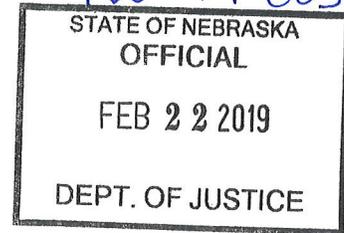




STATE OF NEBRASKA
Office of the Attorney General

2115 STATE CAPITOL BUILDING
LINCOLN, NE 68509-8920
(402) 471-2682
TDD (402) 471-2682
FAX (402) 471-3297 or (402) 471-4725

No. 19-003



DOUGLAS J. PETERSON
ATTORNEY GENERAL

SUBJECT: LB 420 – Constitutionality of “Circuit Breaker” Providing Refundable Income Tax Credit

REQUESTED BY: Senator Kate Bolz
Nebraska State Legislature

WRITTEN BY: Douglas J. Peterson, Attorney General
Lynn A. Melson, Assistant Attorney General

INTRODUCTION

You have requested an opinion from this office on the constitutionality of LB 420, known as the Property Tax Circuit Breaker Act. In general terms, this bill would provide a refundable income tax credit for certain qualified taxpayers if the taxpayer’s property taxes or rent exceed a certain percentage of the taxpayer’s income.

LB 420, § 3(3) defines a “qualifying agricultural taxpayer” as “an individual who owns agricultural land and horticultural land that is located in this state and that has been used as part of a farming operation which has federal adjusted gross income of less than three hundred fifty thousand dollars in the most recently completed taxable year.”¹ Section 4(2) then provides that an agricultural taxpayer, who qualifies for an income tax credit under the Act, will receive “a tax credit in an amount equal to the amount of property taxes paid on the agricultural land and horticultural land during the most recently

¹ The bill defines both qualifying agricultural taxpayers and qualifying residential taxpayers as “individuals.” As the owners of agricultural and residential properties might be a partnership, corporation, trust or other legal entity, you may wish to use a different term such as “person” to include those other entities.

completed taxable year minus seven percent of that taxpayer's federal adjusted gross income." Section 4(5) provides that only one tax credit may be claimed under this section per parcel of agricultural or horticultural land.²

LB 420, § 3(4) defines a "qualifying residential taxpayer" as "an individual who owns or rents his or her principal residence in the State of Nebraska and who has federal adjusted gross income of less than one hundred thousand dollars for a married filing jointly taxpayer or fifty thousand dollars for any other taxpayer." Section 5 provides that a residential taxpayer, who paid property taxes on his or her principal residence and who qualifies for an income tax credit under the act, will be eligible for an income tax credit equal to the "amount by which the total amount of property taxes paid on the principal residence exceeds the sum of the amounts calculated in subdivision (3)(b)" of § 5. These amounts are based on specified percentages of the taxpayer's federal adjusted gross income. A residential taxpayer, who paid rent for his or her principal residence and who qualifies for an income tax credit under the act, will be eligible for an income tax credit equal to the "amount by which twenty percent of the total amount of rent paid exceeds the sum of the amounts calculated in subdivision (4)(b)" of § 5. These amounts are again based on specified percentages of the taxpayer's federal adjusted gross income. Subdivision (5) of § 5 also includes maximum income credits or credit caps allowed to qualifying residential taxpayers. Finally, § 5(11) provides that only one tax credit may be claimed under this section per residence.

Your letter states "[B]ecause a circuit breaker affords tax relief to individuals according to income level, we are asking for an Attorney General's opinion as to whether such a policy is in conflict with the Nebraska Constitution." Your request does not articulate a specific constitutional provision which LB 420 may contravene. We have previously stated that a general question on the constitutionality of proposed legislation will necessarily result in a general response from this office. Op. Att'y Gen. No. 09008 (April 16, 2008). Therefore, our analysis will discuss generally provisions of our state constitution regarding commutation of taxes, equal protection, special legislation, the uniformity clause and the commerce clause.

ANALYSIS

A. Commutation of Taxes.

As a preliminary matter, we note that "[S]tatutes are afforded a presumption of constitutionality, and the unconstitutionality of a statute must be clearly established before it will be declared void." *Gourley v. Nebraska Methodist Health System, Inc.*, 265 Neb. 918, 942, 663 N.W.2d 43, 68 (2003). If LB 420 is enacted, anyone seeking to have its provisions declared unconstitutional will bear the burden of overcoming the presumption of constitutionality.

² LB 420 does not address how to treat a situation in which otherwise eligible multiple owners or renters wish to claim the income tax credits.

Nebraska's "commutation clause" is found at Neb. Const. art. VIII, § 4, which provides, in part:

Except as to tax and assessment charges against real property remaining delinquent and unpaid for a period of fifteen years or longer, the Legislature shall have no power to release or discharge any county, city, township, town, or district whatever, or the inhabitants thereof, or any corporation, or the property therein, from their or its proportionate share of taxes to be levied for state purposes, or due any municipal corporation, nor shall commutation for such taxes be authorized in any form whatever

This office has previously addressed the commutation clause with regard to the constitutionality of refundable income tax credits. In Op. Att'y Gen. No. 18001 (March 21, 2018), we analyzed the constitutionality of two bills which would provide a refundable income tax credit based on a percentage of property taxes paid during the taxable year. As the commutation clause was discussed at length in that recent opinion, we will summarize that discussion here.

The Nebraska Supreme Court has held that the commutation clause "prevents the Legislature from releasing either persons or property from contributing a proportionate share of the tax." *Sarpy County Farm Bureau v. Learning Community of Douglas and Sarpy Ctys.*, 283 Neb. 212, 244, 808 N.W.2d 598, 621 (2012). The Court has also held that an act which allowed delinquent property taxes to be paid in installments violated the commutation clause, stating that "the legislature not only shall have no power to release or discharge any one from the payment of his share of taxes, but a commutation for taxes in any form whatever is prohibited . . . it is quite apparent that the legislature is prohibited by the Constitution from changing the method of payment of any tax once levied." *Steinacher v. Swanson*, 131 Neb. 439, 446, 268 N.W. 317, 321 (1936).

More recently, the Court considered whether the prohibition against the commutation of taxes applied to taxes other than property taxes, and held the constitutional prohibition did not apply to an excise tax. *Banks v. Heineman*, 286 Neb. 390. 837 N.W.2d 70 (2013). Therefore, in Op. Att'y Gen. No. 18001 at 4, with regard to the two bills discussed therein, we concluded as follows:

The income tax credits allowed under LB 829 and LB 947 do not, at least directly, fall within the meaning of "commutation" as defined by the Nebraska Supreme Court. The income tax credits, while determined on the basis of a percentage of property taxes paid, do not alter or change the amount of property taxes paid, nor do they substitute one form of payment of property taxes for another. Further, while the income tax is not an "excise" tax, a form of taxation the Court has specifically recognized is not subject to the commutation restriction, it is not a property tax within the meaning of art. VIII, § 1, and thus is not a tax subject to the prohibition against the "commutation" of taxes in art. VIII, § 4.

Qualification for the refundable income tax credits proposed in LB 420 depends on both the taxpayer's income and the amount of property taxes paid. LB 420, if enacted, would not change the amount of property taxes paid to local authorities. For the reasons discussed more fully in that prior opinion, we reach the same conclusion that the income tax credits allowed under LB 420 do not directly fall within the meaning of commutation as defined by the Court and would likely be found constitutional. However, we also point out, as we did in footnote 2 of Op. Att'y Gen. No. 18001, that "it is possible a court could view the allowance of an income tax credit based on property taxes paid as an indirect attempt to impermissibly commute property taxes in contravention of art. VIII, § 4"

B. Equal Protection.

As your request letter refers to affording tax relief to individuals "according to income level," we include a discussion of equal protection principles with regard to different treatment of taxpayers based on different income levels. The Nebraska Supreme Court has stated that the equal protection clause of Neb. Const. art. I, § 3, and that of the Fourteenth Amendment of the United States Constitution, "have identical requirements for equal protection challenges." *DeCoste v. City of Wahoo*, 255 Neb. 266, 274, 583 N.W.2d 595, 601 (1998). Unless a "fundamental right" or "suspect classification" is involved, the equal protection clause generally allows government to make distinctions among groups and to treat different groups differently so long as there is a "rational basis" serving a legitimate governmental purpose for such differing treatment. *Le v. Lautrup*, 271 Neb. 931, 716 N.W.2d 713 (2006). Stated another way, the equal protection provisions of the state and federal constitutions generally prohibit improper disparate treatment or improper classifications of people who are otherwise similarly situated.

Specifically with regard to state tax classifications or schemes, "the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." *Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356, 359 (1973). We are not aware of any suspect classification or fundamental rights implicated by LB 420. And, in our view, a rational basis can likely be articulated to justify tax relief for those taxpayers with lower income levels who are most severely affected by property tax increases.

LB 420, § 2 declares the purpose of the Act "is to provide tax relief through a refundable income tax credit for taxpayers with limited income available to pay property taxes." Also, as you state in your request letter, the "circuit breaker [in LB 420] triggers an income tax credit for a taxpayer if property taxes exceed a certain percentage of the individual's income As income increases, the circuit breaker credit calculation assumes that taxpayers can afford to spend a greater percentage of income on property taxes."

Other jurisdictions have held that providing tax relief to taxpayers according to income level is constitutional. The New Hampshire Supreme Court addressed questions propounded by the state House of Representatives in *Opinion of the Justices*, 111 N.H.

136, 276 A.2d 821 (1971). The court was asked to address the constitutionality of a proposed legislative bill, which, in part, would provide an income tax credit for claimants depending on the amount by which the property taxes or rent accrued on a claimant's homestead exceeded six percent of the claimant's household income. Describing the proposed provision as a system of tax relief for low income taxpayers, the court found that it would not violate any constitutional provision.

The Vermont Supreme Court held that the \$75,000 income ceiling in a Homestead Property Tax Income Sensitivity Adjustment law was constitutional. *Schievella v. Department of Taxes*, 171 Vt. 591, 765 A.2d 479 (2000). This statutory act included a limit on property taxes on homestead property based on income level. Noting that the Vermont constitution's proportional contribution clause imposes the same limits on the state's power to tax as does the equal protection clause of the Fourteenth Amendment of the U.S. Constitution, the court employed a rational basis analysis and stated that "granting tax relief based on the income of taxpayers is not irrational." *Id.* at 593, 765 A.2d at 482.

C. Special Legislation

There may also be a question whether the provisions of LB 420 establish an unreasonable classification in violation of the prohibition against special legislation in Neb. Const. art. III, § 18. Article III, § 18, provides in relevant part:

The Legislature shall not pass local or special laws in any of the following cases, that is to say:

* * *

Granting to any corporation, association, or individual any special or exclusive privileges, immunity, or franchise whatever In all other cases where a general law can be made applicable, no special law shall be enacted.

The test for determining whether legislation is prohibited as special legislation is stricter than the rational basis test employed in an equal protection analysis. The Nebraska Supreme Court has stated that a legislative act can violate art. III, § 18, as special legislation "in one of two ways: (1) by creating a totally arbitrary and unreasonable method of classification, or (2) by creating a permanently closed class." *Haman v. Marsh*, 237 Neb. 699, 709, 467 N.W.2d 836, 845 (1991). "A special legislation analysis focuses on a legislative body's purpose in creating a challenged class and asks if there is a substantial difference of circumstances to suggest the expediency of diverse legislation." *J. M. v. Hobbs*, 288 Neb. 546, 557, 849 N.W.2d 480, 489 (2014). "Classifications for the purpose of legislation must be real and not illusive; they cannot be based on distinctions without a substantial difference." *Big John's Billiards, Inc. v. State*, 288 Neb. 938, 945, 852 N.W.2d 727, 735 (2014).

As no closed class is implicated by LB 420, the question is the reasonableness of the classifications created, which limit the income tax credits to lower income taxpayers and which limit the income tax credits to residential and agricultural property taxpayers. The language of LB 420, § 2 and your request letter provide some reasons for the difference in treatment according to income level. You have not expressed a legislative purpose in limiting the income tax credits to certain residential and agricultural property taxpayers, while leaving out those business taxpayers who own commercial and industrial property. A court's analysis in a special legislation challenge would focus on the Legislature's purpose in creating a class of taxpayers as expressed in the plain language of the bill or as demonstrated in the legislative record of the bill. While it is possible that there is "a substantial difference of circumstances" that would justify different treatment of the business taxpayers, we must note that a court would employ a more stringent standard when faced with a special legislation challenge.

D. Uniformity Clause.

Your question about granting tax relief according to income level might also be read to inquire about the application of Neb. Const. art. VIII, § 1. The "uniformity clause" of our state constitution provides that "[T]axes shall be levied by valuation uniformly and proportionately upon all real property and franchises . . . except as otherwise provided in or permitted by this Constitution."

The Nebraska Supreme Court has held that "further reading of article VII, § 1, makes it clear that only property taxes must be uniform and proportionate." *State v. Galyen*, 221 Neb. 497, 502, 378 N.W.2d 182, 186 (1985). A franchise tax based on or measured by the income of a corporation was not a property tax and could not violate the requirements of uniform and proportionate valuation in Neb. Const. art. VIII, § 1. *Anderson v. Tiemann*, 182 Neb. 393, 403-04, 155 N.W.2d 322, 329 (1967). See also *Banks v. Heineman*, 286 Neb. 390, 837 N.W.2d 70 (2013), in which the Court concluded that the scope of the uniformity clause and the scope of the commutation clause are the same such that neither apply to an excise tax.

While we note that the Nebraska Supreme Court has adopted a strict construction of our state's uniformity clause which may lead to a different result, courts of other jurisdictions have held that basing eligibility for an income tax credit on income level does not violate the uniformity clauses in those states' constitutions. For example, the Wisconsin Court of Appeals determined that a particular state statute, which authorized a farmland preservation credit, but limited eligibility for the tax credit by the amount of the claimant's household income, was constitutional in *McManus v. Wisconsin Dept. of Revenue*, 155 Wis. 2d 450, 455 N.W.2d 906 (1990). The Court explained that the purpose of the farmland preservation credit was "to provide credit to owners of farmland which is subject to agricultural use restrictions through a system of income tax credits and refunds . . ." *Id.* at 456, 455 N.W.2d at 908. The taxpayers receiving the credit paid their property tax bill in full and could then apply for a credit against their income taxes if their income did not exceed a threshold amount. The Court held that the law was a relief

statute and, therefore, not subject to the uniformity clause of the Wisconsin state constitution. See also *Baker v. Matheson*, 607 P.2d 233 (Utah 1979) in which the Utah Supreme Court held that a legislative act which allowed homeowners and renters to file claims for refunds of state general fund revenue violated neither the state constitution's uniformity clause nor the equal protection clause.

E. Commerce Clause.

This office has twice in the past year addressed whether legislation proposing an income tax credit based on a percentage of property taxes paid violated the Commerce Clause. Op. Att'y Gen. No. 18001 (March 21, 2018) and Op. Att'y Gen. No. 18004 (September 28, 2018). A portion of our discussion of Commerce Clause principles relevant to analyzing the constitutionality of such legislation was as follows:

The Commerce Clause authorizes Congress to "regulate Commerce . . . among the several States." U.S. Const. art. I, § 8, cl. 3. "Though phrased as a grant of regulatory power to Congress, the Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles in commerce." *Oregon Waste Systems, Inc. v. Dep't of Environmental Quality*, 511 U.S. 93, 98 (1994). This "negative command, known as the dormant Commerce Clause, prohibit[s] certain state taxation even when Congress has failed to legislate on the subject." *Oklahoma Tax Comm'n v. Jefferson Lines, Inc.*, 513 U.S. 175, 179 (1995) "[T]he first step in analyzing any law subject to judicial scrutiny under the negative Commerce Clause is to determine whether it 'regulates evenhandedly with only "incidental" effects on interstate commerce, or discriminates against interstate commerce.'" *Oregon Waste Systems, Inc.*, 511 U.S. at 99 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)) In assessing if a state tax impermissibly discriminates against interstate commerce, a court must consider not only the tax, but also any credits, exemptions, or exclusions.

Op. Att'y Gen. No. 18001 at 5-6.

Under LB 420, a refundable income tax credit may be available to both qualifying agricultural taxpayers and qualifying residential taxpayers. We will address separately those two classes of taxpayers in our discussion of the Commerce Clause. First, a "qualifying agricultural taxpayer" is defined at LB 420, § 3(3) as "an individual who owns agricultural land and horticultural land that is located in this state and that has been used as part of a farming operation which has federal adjusted gross income of less than three hundred fifty thousand dollars" This language makes no distinction based on residency. As we noted in both of the 2018 opinions cited above, taxpayers subject to Nebraska income tax can include both resident and nonresident individuals and entities. Resident individuals are taxed on their "entire net income," while nonresident individuals

are taxed on income “derived from sources within” Nebraska. See Neb. Rev. Stat. § 77-2715(1) (Cum. Supp. 2016).

The language of LB 420 pertaining to qualifying agricultural taxpayers refers to taxpayers who own agricultural land in Nebraska, pay property taxes on that land, and engage in a farming operation which includes the use of that land. As was the case with LB 829, which we discussed in Op. Att’y Gen. No. 18001, the bill does not discriminate on its face against nonresidents subject to Nebraska income tax. To the extent that eligibility for the income tax credit is based on paying property taxes on real property in Nebraska and not the residency of the taxpayer, arguably there would be no potential for improper discrimination against nonresidents who qualify for the “agricultural taxpayer” provisions of LB 420.

Looking at the effects of LB 420 on interstate commerce, and particularly on nonresidents, the question is whether it would negatively impact nonresidents who do not have income sourced to Nebraska and are thus not subject to income tax. They would receive no income tax credit despite paying property taxes in the state. If all taxpayers applying for the income tax credit are subject to Nebraska income tax due to being engaged in a farming operation in Nebraska, then both residents and nonresidents would be able to claim the income tax credit. However, if certain nonresident taxpayers who are eligible for the income tax credit are not subject to Nebraska income tax, as we recommended in Op. Att’y Gen. No. 18001 at 6, “a mechanism should be created to allow the credit to be claimed by those not otherwise subject to Nebraska income tax.”

Turning to the provisions of LB 420 pertaining to “residential taxpayers”, LB 420, § 3(4) defines a “qualifying residential taxpayer” as “an individual who owns or rents his or her principal residence in the State of Nebraska and who has federal adjusted gross income of less than one hundred thousand dollars for a married filing jointly taxpayer or fifty thousand dollars for any other taxpayer.” This language might be said to implicate the Commerce Clause as it limits eligibility for the income tax credit to those taxpayers who own or rent their principal residence in the state. Section 5(2) then provides that the qualifying residential taxpayer must have “resided at the property described in the qualifying residential taxpayer’s application for at least six months of the most recently completed taxable year”

In Op. Att’y Gen. No. 18001 at 7 we discussed a proposed homestead credit that would allow an income tax credit to residents who own a homestead, the term “homestead” generally meaning a residence occupied by an owner from January 1 through August 15 in each year. Neb. Rev. Stat. § 77-3502 (2009). In that opinion we cited three cases from other jurisdictions in which those courts reasoned that a homestead exemption based on ownership and use of the property as a permanent or primary residence, as opposed to the status of the owner as a resident or nonresident, does not violate the Commerce Clause. See, for example, *Reinish v. Clark*, 765 So. 2d 197 (Fla. Dist. Ct. App. 2000), in which the court found that a homestead exemption furthered a legitimate governmental purpose, the protection of the primary permanent

home. “Like an exemption, an income tax credit based on status as an owner of a homestead, as opposed to resident or nonresident status, would not result in discriminatory treatment which would violate the Commerce Clause.” Op. Att’y Gen. No. 18001 at 8.

We cited *Baker v. Matheson*, 607 P.2d 233 (Utah 1979), in section D., above, for its discussion of equal protection principles and the Utah state constitution’s uniformity clause. We note here that the Utah Supreme Court, in *Baker v. Matheson*, also discussed whether the Utah law allowing certain homeowners and renters to file claims for refunds of state general fund revenue, discriminated against nonresidents so as to violate the privileges and immunities clause of the U.S. Const., art. IV, § 2. That clause provides, “The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens of the several States.”

The statutes at issue in *Baker v. Matheson* permitted the “owner of a dwelling” to receive payment based on a percentage of the property taxes paid and the “renter of a dwelling comprising a household” to receive payment based on a percentage of the rent paid during the prior year. A “dwelling” meant the “primary residence” of that owner or renter. The Act also required the eligible owners and renters to be a state resident for one year. Yet, the Court found no impermissible discrimination against nonresidents. “However, that requirement is based in part on the necessity of establishing a class of persons who, because of their residency in the State, have experienced the full impact of the evils with which the Legislature was attempting to cope. It was not aimed at excluding citizens of other states from the benefits of the Act.” *Id.* at 247.

Similarly, an argument can be made that the income tax credit allowed to residential taxpayers under LB 420 is based on the ownership and occupancy of the property as a primary residence rather than the status of the owner or renter as a resident or nonresident. However, to the extent that an argument might also be made that the language of LB 420 specifically refers to “residential” taxpayers and bases eligibility to claim the credit on residency, demonstrating an intent to discriminate against nonresidents, you may wish to amend the bill to more specifically provide that the credit be based on ownership and occupancy of the property regardless of residency.³ In addition, it is unclear whether all “qualifying residential taxpayers” would have income sourced to Nebraska such that they would be subject to income tax here. As the income tax credit proposed by LB 420 is refundable, you may wish to create a mechanism to allow the credit to be claimed by those not otherwise subject to Nebraska income tax so as to avoid any potential impermissible discrimination.

³ Another possible alternative for financially assisting residential taxpayers, which might avoid any constitutional concerns, would be to grant a general homestead exemption under Neb. Const. art. VIII, § 2.

CONCLUSION

Based upon the lengthy discussion of potential constitutional concerns above, we do not believe that LB 420 clearly contravenes any of those constitutional principles. However, in our view, the bill's provisions create some uncertainties as noted in this opinion.

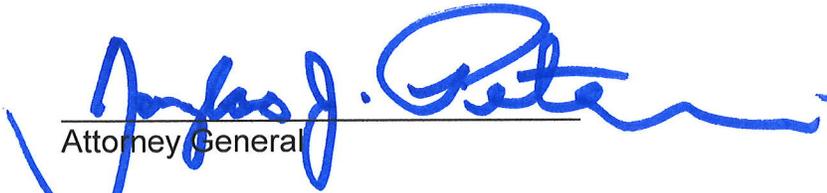
Sincerely,

DOUGLAS J. PETERSON
Attorney General



Lynn A. Melson
Assistant Attorney General

Approved by:



Attorney General

pc Patrick J. O'Donnell
Clerk of the Nebraska Legislature