

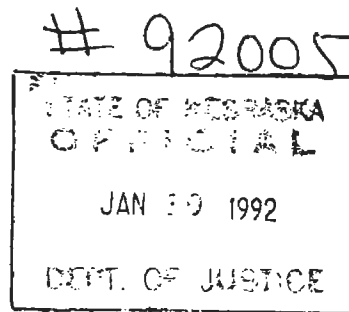


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DATE: January 9, 1992

SUBJECT: Proposed Constitutional Amendment Authorizing the
Exemption of Livestock from Property Taxation.

REQUESTED BY: Senator Roger Wehrbein
Nebraska State Legislature

WRITTEN BY: Don Stenberg, Attorney General
L. Jay Bartel, Assistant Attorney General

You have requested our opinion, under two scenarios, of the constitutionality of establishing a classification exempting "all livestock" from property taxation.

Under your first scenario, the Nebraska Constitution would be amended to: (1) authorize "separate and distinct treatment of tangible personal property for tax purposes;" (2) authorize the Legislature "to classify and exempt classes of tangible personal property from taxation;" and (3) authorize the Legislature to tax "depreciable tangible personal property." Presumably, your reference to permitting the Legislature to tax "depreciable tangible personal property" is intended to permit the Legislature to tax tangible personal property based on its depreciated value as determined for federal income tax purposes. Your question under this scheme is whether a legislative classification exempting all livestock from property taxation would create an unconstitutional classification if the Legislature were to also enact a tax on depreciable tangible personal property (other than depreciable livestock) based on its "depreciated value."

In Natural Gas Pipeline Co. v. State Bd. of Equal., 237 Neb. 357, 466 N.W.2d 461 (1991), the Nebraska Supreme Court addressed

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the validity under Neb. Const. art. III, § 18, of a legislative classification exempting "railroad rolling stock" from personal property taxation. Discussing the import of the prohibition against the enactment of special legislation or the establishment of unreasonable legislative classifications under Article III, § 18, the court, quoting State ex rel. Cone v. Bauman, 120 Neb. 77, 82-83, 231 N.W. 693, 695 (1930), stated:

The rule is well established that the legislature may, for the purpose of legislating, classify persons, places, objects or subjects, but such classification must rest upon some difference in situation or circumstance which, in reason, calls for distinctive legislation for the class. The class must have a substantial quality or attribute which requires legislation appropriate or necessary for those in the class which would be inappropriate or unnecessary for those without the class.

237 Neb. at 370, 466 N.W.2d at 470.

The court further noted: "A legislative classification must operate uniformly on all within a class which is reasonable. Exemptions are allowed where they are made applicable to all persons of the same class similarly situated." Id. (citations omitted).

In striking down the exemption for "railroad rolling stock" established under LB 7, the court in Natural concluded:

The Legislature's exemption of railroad rolling stock is not based on any real distinction between railroads and other common carriers.

* * *

We fail to see any real and substantial difference between personal property used for income production by one type of business and the same type of income-producing personal property used by another type of business.

Id. at 371, 466 N.W.2d at 470.

Shortly after issuing its decision in Natural, the court further defined the scope of the prohibition against special legislation in Haman v. Marsh, 237 Neb. 699, 467 N.W.2d 836 (1991). In Haman, the court noted a distinction between the rational basis standard of review employed in analyzing legislative classifications under the federal equal protection clause which do not involve a suspect class or a fundamental right, and the

standard employed in assessing the validity of legislative classifications under the special legislation prohibition in the Nebraska Constitution. Specifically, the court stated:

The test of validity under the special legislation prohibition is more stringent than the traditional rational basis test. Classifications must be based on some substantial difference of situation or circumstance that would naturally suggest the justice or expediency of diverse legislation with respect to the objects to be classified.

Id. at 713, 467 N.W.2d at 846-47 (citations omitted) (emphasis in original).

Under your first scenario, the Legislature would act, pursuant to constitutional authority, to classify and exempt all livestock from property taxation. In addition, the Legislature would act to tax tangible personal property subject to depreciation (other than depreciable livestock) at its value as determined after reducing such by depreciation allowed for federal income purposes. Irrespective of other constitutional concerns which such legislation may raise, we believe that legislation of this nature would run afoul of Article III, § 18.

Pursuant to federal law, a deduction is afforded for income tax purposes for the exhaustion, wear and tear of property used in a trade or business, or of property held for the production of income. I.R.C. § 167. Depreciation is allowable for tangible property but not for inventories, stock in trade, land apart from its improvements, or a depletable natural resource. Treas. Reg. § 1.167(a)-2. Farm buildings (except a personal dwelling), farm machinery, and other physical property (except land) are depreciable. Livestock acquired for work, breeding, or dairy purposes may be depreciated unless included in inventory. Treas. Reg. § 1.167(a)-6.

Thus, under your first scenario, the Legislature would establish all livestock as a class exempt from taxation, while establishing a class of depreciable tangible personal property as being subject to taxation based on its depreciated value. The class of depreciable tangible personal property subject to taxation would, however, not include depreciable livestock, which would be exempt by virtue of the exemption granted to all livestock. In our view, legislative enactment of a classification of this nature would violate the special legislation prohibition in Article III, § 18, as it would create an impermissible difference in treatment between similar property of the same class without the existence of any "real and substantial difference" justifying different treatment of some personal property within the class of depreciable

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personal property (depreciable livestock) and all other depreciable personal property. In other words, if the classification of personal property for ad valorem tax purposes is to be based on the "depreciated value" of personal property, it is highly unlikely that our supreme court would sustain the validity of the type of distinction proposed under your first scenario, which removes part of the class of depreciable personal property (depreciable livestock) from the burden of taxation imposed on the remainder of the class.

Under your second scenario, you ask us to consider whether a constitutional amendment specifically exempting all livestock from taxation, but authorizing the Legislature to classify and tax personal property based on its value as depreciated for federal income tax purposes (except depreciable livestock exempted from taxation under the constitution) would constitute impermissible "special legislation" prohibited by Neb. Const. art. III, § 18.

The simple answer to your question is that the adoption of a state constitutional amendment of this nature would not, in and of itself, violate Article III, § 18. The prohibition contained in Article III, § 18, is a restriction on the power of the Legislature to enact legislation creating unreasonable classifications. As the classification creating different treatment of depreciable livestock and other depreciable personal property would arise by virtue of a classification created by the State Constitution, as opposed to legislative action creating the classification, the provisions of Article III, § 18, would not apply under this scenario.

The question which remains, however, is whether the establishment of such different treatment in the taxation of depreciable personal property under state law (either constitutional or statutory) would violate the guarantee of equal protection mandated under the Fourteenth Amendment to the United States Constitution.

The equal protection clause "imposes no iron rule of equality, prohibiting the flexibility and variety that are appropriate to reasonable schemes of state taxation." Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 526 (1959). In structuring their internal tax structures, "the States have large leeway in making classifications and drawing lines which in their judgment produce reasonable systems of taxation." Lenhausen v. Lake Shore Auto Parts Co., 410 U.S. 356, 359 (1973). It is inherent in a state's power to tax that it be free to select the subjects of taxation, and to grant exemptions. Carmichael v. Southern Coal and Coke Co., 301 U.S. 495 (1937). In order for a state tax classification or scheme to withstand scrutiny under the equal protection clause, it is necessary only to consider whether the challenged classification

or tax is rationally based and related to a legitimate state purpose. Exxon Corp. v. Eagerton, 462 U.S. 176 (1983). "A state tax law is not arbitrary although it 'discriminate[s] in favor of a certain class. . . if the discrimination is founded upon a reasonable distinction, or difference in state policy,' not in conflict with the Federal Constitution." Kahn v. Shevin, 416 U.S. 351, 355 (1974) (quoting Allied Stores of Ohio, Inc. v. Bowers, 358 U.S. 522, 528 (1959)).

Clearly the proposed classification favors depreciable livestock over other forms of depreciable personal property. The question is whether this classification is rationally based and related to a legitimate state purpose. Although the question is not free from doubt, we believe that a sound argument can be made that a rational basis exists to support the different classification and taxation of livestock (including depreciable livestock) and other depreciable personal property. The livestock industry is vitally important to the State of Nebraska. It generates income not only to those who own and sell livestock, but to grain farmers, livestock processing operations, and others. Nebraska cattlemen must compete with other states where livestock may not be subject to property taxation. Because of its potential for substantial market price fluctuations, the industry is recognized as a particularly risky one.

As previously noted, the United States Supreme Court has accorded states wide latitude in making classifications and creating distinctions for tax purposes, and has sustained state taxing schemes that have distinguished between personal property owned by corporations as opposed to individuals, Lenhausen v. Lake Shore Auto Parts Co., supra, between anthracite coal and bituminous coal, Heisler v. Thomas Colliery Co., 260 U.S. 245 (1922), and between commercial warehouses and private warehouses. Independent Warehouses, Inc. v. Scheele, 331 U.S. 70 (1947). The Nebraska Supreme Court is, of course, bound to follow the principles of judicial review under the equal protection clause of the Fourteenth Amendment established by the United States Supreme Court. While the Nebraska Supreme Court has taken a restrictive approach in analyzing classifications in the property tax area, we believe that, given the limited judicial scrutiny applicable to tax classifications under the rational basis standard of review utilized under the federal equal protection clause, such a classification would not be wholly indefensible.¹

¹ As you have not addressed any question to us concerning the constitutionality of the establishment of "depreciable personal property" as a classification for tax purposes, we have not addressed any constitutional issues which the adoption of such a classification may raise beyond your questions pertaining to the

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Very truly yours,

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APPROVED BY:



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exclusion of depreciable livestock from the class of personal property to be taxed on the basis of its depreciated value, either by statute or pursuant to a constitutional amendment.