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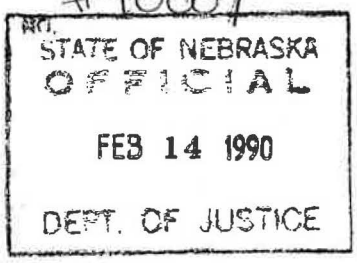

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DATE: February 14, 1990

SUBJECT: Constitutionality of LB 1115 - Amendment of the Definition of Real Property for Tax Purposes

REQUESTED BY: Senator W. Owen Elmer
Nebraska State Legislature

WRITTEN BY: Robert M. Spire, Attorney General
L. Jay Bartel, Assistant Attorney General

You have requested our opinion on certain questions relating to the constitutionality of LB 1115. Generally, LB 1115 would alter the current property tax scheme by exempting all personal property other than motor vehicles from taxation, and by redefining the term "real property" in Neb.Rev.Stat. §77-103 (Reissue 1986) (amended, Laws 1989, 1st Special Session, LB 1).

Your first question is whether the proposed redefinition of the term "real property" in §77-103, contained in §24 of LB 1115, is constitutional. Section 24 provides, in pertinent part:

> (1) Real property shall include both type A and type B real property.
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> (2) Type A real property shall mean all land, including land under water, and all mines, minerals in place, quarries, sand and gravel pits, mineral springs and wells, and oil and gas wells.
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> (3) Type B real property shall mean any improvement, upon or beneath type A real property, which remains, in the normal course of events, affixed upon or beneath such property for longer than twelve months. For purposes of this subsection, improvement shall mean any property that remains fixed and stationary by design in relation to the type A real property for twelve months or more, and affixed shall mean actually or constructively annexed or attached.

Recently, we addressed at length the constitutionality of legislation amending the definition of real property in §77-103. Attorney General Opinion No. 89071, November 13, 1989. In this opinion, we considered whether it was permissible for the Legislature to adopt a statutory definition of real property for tax purposes which differed from adherence to the common law standards which the Nebraska Supreme Court had found in Northern Natural Gas Co. v. State Board of Equalization and Assessment, 232 Neb. 806, 443 N.W.2d 249 (1989) ["Northern"] to be included in §77-103. Noting the general rule that "[i]t is competent for the Legislature to classify for purposes of legislation, if the classification rests on some reason of public policy, 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. . ." (Stahmer v. State, 192 Neb. 63, 68, 218 N.W.2d 893, 896 (1974)), we concluded the Legislature was not necessarily precluded from enacting legislation altering the definition of real property under §77-103, provided a reasonable basis could be articulated to justify any classification established by such redefinition.

During the special session convened in November, 1989, the Legislature amended the definition of "real property" in §77-103 to include ". . . pipelines, railroad track structures, electrical and telecommunications poles, towers, lines, and all items actually annexed to such property, and any interest pertaining to the real property or real estate." 1989 Neb. Laws, 1st Special Session, LB 1. No judicial determination has been made as to the constitutionality of this amendment to §77-103.

As noted in our previous opinion, several states have adopted statutory definitions of real property or real estate for tax purposes that include types of property which, under the common law of fixtures, would likely be considered to be personalty. See, e.g., N.Y. Real Property Tax Law §102, Subd. 12 (McKinney 1984 and Supp. 1989); Iowa Code Ann. §427 A.1, Subd. 1 (West Supp. 1989); N.D. Cent. Code §57-02-04, Subd. 3 (1983). In sustaining the constitutionality of the New York statutory definition, the New York Supreme Court stated: "The Legislature has the power to classify and define what property is taxable as real property, and for some time prior to the enactment of the statute in question the Tax Law has provided that certain property, which under the common law is personal property, is subject to tax as real property." Beagell v. Douglas, 2 Misc.2d 361, 363, 157 N.Y.S.2d 461, 463 (N.Y.Sup.Ct. 1955). See also Signal Oil and Gas Co. v. Williams County, 206 N.W.2d 75 (N.D. 1973) (holding provision of property tax law defining as "real property" machinery and equipment used in refining oil and gas did not create unreasonable classification in violation of State Constitution or the Equal Protection Clause of the Federal Constitution); Heritage Cablevision v. Marion County

Board of Supervisors, 436 N.W.2d 37 (Iowa 1989) (rejecting facial constitutional challenge to Iowa statute exempting most, but not all, tangible personal property by classifying certain types of property as real property).

Based on the foregoing, it does not appear to be clearly unreasonable for the Legislature to classify property as real or personal for tax purposes in a manner which differs from adoption of the common law tests regarding fixtures, provided the classifications established are reasonable. To the extent §24 of LB 1115 proposes to alter the current definition of "real property" in such a manner, it is not inherently objectionable as creating an unreasonable classification, as support from other jurisdictions exists to sustain the definition of real property for tax purposes in a manner which includes types of property which, under the common law of fixtures, would be considered personalty.

This is not to say, however, that the classification established could not be challenged as unreasonable. An owner of property subject to taxation as "type B real property" under the bill may be able to successfully argue the taxation of such property is unreasonable when similar property is classified as personal property and therefore exempted from taxation. While the Nebraska Supreme Court upheld the Legislature's power to classify and exempt certain types of personal property in Stahmer v. State, supra, the Court has not yet had occasion to consider the constitutionality of legislation similar to LB 1115. As was noted, no judicial determination has been made as to the validity of the amendment to §77-103 accomplished by the passage of LB 1 during the recent special session. Thus, it is not clear that the Court will uphold the type of redefinition of real and personal property proposed under the terms of LB 1115.

It should be noted there is case law in Nebraska which indicates our Court may take a more restrictive view than courts from other states with regard to the Legislature's ability to classify and define terms in the area of property taxation. In Moeller, McPherrin and Judd v. Smith, 127 Neb. 424, 255 N.W. 551 (1934) ["Moeller"], the Court held unconstitutional legislative action altering the taxation of tangible and intangible property accomplished by the enactment of a statute defining the term "tangible property" to include property which, by nature, was intangible. In particular, the Court stated:

> May a legislature, under the guise of defining a word, do so with a definition which contravenes our Constitution, and which is not true or legal in fact? Class 2 of tangible property, as defined in House Roll No. 9, is intangible property as defined by the leading dictionaries.

* * *

> Can the legislature define and designate as tangible that which is, in fact and in truth, intangible? It may be admitted that the legislature has power to define words used by it, but is this an unlimited power, or is it subject to a reasonable construction? Tangible is the direct opposite of intangible; and can the legislature, under the guise of calling it two separate classes of tangible property, include all intangible property under class 2 of tangible property? In our opinion, there is a limit to the legislature's power to nullify and circumvent constitutional provisions by putting an arbitrary, but improper and unfounded, definition upon a certain word.
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> The Constitution of Nebraska clearly provides for two kinds of personal property for purposes of taxation, and the legislature has abrogated one of these by the device of calling it a class under the other. The legislature could not directly blot out a provision of the Constitution; has it not, by House Roll No. 9, attempted to do it indirectly?
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> If the Constitution gives one definition of a legal term, and a statute another, it is the duty of a court to declare that the Constitution governs.

Id. at 433, 255 N.W. at 555-56.

Furthermore, in State ex rel. Meyer v. Peters, 191 Neb. 330, 215 N.W.2d 520 (1974) ["Peters"], the Court declared unconstitutional a statute exempting from property taxation household goods, "including major appliances either attached or detached to real property," and personal effects. The legislation was assertedly enacted pursuant to Article VIII, Section 2, of the Nebraska Constitution, which provided, in part: "Household goods and personal effects, as defined by law, may be exempted from taxation in whole or in part, as may be provided by general law. . . ." (Emphasis added). In holding the phrase "household goods and personal effects, as defined by law "in Article VIII, Section 2, referred to existing law at the time of adoption of the constitutional amendment in a descriptive and limiting manner, the court stated:

> Any definitional powers given to the Legislature are prefixed and limited. The power to define household goods and personal effects necessarily is limited to those articles which ordinarily would be understood to

> be embraced within that term. Certainly, it cannot be interpreted to give the Legislature power to include air-conditioning systems, furnaces, automobiles, or real estate within the term "household goods and personal effects." Since there must be a limit to such powers, it is reasonable to find the common law concepts serve as guides.
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> * * *
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> In any event, any power to define household goods must be limited for the term "household goods" to have any meaning whatever. It is obvious that the Legislature could not be allowed to define all property in the state as household goods and personal effects. To permit it to do so would allow it to negate other parts of the Constitution.

Id. at 334-35, 215 N.W.2d at 524-25.

While it is possible to distinguish the situations addressed by the Court in Moeller and Peters from the one presented herein, it is certainly conceivable that our Court may adopt a narrower and more limited view of the Legislature's power to classify and define in this area than courts from other jurisdictions. This may be particularly true in light of the Court's recent decision in Northern, supra, discussing extensively the application of the law of fixtures in assessing whether property is to be deemed real or personal for tax purposes. In sum, while there is law from other states supporting the validity of legislation defining real property for tax purposes in a manner similar to that proposed under LB 1115, we cannot definitively conclude that our Court would, in light of prior Nebraska case law, sustain the classifications established under LB 1115 as constitutional.

You have also asked us to consider whether the provisions of §61 of LB 1115 are constitutional. The apparent intent of subdivision (2)(a) of §61 is to preserve the personal property tax exemption incentives contained in Neb.Rev.Stat. §77-4105 (Cum.Supp. 1988) for taxpayers who have entered into agreements under the Employment and Investment Growth Act prior to the effective date of LB 1115. In this regard, subdivision (2)(a) retains the current statutory language separately classifying personal property in the nature of "turbine-powered aircraft," "mainframe business computers," and business equipment "involved directly in the manufacture or processing of agricultural products." This subdivision also provides "such property shall be exempt from the tax on personal property. . . ."

Our primary concern with the language of subdivision (2)(a) of §61 is that, by virtue of the redefinition of "real property" in §24 of LB 1115, it is quite possible that much of the property separately classified as personal under §77-4105(2) would constitute "type B real property" under LB 1115. While turbine-powered aircraft would not be affected by the redefinition of real property, mainframe business computers or business equipment involved in manufacturing or processing agricultural products may well fall within the definition of "real property" as "type B real property." Thus, as §61 simply retains an exemption for the property enumerated from "personal property tax," such exemption would be meaningless if the property is no longer personal property for tax purposes under Nebraska law. To the extent this alters the terms of existing agreements entered into pursuant to the Employment Investment Growth Act, we believe a serious question as to the unconstitutional impairment of contractual obligations is raised under Article I, Section 16, of the Nebraska Constitution, by the provisions of subdivision (2)(a) of §61.

Subdivision (2)(b) of §61 is apparently intended to alter the property tax incentives available in connection with agreements entered into after the effective date of LB 1115. Under subdivision (2)(b), taxpayers owning "type B real property" are to receive a credit against the income tax liability of the taxpayer for the amount of any ad valorem taxes paid on such property. We believe there is a strong possibility that a court would find this provision unconstitutional. Article VIII, Section 2, provides, in part "The Legislature may classify personal property in such manner as it sees fit, and may exempt any of such classes, or may exempt all personal property from taxation. No property shall be exempt from taxation except as provided in the Constitution. . . ." (Emphasis added). While the Legislature has the power to classify and exempt personal property under this constitutional provision, the Legislature does not have such authority with regard to the classification and exemption of real property. Under subdivision (2)(b) of §61, a credit against income tax liability is granted as to real property taxes paid by certain taxpayers. In our view, the provision of relief from the payment of a tax on real property in this manner would likely be viewed as an unconstitutional attempt to indirectly grant an exemption for real property not authorized by the Constitution. It is axiomatic that the Legislature may not circumvent the effect of an express provision of the Constitution by doing indirectly what it may not do directly. Nebraska Public Power District v. Hershey School District, 207 Neb. 412, 299 N.W.2d 514 (1980). We have, in prior opinions, indicated our belief that similar attempts to avoid the effect of the limitations and requirements of Article VIII, Sections 1 and 2, would not meet with judicial favor. Report of Attorney General, 1971-72, Opinion Nos. 104, 106, and 108.

In conclusion, it is our opinion that, for the specific reasons stated herein, certain portions of LB 1115 are constitutionally suspect.

Very truly yours,

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cc: Patrick J. O'Donnell
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APPROVED BY:

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