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SUBJECT: Constitutionality of Refundable Income Tax Credits in Proposed Constitutional Amendment.

REQUESTED BY: Senator Steve Erdman
Nebraska Legislature

WRITTEN BY: Douglas J. Peterson, Attorney General
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INTRODUCTION

You have requested our opinion concerning the constitutionality of a legislative resolution proposing to amend the Nebraska Constitution by adding a new section providing a refundable Nebraska income tax credit in the amount of thirty-five percent of property taxes paid by the taxpayer during the taxable year. The credit would be available for taxable years beginning on or after January 1, 2021. You ask us to address two questions regarding the constitutionality of the proposed constitutional amendment: (1) Does the proposal violate the dormant Commerce Clause?; and (2) Does the proposal discriminate against non-resident Nebraska property taxpayers?

ANALYSIS

A. Commerce Clause.

Recently, we addressed whether legislation proposing an income tax credit based on a percentage of property taxes paid during the taxable year violated the Commerce Clause. Op. Att'y Gen. No. 18-001 (March 21, 2018). We summarized the Commerce Clause principles relevant to analyzing the constitutionality of such legislation 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) [*Oregon Waste Systems*]. 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). Under the four-part test adopted by the Court to govern the validity of state taxes under the Commerce Clause, a tax will be sustained against Commerce Clause challenge “when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.” *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274, 279 (1977).

“[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*, 511 U.S. at 99 (quoting *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979)). “[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 Systems*, 511 U.S. at 99. “[A] state tax that favors in-state business over out-of-state business for no other reason than the location of the business is prohibited by the Commerce Clause.” *American Trucking Ass’n, Inc. v. Scheiner*, 483 U.S. 266, 286 (1987). “[T]he degree of a differential burden or charge on interstate commerce ‘measures only the *extent* of the discrimination’ and ‘is of no relevance to the determination whether a State has discriminated against interstate commerce.’” *Oregon Waste Systems*, 511 U.S. at 100 n.4 (quoting *Wyoming v. Oklahoma*, 502 U.S. 437, 455 (1992) (emphasis in original)).

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. See *Maryland v. Louisiana*, 451 U.S. 725, 756 (1981) (Invalidating Louisiana tax on use of natural gas in the state in part because allowing credits only to those engaged in in-state economic activity effectively immunized local interests from the tax); see also *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 211 (1994) (Scalia, J., concurring) (“[E]xemption’ from or ‘credit’ against a ‘neutral tax’ . . . no different in principle” than tax that directly discriminates against out-of-state interests). Various tax exemptions or credits have been held to violate the Commerce Clause. See, e.g., *Camps Newfoundland/Owatonna, Inc. v. Town of Harrison, Maine*, 520 U.S. 564 (1997) (Invalidating property tax exemption for charitable institutions that was limited to

institutions serving principally state residents); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269 (1988) (Invalidating Ohio statute that provided tax credit for sales of ethanol produced in-state, but not ethanol produced in certain other states).

"[A] tax may violate the Commerce Clause if it is facially discriminatory, has a discriminatory intent, or has the effect of unduly burdening interstate commerce." *Amerada Hess Corp. v. Director, Div. of Taxation*, 490 U.S. 66, 75 (1989). "If a restriction on commerce is discriminatory, it is virtually *per se* invalid." *Oregon Waste Systems*, 511 U.S. at 99. A discriminatory law will be invalidated unless "it advances a legitimate local purpose that cannot be adequately served by reasonable nondiscriminatory means." *Id.* at 100 (*quoting New Energy Co. of Ind. v. Limbach*, 486 U.S. 2169, 278 (1988)). "By contrast, nondiscriminatory regulations that have only incidental effects on interstate commerce are valid unless 'the burden imposed on such commerce is clearly excessive in relation to the putative local benefits.'" *Oregon Waste Systems*, 511 U.S. at 99 (*quoting Pike v. Bruce Church*, 397 U.S. 137, 142 (1970)).

Op. Att'y Gen. No. 18-001 at 5-6.

Both resident and nonresident individuals are subject to Nebraska income tax. See Neb. Rev. Stat. § 77-2715(1) (Cum. Supp. 2016). Resident individuals are taxed on their "entire net income," while nonresident individuals are taxed on income "derived from sources within" Nebraska. *Id.* Both resident and nonresident estates and trusts, and their beneficiaries, are subject to Nebraska income tax. Neb. Rev. Stat. § 77-2717 (Cum. Supp. 2016). Corporations are also subject to income tax. Neb. Rev. Stat. § 77-2734.02(1) (Cum. Supp. 2016).¹ Nebraska income tax also applies to resident and nonresident partners of partnerships, as well as resident and nonresident shareholders of Subchapter S corporations or members of limited liability companies. Neb. Rev. Stat. §§ 77-2727 (Cum. Supp. 2016) and 77-2734.01 (Cum. Supp. 2016).

Under LB 829, one of the legislative proposals addressed in our recent opinion, a refundable income tax credit was allowed "to each taxpayer...in the amount of fifty percent of the school district taxes levied on the taxpayer's property and paid by the taxpayer during [the] taxable year." LB 829, § 3. While "taxpayer" was not defined, we noted "it presumably refer[ed] to all taxpayers subject to Nebraska income tax." Op. Att'y Gen. No. 18-001 at 7. As noted, "taxpayers" subject to Nebraska income tax can include both resident and nonresident individuals and entities. We concluded that, "by stating 'each taxpayer' [was] entitled to the credit, we interpret[ed] the bill to extend the credit to any taxpayer subject to the Nebraska income tax, resident or nonresident." *Id.* As "[a]vailability of the credit [was] based on whether a person or entity [was] subject to

¹ Corporations operating as a unitary business both within and outside Nebraska determine taxable income by use of an apportionment formula. Neb. Rev. Stat. §§ 77-2734.05 and 77-2734.06 (2009).

Nebraska income tax and pa[id] property tax in Nebraska, not residency...,” we concluded “the bill [did] not discriminate on its face against nonresidents subject to Nebraska income tax.” *Id.*

We noted, however, that LB 829’s limitation of the credit to persons or entities subject to Nebraska income tax “result[ed] in different treatment of some nonresidents.” *Id.* Specifically, we stated:

In this regard, nonresidents who do not have income sourced to Nebraska and are thus not subject to income tax, but own property on which taxes are paid, would receive no income tax credit. While this may not impact a significant number of nonresidents, there is no “de minimis” defense to a charge of discriminatory taxation under the Commerce Clause.” *Fulton Corp. v. Faulkner*, 516 U.S. 325, 334 n.3 (1996). The income tax credit is intended to provide tax relief to property taxpayers. By allowing the credit only to those subject to income tax, some property taxpayers (nonresidents that pay property taxes but are not subject to income tax) are denied relief. This discrimination against certain nonresidents would disfavor primarily out-of-state interests, which the Commerce Clause prohibits absent a showing that limiting the credit advances a legitimate local interest that cannot adequately be served by nondiscriminatory alternatives. Accordingly, to remove any potential impermissible discrimination, the credit should be extended to all property taxpayers, resident and nonresident, whether or not they are subject to Nebraska income tax. As the credit is refundable, a mechanism should be created to allow the credit to be claimed by those not otherwise subject to Nebraska income tax.

Op. Att’y Gen. No. 18-001 at 7-8.

While rules governing the interpretation of statutes generally apply to constitutional provisions, constitutional provisions “receive a broader and more liberal construction than statutes.” *Hall v. Progress Pig, Inc.*, 259 Neb. 407, 414, 610 N.W.2d 420, 427 (2000). “Constitutional provisions, like statutes, are not open to construction as a matter of course; construction is appropriate only when it has been demonstrated that the meaning of the provision is not clear and therefore that construction is necessary.” *Pig Pro Nonstock Coop. v. Moore*, 253 Neb. 72, 81, 568 N.W.2d 217, 223 (1997). “The words and terms of a constitutional provision are to be interpreted and understood in their most natural and obvious meaning, unless the subject indicates or the text suggests that they have been used in a technical sense.” *State ex rel. Douglas v. Beermann*, 216 Neb. 849, 853-54, 347 N.W.2d 297, 301 (1984).

The language of the legislative resolution proposing to amend the constitution to provide a refundable income tax credit makes no distinction based on residency or Nebraska income tax liability. Rather, it states a credit is provided against Nebraska income tax in an amount equal to thirty-five percent of property taxes “levied on real property located in this state” and “[p]aid by the taxpayer during the taxable year.” Unlike LB 829, which utilized the term “taxpayer” to refer to a person or entity subject to Nebraska

income tax, the legislative resolution uses the term "taxpayer" to refer to the person or entity paying property taxes on real property in Nebraska. Thus, qualification for the credit is based on payment of real property taxes in Nebraska, not residency of the taxpayer, or the taxpayer being subject to Nebraska income tax.² As the refundable income tax credit provided by this resolution would be available to any real property taxpayer, there would be no potential for improper discrimination against nonresidents or out-of-state interests which could run afoul of the Commerce Clause.

B. Discrimination Against Non-Resident Nebraska Property Taxpayers.

Your second question, which asks if the proposed constitutional amendment would impermissibly "discriminate against non-resident Nebraska property taxpayers," does not identify any specific constitutional provision which the amendment may violate. As it pertains to unconstitutional discrimination against non-residents, it is appropriate to consider if the proposal violates the Privileges and Immunities Clause. 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 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 citizen of other States, so far as the advantages resulting from citizenship in those States are concerned." *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 180 (1868). "[T]he 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." *Ward v. Maryland*, 79 U.S. (12 Wall.) 418, 430 (1870).³

"Like many other constitutional provisions, the privileges and immunities clause is not an absolute." *Toomer v. Witsell*, 334 U.S. 385, 396 (1948) [*Toomer*]. As explained in *Toomer*, the clause proscribes

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.

² The proposed amendment requires the Legislature to "provide by law" for the refundable credit. Thus, to be consistent with the language of the amendment, legislation to implement the credit must provide a means for all property taxpayers, resident or non-resident, to claim the credit, whether or not they are subject to Nebraska income tax.

³ While the terms "resident" and "citizen" are not synonymous, "a general taxing scheme...[that] discriminates against all nonresidents, has the necessary effect of including in the discrimination those who are citizens of other states." *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60, 79 (1920).

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.

Thus, in analyzing whether a law distinguishing between residents and nonresidents contravenes the Privileges and Immunities Clause, the inquiry focuses on whether "(i) there is a substantial reason for the difference in treatment; and (ii) the discrimination against nonresidents bears a substantial relationship to the State's objective." *Supreme Court of New Hampshire v. Piper*, 470 U.S. 274, 284 (1985).

State laws which deny nonresidents a general tax exemption or deduction without substantial justification have been held to violate the Privileges and Immunities Clause. See, e.g., *Lunding v. New York Tax Appeals Tribunal*, 522 U.S. 287 (1998) (No substantial justification supported statute that effectively denied only nonresident taxpayers an income tax deduction for alimony paid.); *Travis v. Yale & Towne Mfg. Co.*, 252 U.S. 60 (1920) [*"Travis"*] (Invaliding statute that denied only nonresidents an exemption from tax on a certain threshold of income.). States may, however, limit nonresidents' deductions of business expenses and nonbusiness deductions based on the relationship between those expenses and in-state property or income. *Schaffer v. Carter*, 252 U.S. 37 (1920) (Upholding Oklahoma statute denying deductions for out-of-state losses to nonresidents who were subject to Oklahoma's tax on in-state income.); *Travis*, 252 U.S. at 75-76 (Recognizing that *Schaffer* "settled...[t]hat 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 connected with income arising from sources within the taxing state."). Statutes limiting property tax relief or credits to resident property owners have been held to violate the Privileges and Immunities Clause. *Borden v. Selden*, 259 Iowa 808, 146 N.W.2d 306 (1966) (Invalidating agricultural land tax credit applicable only to land owned by residents.); *Opinion of the Judges*, 81 S.D. 629, 140 N.W.2d 34 (1966) (Definition of "individual taxpayer" qualified to receive distributions of tax relief in the form of a credit and refund was unconstitutional as it was limited to resident owners of real or personal property.).

In *Anderson v. Tiemann*, 182 Neb. 393, 155 N.W.2d 322 (1967), the Nebraska Supreme Court held that allowing only residents a "food sales tax credit" against Nebraska income tax did not constitute unjust or unreasonable discrimination under the Privileges and Immunities Clause. Initially, the court noted that the credit was part of the sales tax rather than the income tax, and it "seem[ed] reasonable for the Legislature to determine that generally a state sales tax on food for personal use will be paid almost universally by residents of the state, while purchases of such foods in the state by nonresidents are ordinarily minimal." *Id.* at 405, 155 N.W.2d at 330. It emphasized that the cases cited to support the claim the credit was invalid were "either property tax cases

or income tax cases involving personal exemptions," not sale tax cases. *Id.* at 407, 155 N.W.2d at 331. The court found that, "[v]iewed as a form of state sales tax exemption, the classification between residents and nonresidents as to the credit or refund of sales taxes on food for personal use is supported by valid independent reasons other than mere residence." *Id.* Nor would the result be different if the credit were treated as part of the income tax, as "[a] credit or deduction on income tax for sales taxes paid on food for personal use should logically be treated as a personal expense deduction, as opposed to a business expense deduction." *Id.* The court concluded by stating:

In our opinion, there are substantial reasons for the disparity of treatment between residents and nonresidents and the classification is not discriminatory nor arbitrary. Many facts support this classification, whether the credit, refund, or deduction, be viewed from the aspect of a sales tax or an income tax. The Legislature may have been of the opinion that food purchases for personal use are so closely related to the state of residence, particularly with respect to the imposition of a state sales tax, that any exemption, credit, deduction, or refund should be allowed only by the state of residence and not by every other state in which some part of the taxpayer's income might be found and taxed. The wisdom of such a legislative policy is a matter for legislation rather than judicial decision. We hold that the allowance and limitation of the food sales tax credit only to residents does not constitute unjust or unreasonable discrimination under the privileges and immunities and equal protection clauses of the Fourteenth Amendment. 182 Neb. at 408, 155 N.W.2d at 332.

As noted in response to your first question, the language of the legislative resolution proposing to amend the constitution to provide a refundable income tax credit makes no distinction based on residency or Nebraska income tax liability. Rather, it states a credit is provided against Nebraska income tax in an amount equal to thirty-five percent of property taxes "levied on real property located in this state" and "[p]aid by the taxpayer during the taxable year." Thus, qualification for the credit is based on payment of real property taxes in Nebraska, not residency of the taxpayer, or the taxpayer being subject to Nebraska income tax. As the refundable income tax credit provided by this resolution would be available to any real property taxpayer, there would be no potential for improper discrimination against nonresidents that would violate the Privileges and Immunities Clause.

CONCLUSION

The refundable income tax credit provided under the proposed constitutional amendment is not limited to Nebraska residents. Accordingly, it does not discriminate against nonresidents or primarily out-of-state interests in violation of the Commerce Clause. Also, as eligibility for the credit is not limited to Nebraska residents, it does not run afoul of the Privileges and Immunities Clause.

Very truly yours,

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