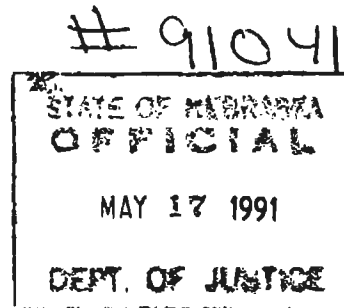




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DATE: May 17, 1991

SUBJECT: Whether a "Surcharge" Imposed on Depreciation Claimed as a Deduction for Income Tax Purposes Violates the Prohibition in Neb. Const. Art. VIII, Section 1A Against the State "Levying a Property Tax for State Purposes."

REQUESTED BY: Senator W. Owen Elmer
Nebraska State Legislature

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

You have requested our opinion as to whether the imposition of a "surcharge" on depreciation claimed as a deduction from gross income for federal income tax purposes (which, correspondingly, would result in a reduction in taxable income for purposes of determining Nebraska income tax liability) would violate the prohibition in Neb. Const. art. VIII, § 1A, against the state "levying a property tax for state purposes." The "surcharge" would apparently be collected by the state, and would be computed on the basis of a percentage of the deduction for cost recovery allowable under I.R.C. §§ 167 and 168 on property used in a trade or business held for the production of income, except that financial institutions taxed under Neb.Rev.Stat. § 77-3802 (Reissue 1990)

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would be assessed a charge on the reduction in net financial income for cost recovery on property used in a trade or business or property held for the production of income comparable to amounts allowable under I.R.C. §§ 167 and 168. Therefore, the issue raised by your request is whether a "surcharge" imposed on this basis is a "property tax" levied for "state purposes" within the prohibition in Article VIII, Section 1A. In analyzing this issue, the fundamental inquiry must be whether the "surcharge" in question is in the nature of a "property tax" within the meaning of this constitutional provision.

"[T]he character or nature of a particular tax must be determined by its operation, practical results and incidents, and by the substance and natural and legal effect of the language employed in the statute or law imposing it. Such factors should be relied upon, rather than the name given the tax by the Legislature."

71 Am.Jur.2d State and Local Taxation, § 22 (1973) (footnotes omitted); see also 84 C.J.S. Taxation, § 3b. (1954).

With respect to property taxes, the following general characteristics have been recognized:

Taxes on property are taxes assessed on all property or on all property of a certain class located within a certain territory on a specified date in proportion to its value, or in accordance with some other reasonable method of apportionment, the obligation of which is absolute and unavoidable and is not based upon any voluntary action of the person assessed. A property tax is measured by the amount of property owned by the taxpayer on a given day, and not by the total amount owned by him during the year.

* * *

If the tax is computed upon a valuation of property, and assessed by assessors either where it is situated or at the owner's domicil [sic], although privileges may be included in the valuation, it is considered a property tax.

71 Am.Jur.2d State and Local Taxation, supra, at §§ 24 and 26 (footnotes omitted).

In contrast, impositions characterized as "excise taxes" have generally been identified as follows:

In its modern sense an excise tax is any tax which does not fall within the classification of a poll or property tax, and which embraces every form of burden not laid directly upon persons or property. The obligation to pay an excise tax is based upon the voluntary action of the person taxed in performing the act, enjoying the privilege, or engaging in the occupation which is the subject of the excise, and the element of absolute and unavoidable demand is lacking.

* * *

If a tax is imposed directly by the Legislature without assessment, and its sum is measured by the amount of business done or the extent to which the privileges have been enjoyed or exercised by the taxpayer, irrespective of the nature or value of the taxpayer's assets, it is regarded as an excise.

* * *

If a tax is in its nature an excise, it does not become a property tax because it is proportioned in amount to the value of the property used in connection with the occupation, privilege, or act which is taxed.

71 Am.Jur.2d State and Local Taxation, supra, §§ 25 and 28 (footnotes omitted).

In State v. Galyen, 221 Neb. 497, 378 N.W.2d 182 (1985), the Nebraska Supreme Court addressed the distinction between a "property" tax and an "excise" tax. In Galyen, the court addressed, inter alia, the questions of whether a fee of twenty-five cents per head of cattle sold in Nebraska was a property tax or an excise tax, and, if an excise tax, whether the tax was subject to the uniformity and proportionality requirements of Neb. Const. art. VIII, § 1. In assessing the nature of the tax as a "property" tax or an "excise" tax, the court noted the following definitions of these terms:

Black's Law Dictionary (5th Ed. 1979) at 506 defines an excise tax as 'A tax imposed on the performance of an act. . . . Tax laid on manufacture, sale, or consumption of commodities. . . .' On the other hand, Black's Law Dictionary, supra, at 1097, defines a property tax as 'A tax levied on both real and personal property; the amount of the tax being dependent on the value of the property, generally expressed as a uniform rate per thousand of valuation.'

221 Neb. at 500, 378 N.W.2d at 185.

Citing its prior decision in Licking v. Hayes Lumber Co., 146 Neb. 240, 19 N.W.2d 148 (1945) (holding a tax imposed as an annual charge upon the right to continue corporate existence was not a property tax, although computed on the basis of the amount of capital stock), as well as other decisions holding a tax imposed on the doing of an act were excise taxes and not property taxes, the court in Galyen held the tax at issue was an excise tax and not a property tax. 221 Neb. at 500-502, 378 N.W.2d at 185-86. The court further held that, as the tax did not constitute a property tax, the principle of uniformity in Article VIII, Section 1, did not apply. Id. at 502-503, 378 N.W.2d at 186-87.

In addition, while our Supreme Court has not engaged in an extended discussion of the meaning of the term "ad valorem" taxation (which, of course, is the basis associated with property taxation), the court in State ex rel. Meyer v. Story, 173 Neb. 741, 744, 114 N.W.2d 769, 772 (1962), stated: "The phrase 'ad valorem' means literally 'according to the value,' and is used in taxation to designate an assessment of taxes against property at a certain rate upon its value." (citations omitted). See also Report of Attorney General 1979-80, Opinion No. 47, p.73 (discussing meaning of the term "ad valorem" taxation).

Against this background, we must attempt to characterize the nature of the depreciation "surcharge" at issue. In this regard, we note that a "surcharge," in this context, is defined as the imposition of "an additional tax, impost, or cost." Black's Law Dictionary 1292 (6th ed. 1990). The term apparently is generally used to refer to a "surtax," which is defined as "[a]n additional tax on what has already been taxed." Black's Law Dictionary, supra, at 1296. Various states have, consistent with this definition, imposed "surtaxes" or "surcharges" in addition to taxes normally imposed under their income tax laws. See, e.g., Conn. Gen. Stat. Ann. § 12-214(b) (Cum. Supp. 1991); Ill. Rev. Stat. Ch. 120, § 2-201(d) (Supp. 1990); Kan. Stat. Ann. § 79-32,110(c)(2) (1989); Mont. Code Ann. § 15-31-121 (1989); N.Y. Tax Law §§ 209-A and 290-A (McKinney Cum. Supp. 1991).

The proposed "surcharge" on depreciation, in contrast to these exactions, is not imposed on the basis of an additional charge computed on income or tax liability; rather the charge is imposed on an amount which represents a deduction from the basis utilized to determine income tax liability. We have been unable to find any statutory provisions imposing an exaction of this nature, or any caselaw addressing the characterization of a tax of this type.

In spite of this dearth of authority, we must attempt to address the question of the nature of the proposed tax at issue. In attempting to categorize a "surcharge" on depreciation, we believe it is appropriate to analyze the basis upon which the deduction for depreciation is allowed for income purposes and its relationship (or lack thereof) to the value of property to determine if this exaction is, in fact, a "property tax" within the meaning of Article VIII, Section 1A.

[A]s a matter of accounting theory, depreciation is simply an accounting device intended to allocate the cost of using an asset to the periods in which that use contributes to revenue by approximating the gradual diminution in value of the asset over time due to age, wear and tear, and obsolescence.

Hawkins v. Commissioner, 713 F.2d 347, 351 (8th Cir. 1983); see also Massey Motors, Inc. v. United States, 364 U.S. 92 (1960); Hertz Corp. v. United States, 364 U.S. 122 (1960). See generally H. Sellin, Attorney's Handbook of Accounting, § 5.08 (Rev. 1988).

The distinction between "actual value" for property tax purposes, and "value" determined by reference to the "value" of property for federal income tax purposes, was directly addressed by the Nebraska Supreme Court in State ex rel. Meyer v. McNeil, 185 Neb. 586, 177 N.W.2d 596 (1970). McNeil involved the issue of whether a legislative act declaring that the values of agricultural income producing machinery and equipment used by any business required to report taxable income under the Internal Revenue Code be used by county assessors for property tax purposes violated Neb. Const. art. VIII, § 1. In determining this method of valuing property for tax purposes violated the State Constitution, the court specifically noted the fact that the "value" of such property for income tax purposes bore no relation to the "actual value" determination required to comply with Article VIII, Section 1. In this regard, the court stated:

[T]he Internal Revenue Code does not purport to determine the value of agricultural income-producing machinery and equipment. Its purpose is to fix an equitable rate of depreciation of personal property used in a trade or business over the estimated useful life of the property rather than have it fall in a single year period. Its purpose is not to fix the actual value of the property at any given time, but to amortize depreciation during its life in determining net annual income. The revenue act therefore does not purport to determine actual value of farm machinery and equipment at any given time and is

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wholly unrelated to actual value for taxation purposes required by the law of this state.

Id. at 589, 177 N.W.2d at 599 (emphasis added).

Therefore, in our opinion, the Legislature may impose a tax computed on the amount of depreciation claimed for income tax purposes without violating Article VIII, Section 1A, at least so long as the tax imposed does not exceed the state income tax benefit resulting from the depreciation deduction. The proposed "surcharge" does not fit within the conventional definition of an "ad valorem" property tax, which is the type of exaction the state is prohibited from imposing under Article VIII, §1A. In actuality, as the court noted in McNeil, the amount of depreciation claimed as a deduction for income tax purposes in a given year does not necessarily bear any relationship to the value of the property depreciated. To the extent that an element of "value" can be said to be encompassed in the concept of depreciation, in the sense that the allowance of a deduction for income tax purposes for depreciation is based, in part, on recognition of the loss in value of an asset over time, we believe this would not render the proposed "surcharge" on depreciation an impermissible "property tax" imposed in violation of Article VIII, §1A. The relationship between any such "value" element in the depreciation concept, and the determination of the "actual value" of property for tax purposes, is too unrelated and tenuous to permit the conclusion that a surcharge on depreciation would be found unconstitutional on this basis.

Furthermore, there is no requirement that the state, for purposes of calculating state income tax liability, allow any deduction for depreciation such as is permitted under federal tax law. The imposition of a charge of this nature would, in effect, simply reduce any benefit received by taxpayers electing to claim such a deduction. To the extent the allowance of a deduction for depreciation expense for state income tax purposes is a matter of legislative grace, it would seem anomalous to conclude that the imposition of a tax having the effect of reducing the benefit of such a deduction would not be constitutionally permissible.

We would be remiss, however, if we did not counsel that our conclusion is by no means certain. Our supreme court has repeatedly admonished that the Legislature may not circumvent the Constitution by attempting to do indirectly that which it may not accomplish directly. Haman v. Marsh, 237 Neb. 699, ___ N.W.2d ___ (1991); Banner County v. State Bd. of Equal., 226 Neb. 236, 411 N.W.2d 35 (1987). It is not inconceivable that the court would view legislation of this nature to be, in substance and effect, an "indirect" attempt by the state to impose a tax on the "value" of

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property prohibited by Article VIII, Section 1A. While, for the reasons previously articulated, we believe the tax in question is defensible against constitutional attack on this basis, there is no assurance that our supreme court would not view the tax as an indirect means for the state to impose a "property tax," in contravention of Article VIII, Section 1A.

With this concern in mind, we would recommend that rather than a tax surcharge on depreciation (which has some appearance of being a property tax), the Legislature could better reach the same objective by simply disallowing a percentage of depreciation expense as a deduction from income for state income tax purposes. Mechanically this might be accomplished by adding a portion of depreciation claimed for federal income tax purposes to taxable income for state income tax purposes.

A law written in this manner would, in our opinion, avoid the various Nebraska Constitutional provisions related to property taxes because the tax would clearly be a tax on income.

This is not a recommendation that income taxes should be increased. That is a decision which the Legislature and the Governor must make.

However, if the Governor and the Legislature wish to increase income taxes in a manner related to depreciation, a method that directly denies a portion of the depreciation deduction is much more clearly constitutional than is a surcharge on depreciation.

Very truly yours,

DON STENBERG
Attorney General

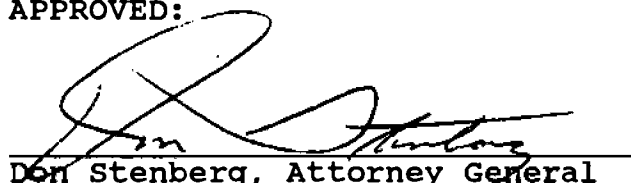


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cc: Patrick O'Donnell
Clerk of the Legislature

7-65-7.4

APPROVED:


Don Stenberg, Attorney General