

DISTRICT COURT UPHOLDS OCCUPATION TAX FOR COMPACT COMPLIANCE

*David J. A. Bargaen, Esq.
Rembolt Ludtke LLP*

In a decision issued March 12, 2010, the Lancaster County District Court, Judge Robert Otte, in the case *Kiplinger v. Nebraska Department of Natural Resources et al.*, found that the occupation tax authorized by LB 701 to be levied by Republican River basin Natural Resources Districts (“NRDs”) to raise funds to aid in maintaining Republican River Compact compliance did not violate the Nebraska Constitution.

LB 701 was signed into law in 2007 authorizing “a [natural resources] district with jurisdiction that includes a river subject to an interstate compact among three or more states and that also includes one or more irrigation districts within the compact river basin” to levy both a property tax and occupation tax on irrigated acres within such district. Funds raised by the taxes were to be used to finance so-called river enhancement bonds that were authorized to raise funds to purchase surface water rights from irrigators and irrigation districts to help maintain flows in the Republican River sufficient to keep Nebraska in compliance with the Republican River Compact. The Nebraska Supreme Court last year struck down the property tax authorized by LB 701 as violating the Duis amendment to the Nebraska Constitution that precludes the levying of a property tax for a state purpose: “The state shall be prohibited from levying a property tax for state purposes.” Neb. Const. Art. VIII, § 1A.

In *Kiplinger*, plaintiffs were residents and taxpayers of natural resources districts in the Republican River basin and of the State, having an ownership interest in irrigated agricultural land. Basin NRDs levied a \$10 per certified irrigated acre occupation tax “upon the activity of irrigation of agricultural lands” pursuant to Neb. Rev. Stat. § 2-3226.05. Plaintiffs argued the statute authorizing the occupation tax constituted special legislation, resulted in a commutation of taxes, and constituted a property tax for state purposes, all in violation of the Nebraska Constitution.

The Court held that the occupation tax was not really a “property tax in disguise” as plaintiffs had argued. The Court noted that the occupation tax is not tied to the value of land, but is capped at \$10 per irrigated acre. It also held that the tax is essentially an excise tax contingent upon the owner’s decision to irrigate or not. The Court also noted that landowners could opt out of the tax by decertifying their acres as irrigated. Thus, the Court said the occupation tax was not akin to the property tax found unconstitutional in *Garey v. Nebraska Department of Natural Resources*.

The Court next addressed whether the occupation tax resulted in a commutation of tax liability from taxpayers in the rest of the state to taxpayers in the basin NRD districts, and between taxpayers in the basin itself, for purposes of financing Compact compliance. The Court held that the occupation tax may benefit not only taxpayers in the rest of the state, but benefits those paying the tax and landowners like the plaintiffs to the extent water programs paid for in part by such tax may avoid more drastic water regulation to maintain Compact compliance. Thus, the Court held the

Water Law

David J. A. Bargaen
dbargaen@remboltludtke.com

Mark A. Fahleson
mfahleson@remboltludtke.com

Daniel E. Klaus
dklaus@remboltludtke.com

Rembolt Ludtke LLP *Attorneys at Law*

MAIN OFFICE

1201 Lincoln Mall, Suite 102
Lincoln, NE 68508
Fax: 402 / 475-5087
402 / 475-5100

BRANCH OFFICES

125 South 6th Street
Seward, NE 68434
Fax: 402 / 643-3969
402 / 643-4770

3280 Woodridge Boulevard
Suite 160
Grand Island, NE 68801
308 / 384-6888

www.remboltludtke.com

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tax “does not ‘divert taxes raised by one taxing district to the sole use and benefit of another district,’ ” and thus does not constitute a commutation of a tax.

Finally, the Court addressed whether the occupation tax constituted special legislation. The Court used most of the decision to address this point, what many considered to be the central challenge of the tax, and its decision seems to rest to a large extent on the presumption in law that a statute is constitutional, “and all reasonable doubts will be resolved in favor of its constitutionality.” Plaintiffs argued the statute created an unconstitutional closed class to which the statute applied through its language limiting its application to “a district with jurisdiction that includes a river subject to an interstate compact among three or more states and that also includes one or more irrigation districts within the compact river basin.” The Court said it was indisputable that at this time, only the three NRDs primarily in the Republican River basin—the Upper Republican NRD, Middle Republican NRD, and Lower Republican NRD—fell within that classification. The Court reviewed the Supreme Court’s test that

[i]n deciding whether a statute legitimately classifies, the court must consider the actual probability that others will come under the act’s operation. If the prospect is merely theoretical, and not probable, the act is special legislation. The conditions of entry into the class must not only be possible, but reasonably probably of attainment.

The Court noted that though some of the legislative history indicated an intent expressed by some lawmakers that the legislation be limited in scope, that the evidence submitted in this case showed that it was at least feasible that three other river basins—the South Platte, North Platte, and Missouri River—*could* become candidates for another three state compact. The Court compared the legislation with that challenged in the state’s attempt to make whole depositors of the failed Commonwealth Savings Company, and found that the possibility of the class in that case ever having more members was so remote as to be obviously a closed class, but no so in this case. “[T]he state need only negotiate an interstate compact with two other states and, . . . there are at least three river basins that have the potential to come under the classification” The Court also pointed to evidence in the record that an 8-state compact was recently ratified known as the Great Lakes – St. Lawrence River Basin Water Resources Compact to show that the creation of such compacts in the future was not out of the question. The Court concluded that though the plaintiffs pointed to instances in the legislative history of lawmakers opining that the statute was intended to apply narrowly, plaintiffs had “offered no reliable facts to support the opinions.” The Court held that “the record in the present case is insufficient to overcome the presumption of constitutionality of the occupation tax levy passed by the legislature.

An appeal of the case would seem likely, so final disposition of LB 701’s occupation tax may have to await pronouncement by the Nebraska Supreme Court. In the meantime, the Legislature continues to consider LB 862, intended to fix legislatively the “closed class” language of the occupation tax, by expanding the levy authority to any NRD in a river basin where a majority of NRDs use well metering controls. What is clear is that the district court’s opinion is likely not the final word on the matter.

David Barga is an associate with the Lincoln-based law firm of Rembolt Ludtke LLP and may be reached at (402) 475-5100 or dbarga@remboltludtke.com. This article is provided for general information purposes only and should not be construed as legal advice. Those requiring legal advice are encouraged to consult with their attorney.