 1990
DEPT. OF JUSTICE

DATE: March 22, 1990

SUBJECT: LB 1241 - Granting of Tax Credits to Business Firms Purchasing Shares in Specified Business Development Corporations

REQUESTED BY: Senator Rex Haberman
Nebraska State Legislature

WRITTEN BY: Robert M. Spire, Attorney General
L. Jay Bartel, Assistant Attorney General

You have requested our opinion as to the constitutionality of the tax credit provisions contained in LB 1241. Generally, LB 1241 would amend current statutory provisions relating to the Research and Development Authority (Neb.Rev.Stat. §§58-401 through 58-439 (Reissue 1988 and Supp. 1989)) ["Authority"] and the establishment of business development corporations under the Nebraska Business Development Corporation Act (Neb.Rev.Stat. §§21-2101 to 21-2117 (Reissue 1987)). Under LB 1241, the Authority would be required to form a business development corporation to carry out the purpose of providing financing to eligible businesses starting or expanding in or into specified economically distressed "target areas." Your question relates to the amendment under LB 1241 of portions of the Community Development Assistance Act (Neb.Rev.Stat. §§13-201 to 13-208 (Reissue 1987)). In particular, you have asked our opinion as to whether it would be constitutional to extend the income tax credits provided under the Community Development Assistance Act to include credit for amounts used by business firms to purchase shares in a business development corporation formed pursuant to §13 of LB 1241.

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As a general rule, subject to constitutional restrictions, a state may authorize exemptions for income tax purposes. 85 C.J.S. Taxation §1098 (1954).[1] The United States Supreme Court has held a state may constitutionally encourage certain industries or businesses to locate within a state by the granting of certain specialized tax benefits or exemptions. Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522 (1959). In Allied Stores, the Court determined "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" to the United States Constitution. Id. at 528. Classifications adopted by a state in the exercise of its taxing power will be sustained under the Equal Protection Clause if they are rationally related to a legitimate governmental purpose. Exxon Corp. v. Eagerton, 462 U.S. 176 (1983); Allied Stores of Ohio, Inc. v. Bowers, supra. In sustaining a state tax classification exempting from certain taxes employers with less than eight employees and employers in certain specified types of businesses, the Court stated:

> It is inherent in the exercise of the power to tax that a state be free to select the subjects of taxation and to grant exemptions. . . . A legislature is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it.

Carmichael v. Southern Coal and Coke Co., 301 U.S. 495, 509 (1937).

In addition to the protection against arbitrary discrimination afforded under the Fourteenth Amendment to the United States Constitution, the prohibition against special legislation in Article III, Section 18, of the Nebraska Constitution, also inhibits the enactment of unreasonable class legislation. The Nebraska Supreme Court decision in Stahmer v. State, 193 Neb. 63,

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[1] Technically, tax exemptions are different than tax credits or deductions. An exemption is characterized as an immunity from the obligation of paying a tax. A tax credit is an allowance applied to reduce a taxpayer's income tax liability after the tax has been computed, while a deduction is a reduction applied to income before the amount of tax is computed. Black's Law Dictionary, 1310 (5th Ed. 1979); General Motors Corp. v. Mississippi State Tax Commission, 510 So.2d 498 (Miss. 1987). For purposes of analyzing the issues raised by your request, however, such distinctions are not material.

218 N.W.2d 893 (1974), recognizes the power of the Legislature to classify and exempt in matters pertaining to taxation, provided the classifications established are reasonable.

The income tax credits provided under §§2 and 3 of LB 1241 are limited to the class of business firms investing in a business development corporation established pursuant to §13 of the Act by the purchase of shares in the corporation. Thus, to the extent the allowance of such credit is limited to entities investing in business development corporations of this nature, the constitutional question which arises is whether the establishment of such classification is reasonable and rationally related to a legitimate state purpose.

Courts from several jurisdictions have upheld the constitutionality of legislation establishing economic development programs intended to aid and promote business development. Carll v. South Carolina Jobs--Economic Development Authority, 284 S.C. 438, 327 S.E.2d 331 (1985); Minnesota Energy and Economic Development Authority v. Printy, 351 N.W.2d 319 (Minn. 1984); Mid-Michigan Farm and Grain Association, Inc. v. Henning, 127 Mich. App. 735, 339 N.W.2d 243 (1983); DeArmond v. Alaska State Development Corp., 376 P.2d 717 (Alaska 1972). The use of tax credits and other economic incentives, including state programs designed to target capital for business development, have been recognized as valid means by which government may encourage and promote economic development, particularly in areas identified as suffering from economic distress by virtue of high unemployment and a lack of business investment. McGahey, State Economic Development Policy: Strategic Approaches for the Future, 15 N.Y.U.Rev.L. and Soc. Change 43, 47-56 (1986-87). The "enterprise zone" concept embodied in legislation of this nature is designed to expand economic activity and growth in depressed or blighted areas through the establishment of tax and regulatory incentives. Note, Bringing New Life to Enterprise Zones: Congress Finally Takes the First Step with the Housing and Community Development Act of 1987, 35 Wash. U.J.Urb. and Contemp. L. 109, 111-120 (1989).

Section 7 of LB 1241, which amends the provisions of Section 58-401 of the Research and Development Authority Act, includes the following language pertaining to the Legislature's findings and the intent underlying the enactment of the bill:

> (2)(a) There exist in certain areas unacceptable levels of unemployment, poverty, and outmigration caused by the need for expansion of the economic bases in such areas;

(b) Such conditions needlessly increase public expenditures for unemployment compensation, social services, and public safety services;

(c) A necessary element in diversification of the economic bases of such economically distressed areas is providing employment opportunities in and providing essential goods and services to such areas; and

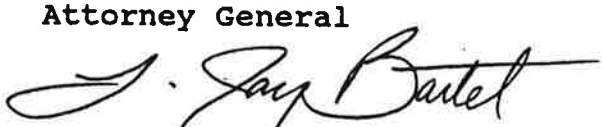
(d) The necessary financial development to stimulate and diversify the economic bases of such areas may properly be accomplished by formation of a business development corporation in which the authority is a member.

Pursuant to §13, business development corporations formed to meet these needs are to provide financing to eligible businesses starting in or expanding into economically disadvantaged locations falling within the definition of "target area" under §10 of the bill. The income tax credits in §§2 and 3 of LB 1241, granted to business firms investing in business development corporations established for this purpose, are therefore intended to provide an incentive for investment in such business development corporations. Under these circumstances, we believe the granting of tax credits for this purpose is neither unreasonable nor arbitrary, as the use of tax credits as an inducement for investment in business development corporations which promote the revitalization of industry in economically distressed areas in this manner clearly is rationally related to furthering a legitimate state interest.

Based on the foregoing, it is our conclusion that the tax credit provisions contained in §§2 and 3 of LB 1241 are valid and constitutional.

Very truly yours,

ROBERT M. SPIRE
Attorney General



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7-389-2
cc: Patrick J. O'Donnell
Clerk of the Legislature

APPROVED BY:

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