

# George Mason University

## State & Local Government Leadership Center

April 12, 2013

**Battle of the Budget.** President Obama submitted his FY2014, \$1.058 trillion budget this week, proposing to eliminate the sequester after this year, curtail federal entitlement spending, and impose limits on federal tax expenditures to raise \$580 billion—including a number affecting state and local governments. While the budget would continue the reduction in federal discretionary funding over the next decade, it would be less than the current decade-long sequester in place, which would lead to \$966 billion in discretionary spending in 2014. The President proposes the new revenue to come from the so-called “Buffett Rule,” requiring that households with annual income over \$1 million pay at least a 30 percent tax rate after charitable deductions. The budget would cut entitlement spending by \$230 billion by adopting a new formula known as “chained consumer price index” that would more slowly increase benefits for Social Security and other programs for inflation. The budget proposes to reduce cost-of-living increases to Social Security and other entitlements, proposing a more restrictive measure of inflation; the President’s budget will seek savings in Medicare through lower payments to hospitals, pharmaceutical companies, and other healthcare providers. The President’s budget proposes to achieve \$9 billion over the next decade by including a \$3 million limit on tax-preferred retirement accounts; the proposal would forbid people from “double dipping” by collecting disability and unemployment insurance benefits at the same time. The budget also seeks higher cigarette and tobacco taxes as a way to pay for new funding for free prekindergarten education.

The Administration proposes to limit the tax rate at which upper-income taxpayers can use itemized deductions and other tax preferences to reduce tax liability to a maximum of 28%. This limitation would reduce the value of the specified exclusions and deductions that would otherwise reduce taxable income in the top three individual income tax rate brackets of 33, 35, and 39.6 percent to 28 percent. The limit would apply to all itemized deductions, including *interest on tax-exempt state and local bonds*, employer-sponsored health insurance, deductions and income exclusions for employee retirement contributions, and certain above-the-line deductions. If a deduction or exclusion for contributions to retirement plans or individual retirement arrangements is limited by this proposal, the taxpayer’s basis would be adjusted to reflect the additional tax paid. The limit would be effective for taxable years beginning after December 31, 2013.

**Domestic Programs.** While the President’s budget proposes to replace the remaining nine years of the sequester, his budget proposes less spending over the next decade than provided for under the caps agreed to as part of the August 2011 debt ceiling agreement. The Obama budget calls for \$1.058 trillion in spending for so-called discretionary domestic programs—spending other than for defense or entitlements such as Medicare. That honors a cap set by Congress and Mr. Obama as part of the 2011 debt-limit deal. This year, domestic spending is 3.7% of the country’s GDP; the President’s budget would reduce that to 3% by 2018, and to 2.5% by 2023—the lowest level since Dwight Eisenhower was President in the early 1950’s. Constrained by a spending cap on domestic programs that he agreed to two years ago, President [Barack Obama](#) has found ways in his latest budget to finance domestic initiatives such as preschool education and highway construction. The budget proposes increased investment for education and clean-energy research, and “pay-fors” to provide funding for infrastructure and preschool education outside of the spending caps. The budget proposes a new \$750 million program to expand preschool education, which is proposed to be offset by increasing the federal tax on cigarettes to \$1.95 a pack, from \$1.01. The

President proposes \$50 billion for road building and other infrastructure, to be offset by a projected decline in spending for the war in Afghanistan. Despite its relative austerity, the President's budget is higher than the \$984 billion provided for discretionary programs this year, after the sequester took effect, according to House Appropriations Committee calculations—setting up an early issue with the House, whose budget, adopted last month, allotted \$966 billion for discretionary programs—a number set on the assumption that the sequester would continue.

**Defense.** The Obama budget proposes cuts in defense spending of about \$100 billion over the next decade, cuts that would include a new round of BRAC base closings as well as affect counties and cities with significant defense and defense contractor presences.

**Taxes & Revenues.** The President's budget could facilitate bipartisan House and Senate tax reform efforts, making clear White House support for corporate tax reform that would limit corporate tax expenditures, devoting the revenues gained to lower rates. The White House took small but important steps toward lawmakers of both parties who favor rewriting the federal tax code. The budget proposal released Wednesday endorses the concept of revamping both the individual and business-tax systems at the same time, something that Republicans say is necessary to prevent political battles that could kill the overhaul effort. The budget also proposes using money from closing loopholes to reduce corporate rates—a step companies view as a way to keep a business-tax rewrite from being swallowed up in deficit-reduction negotiations. The key revenue raising, budget, and federalism proposals:

- Reduce value of tax breaks for higher-income individuals: +\$529 billion: This proposal would cap at 28% the value of itemized deductions and specified exclusions, which would raise \$529 billion over ten years. It would apply to include selected exclusions ranging from interest on municipal bonds to employer-paid health insurance premiums. This year's proposal would extend the limitation to some taxpayers with income below the previous Administration threshold to \$250,000 for couples and \$200,000 for singles.
- Impose new cost-of-living measure for tax brackets, called the "Buffett Rule, which proposes a "Fair Share Tax" or FST:+\$100 billion; This new proposal would constitute a new minimum tax requiring higher income taxpayers to pay at least 30% of their gross income (AGI) in federal taxes, with the rule phasing in between \$1 million and \$2 million of adjusted gross income—but, it would have exceptions: to protect charitable contributions, taxpayers would be permitted a credit equal to 28% of their deductible gifts; taxpayers would be permitted to count any alternative minimum tax liability, the 3.8% Obamacare tax on investment income, and the employee share of payroll taxes toward the 30% minimum tax.
- Increase estate taxes: +\$79 billion;
- Raise tobacco taxes: +\$78 billion (To fund an expansion of early-childhood education programs that would cost \$77 billion over 10 years, the administration proposes to increase the federal cigarette tax to \$1.95 per pack from the current \$1.01.);
- Adopt a 'Buffett Rule' minimum tax for very wealthy taxpayers: +\$53 billion: a new 30% minimum tax for households making more than \$1 million. That would generate an additional \$53 billion. It also proposes revisiting an agreement on the estate tax worked out in the fiscal-cliff compromise, and raising estate-tax levels starting in 2018;
- Change tax treatment of derivatives: +\$19 billion;
- Cap tax-advantaged retirement accounts at about \$3.4 million each: +\$9 billion: a complex formula to limit the size of tax-favored retirement accounts that would, effective next year, set a ceiling of \$3.4 million for people age 62.

## Tax Proposals Specific to State & Local Leaders

- AFF Bonds: Recommends a new “Rebuild America Partnership” program that would allow direct-pay American Fast Forward (AFF) bonds to be used for any project that can currently be financed with tax-exempt private activity bonds, as well as a re-proposed infrastructure bank;
- Increase the AFF subsidy for school construction to 50%;
- Provide a new Manufacturing Communities Tax Credit (NMTC: this is intended to provide new tax credit authority to support qualified investments in communities affected by military base closures or mass layoffs);
- Extend and modify the NMTC, a 39% credit for qualified equity investments in qualified community development entities;
- Reform and expand the Low Income Housing Tax Credit under which states would be authorized to convert some private activity volume cap into authority to issue additional LIHTC credits;
- Proposes the designation of 20 Promise Zones (14 in urban areas and 6 in rural), with such zones eligible for an employment credit and additional first year depreciation;
- Permit current refunding of state and local governmental bonds;
- Increase the national limitation amount for qualified highway or surface freight transfer facility bonds;
- Eliminate the state-by-state volume cap for private activity bonds for water infrastructure;
- Increase the 25% limit on land acquisition restriction on private activity bonds from 25 to 35%;
- Repeal the requirement under municipal bond rules that airports, docks, wharves, and mass commuting facilities must be owned by a governmental unit;
- Facilitate tax compliance with local jurisdictions;
- Simplify the arbitrage (I call them the ribbet rules) investment restrictions;
- Streamline private business limits on governmental bonds;
- Modify to broaden the offset of federal income tax refunds to allow states to collect delinquent state income tax from out-of-state residents.

**State & Local Impact.** The President’s budget proposes \$643.3 billion in outlays for aid to local and state governments for FY2014, an increase of \$98.7 billion from this year, with 50.3% for health care assistance—the bulk of which is for Medicaid, 16.8% for income security programs, 15% for education, training and social services; 11.1% for transportation; 3.3% to community and regional development; and 1% each to justice, and natural resources and environment. The combination of the demographics of aging and inability to raise revenues for transportation are made clear in the President’s budget: in 1960, 35.3% of the federal grants to state and local governments were for payments to individuals and 47.3% for physical capital or public infrastructure; in the President’s budget for next year: 65.5% of state and local grants in the budget are for individuals, and 14.4% for infrastructure. And even that percentage is likely over-estimated, as there appears to be little enthusiasm for the President’s proposed infrastructure bank (the budget requests \$480 million), and the estimates do not take into account the potential disinvestment impact of the Administration’s proposal to limit the tax-exemption of state and local tax-exempt bonds. The Administration proposes a \$472 million reduction (about 22%) in the state revolving loan (SRF) program, nearly a 33% cut in the Rural Water and Waste Disposal program, just over a 10% cut in the LIHEAP low income energy assistance program, and close to 10% in Special Education. The budget seeks the elimination of airport grants for large and medium-hub airports, a 1% cut in CDBG, and a 13% cut in the highway obligation limitation. The budget seeks a 5% cut in the HOME program, and a 20% cut for the Housing for persons with disabilities program. It proposes significant increases in the COPS program (111%), but elimination of the UASI Urban Area Security Initiative program. The budget seeks more than a 10% cut in State and Local Law Enforcement and more than a 20% cut in the High

Intensity Drug Trafficking Areas Program. The budget seeks increased public housing operating funds (about 16%) and nearly a 14% increase for homeless assistance grants.

President Obama's fiscal year 2014 budget again proposed a 28% cap on tax expenditures, including municipal bond interest for the top 2% of income earners. The \$3.7 trillion budget would also implement the so-called Buffett Rule or "Fair Share Tax," requiring households with incomes over \$1 million pay at least 30% of their income, after charitable giving, in taxes. These two proposals, administration officials said, would raise \$580 billion for deficit reduction by limiting high-income tax benefits, without raising tax rates. The budget proposes a new America Fast Forward (AFF) Bond program that would provide a 50% federal subsidy rate for original financings of governmental capital projects for public schools and state universities, as well as new money financings for 501(c)(3) nonprofit educational facilities. The 50% subsidy rate would be available for 2014 and 2015, but could not be used for current refundings. All other taxable, direct-pay AFF bonds would have a 28% subsidy rate, beginning in 2014. The AFF bonds would build off the now-expired Build America Bond program, to attract new sources of capital for infrastructure investments. AFF bonds with the 28% rate could be used for financing for governmental capital projects, current refundings of prior public capital project financings, short-term governmental working capital financings for governmental operating expenses subject to a 13-month maturity limitation, and financings for projects and programs that could otherwise be financed with tax-exempt private-activity bonds. The AFF bond-financed private activity bond projects would still be subject to state volume caps. The President's program would also ease restrictions on certain private activity bonds: It would increase the national limit for highway and service freight transfer facility bonds to \$19 billion from \$15 billion and would eliminate the so-called Private Activity Bond volume cap for water infrastructure projects. The administration also would permit private ownership of tax-exempt private activity bond airports, docks, wharves and mass commuting facilities. In addition, it would increase to 35% from 25% the limit on the use of bond proceeds for land acquisition, to enable more private activity bond proceeds to be used for projects in areas with land costs.

The President's budget proposes \$4 billion in funds in 2014 for grants, loans and loans guarantees for the Transportation Infrastructure Finance and Innovation Act (TIFIA) and the Transportation Investment Generating Economic Recovery or TIGER program. The budget would eliminate the volume cap for private-activity bonds for water infrastructure (water and sewage facilities) beginning with the date of enactment of legislative authority. The budget proposes repeal of the government ownership requirement for certain types of so called "exempt facility" bonds (tax-exempt private activity bonds used for airports, docks, wharves and mass commuting facilities and other projects). The President's budget would repeal the \$150 million non-hospital bond limitation on all outstanding qualified 501(c)(3) bonds; however, the limitation continues to apply to bonds more than 5% of the net proceeds of which finance or refinance working capital expenditures or capital expenditures incurred on or before August 5, 1997. The budget proposes establishment of an independent National Infrastructure Bank to leverage private and public capital to support infrastructure projects of national and regional significance, and his budget proposes \$50 billion for up front infrastructure investments, including \$40 billion for so-called "Fix it First" projects to repair highways, bridges, transit systems and airports nationwide, as well as \$10 billion for competitive programs to encourage innovation in completing high-value infrastructure projects. As part of his budget, the President also proposed an effort to streamline or expedite infrastructure projects by modernizing the federal permitting process to cut through red tape and establishing a goal of cutting time lines in half for major infrastructure projects such as highways, railways, bridges, ports, waterways, pipelines, and renewable energy. Under the request, the infrastructure bank would be a government-owned entity that would be operated independently by non-partisan infrastructure and financial experts. Eligible projects would include transportation, water and energy infrastructure, which would have to be at least \$100 million in size, and be of national or regional significance. The loans would extend to 35 years allowing the bank to be a "patient" "partner" side by side with state, local and private investors. The administration also expects to propose revised tax provisions to attract foreign investors for U.S.

infrastructure projects. But the bank would not be allowed to finance more than 50% of the total cost of a project.

*Unsurprisingly, the President's budget did not include an analysis of the potential impact of the administration's tax and revenue proposals on state and local government. The issue is critical to states, because most state corporate and individual taxes are piggy-backed on the federal system, so that federal changes can have significant, unanticipated impacts on state revenues. Such impacts may be positive—or negative. For instance, the budget's proposals to broaden or eliminate federal corporate tax expenditures would broaden the federal corporate tax base, likely enhancing state corporate income tax revenues—or providing options to reduce state corporate tax rates and still realize comparable revenues. A change of key concern to many state and local leaders, however, is the budget proposal to limit or cap the value of individual income tax breaks to 28%, which would boost income taxes paid by those in the 33% and higher tax brackets—essentially raising taxes next year for couples with taxable income above about \$223,000 currently. That proposal, if adopted, would reduce or limit the incentive for higher income taxpayers to invest in tax-exempt bonds issued by states or local governments, as well as likely discourage charitable donations.*

**Congressional Reaction.** The President's budget and tax proposals—his attempt to carve a middle ground—gained no support in the House, where members called the President's budget dead on arrival, with members complaining at several Congressional hearings yesterday that it would raise tax revenues, increase spending, but do little to advance real tax reform. House Budget Committee Chairman Paul Ryan (R-Wisc.) called it a “status quo” budget: “It doesn't break any new ground; it just goes over old ground. It raises taxes by \$1.1 trillion. It increases spending by nearly \$1 trillion. And it adds \$8.2 trillion to our debt. In short, it takes more from families to spend more in Washington.” Similarly, House Ways and Means Committee Chairman Dave Camp (R-Mi.) at his hearing with new Treasury Secretary Jacob Lew yesterday noted: “America's tax code is broken and I'm committed to working with anyone — Republican or Democrat — to fix it. That's why I was encouraged that the President put forward a plan to tackle a few of the challenges facing our tax code...But the simple truth is that the President's proposal isn't the real reform we need.” Mr. Lew, who had a very long day, spent his afternoon in the Senate, where the reaction was more positive. Senate Finance Committee Ranking Member Orrin Hatch (R-Ut.) told Mr. Lew that the Administration's budget takes “baby steps” towards reforming entitlement programs: “While one may conclude that this is a step in the right direction, it is only a small step. In fact, in the grand scheme of things, it barely registers...Put simply, that means, despite many claims to the contrary, this budget contains no substantive changes to Social Security.” Senate Finance Committee Chairman Max Baucus (D-Mont.) responded positively to the President's tax reform proposals, noting his own commitment to comprehensive tax reform. Chairman Baucus stated he is looking for a “middle ground” such as the Administration had proposed to close loopholes and simplify the tax code: “Some of this revenue should be used to cut taxes for America's families and help our businesses create jobs, and some of the revenue raised in tax reform should also be used to reduce the deficit.” With regard to the entitlement reform proposals, Chairman Baucus said the President's budget calls for Medicare cuts well above the Senate passed budget and it puts a firewall around Social Security: “I'm disappointed by the President's proposal to change how cost of living adjustments are calculated for seniors and military retirees...Any reform of Social Security should be for the solvency of the program, not deficit reduction.”

**Next Steps.** We now have a House-passed and Senate passed budget resolution, and a budget proposed by the President. Senate Budget Committee Chairman Patty Murray (D-Wa.) and House Budget Committee Chairman Paul Ryan (R-Wi.) have indicated their commitment to go to conference to try and reach agreement on a joint resolution—which, if agreed to, would pave the way, potentially, for the adoption of reconciliation instructions, which would mandate the House and Senate tax-writing committees to act on tax legislation by a set deadline. The President's budget, by seeking a middle ground

between the House and Senate passed budget resolutions seeks to encourage such an agreement. Steve Bell, the Senior Director of the Economic Policy Project at the Bipartisan Policy Center and former Republican Staff Director of the Senate Budget Committee, noted: “President Obama’s decision to include a number of entitlement changes that could garner bipartisan support, including the ‘chained Consumer Price Index’ or CPI, in his FY14 budget submission could lead to serious debt stabilization and reduction legislation this year. While we wish the president had recommended more fundamental, structural reforms to federal health programs, the burden to build on the president’s budget falls on Congress.” With a federal election looming next year, the different parties are aware there is a unique chance this year to address the federal tax code and federal tax expenditures. This creates significant risks—and opportunities—for state and local leaders.



**Debt-ceiling.** The House Ways and Means Committee Wednesday held a hearing to consider legislation to prioritize U.S. obligations and the federal government’s ability to continue operations should the U.S. default if the Treasury reached its statutory debt limit and exhausted extraordinary measures—a happening, absent action by Congress, projected to fall in August. House Majority Leader Eric Cantor (R-Va.) told his GOP colleagues Friday that he expects the House to consider a debt prioritization bill, HR 807, sponsored by Rep. Tom McClintock (R-Ca.) “in the near future.” Rep. McClintock has also proposed a Constitutional amendment, H.J. Res. 9, prohibiting the United States government from increasing its debt except for a specific purpose by law adopted by three-fourths of the membership of each House of Congress. In announcing the hearing, Chairman Charles Boustany (R-La.) said, “The Congress created the debt limit as a check on the delegated borrowing power of the President. Given its jurisdiction, it is important that the Committee understand how the government could operate if the government reaches the statutory limit on the debt.” The debt ceiling, which in August of 2011 led to credit rating downgrades for hundreds of state and local governments, was increased after an agreement to set a ticking time bomb in place triggering the sequester unless Congress agreed to measures to achieve comparable deficit reduction. As readers know, Congress failed. The debt ceiling increase adopted was sufficient through part of last January. On February 4th, another fiscal cliff deadline, after Congress agreed to a temporary debt ceiling increase, the President signed it into law. That law created a temporary debt limit suspension to ensure the complete and timely payment of U.S. obligations through the middle of next month, May 18, 2013. After this date, the aggregate debt limit will be amended to reflect the total amount borrowed, which will likely trigger the Treasury to again utilize extraordinary measures, including the suspension of state and local securities, or SLGs. Absent action by the Congress and President, the U.S. is projected to default—or become bankrupt—in August. In addition to the obligations to states and local governments, to citizens, etc., foreign governments hold \$5.6 trillion of the \$16.8 trillion national debt; mainland China is the biggest creditor, holding \$1.3 trillion. Japan owns \$1.1 trillion in U.S. debt. While negotiations over Congressional delegation of the borrowing power have recurred over the course of the republic’s history, this hearing was to “question how the government might operate when the debt limit is reached and extraordinary measures have been exhausted.” In effect, the hearing was to contemplate what the federal government would do in the event of default and its inability to honor its full faith and credit. The Council of Inspector Generals on Financial Oversight has stated that “Treasury officials determined that there is no fair or sensible way to pick and choose among the many bills that come due every day. Furthermore, because Congress has never provided guidance to the contrary, Treasury’s systems are designed to make each payment in the order it comes due.” Bob Woodward, in his book the *Price of Politics*, which examined the “grand bargain” and debt limit discussions between President Obama and Congress, one option contemplated in August 2011, he wrote, was the prioritization of certain obligations, “[Secretary] Geithner was planning a press conference that... would outline the payments that would get priority if the U.S. government went into default.”<sup>[1]</sup> Bottom line, August promises to be hot, and, unsurprisingly, no state or local government adversely affected by the August 2011 debt ceiling action was invited to testify.

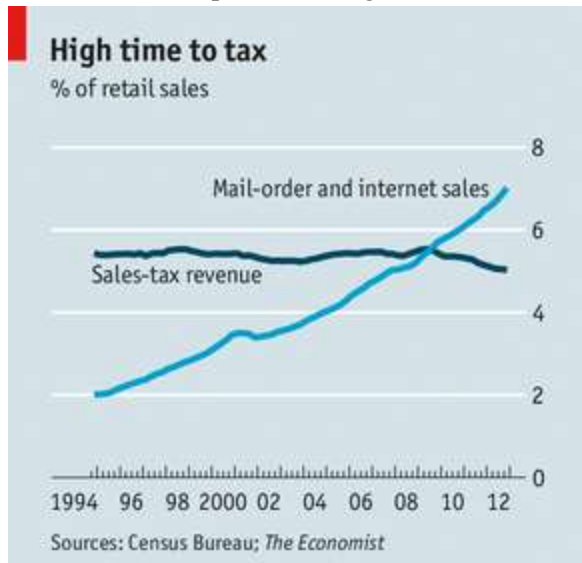
**Mortgages & Homeowners.** As early as next week, under a settlement agreement, about a dozen banks will start making about \$3.6 billion in payments to just over 4.2 million homeowners over shoddy foreclosure practices — payments ranging from \$300 to \$125,000 — from 11 mortgage servicers starting April 12 as part of a January [agreement](#) reached by the Office of the Comptroller of the Currency and the Federal Reserve Board. The agreement provides cash payments to borrowers whose homes were in any stage of the foreclosure process in 2009 or 2010 and whose mortgages were serviced by Aurora, Bank of America, Citibank, Goldman Sachs, HSBC, JPMorgan Chase, MetLife Bank, Morgan Stanley, PNC, Sovereign, SunTrust, U.S. Bank and Wells Fargo. Over 90% of the total payments to borrowers at 11 of those servicers are expected to have been sent by the end of the month. Borrowers who accept payments will still be able to take action related to their foreclosure. Servicers are not allowed to ask borrowers to waive any legal claims they may have against their servicer in connection with accepting payment.

**Have Gun, Will Debate.** Sens. Joe Manchin (D-W.Va.) and Pat Toomey (R-Pa.), backed by Sens. Charles Schumer (D-N.Y.) and Mark Kirk (R-Ill.) reached a bipartisan agreement this week to expand background checks for gun sales, and the Senate easily voted to proceed yesterday overcoming a threatened filibuster. Under the agreement, federal background checks—and paper records of the checks—for sales at gun shows and over the Internet would be required. The agreement would broaden background checks beyond what is required under current federal law: all buyers would have to undergo a background check conducted by a federally licensed dealer when purchasing firearms online or at a gun show. The lawmakers agreed to exempt gun sales or transfers between family members, friends and neighbors. Licensed dealers are already required to conduct background checks and keep a paper record of the sale. The bipartisan agreement considerably boosts the chances of the Senate passing an expansion of background checks. Sen. Manchin said the background-check agreement will be the first amendment offered to the main Senate gun bill. That measure includes provisions to improve school security and strengthen penalties for people buying guns for others who are not authorized to purchase them. It also includes an expansion of background checks that is broader than the Manchin-Toomey agreement. The Senate yesterday voted to let the Senate begin debate on the measure, which could go on through the end of April.

## State & Local Finance

**Taxing Retreat.** Governor Bobby Jindal of Louisiana this week withdrew his proposal to eliminate his state's corporate and individual income tax, partially to be offset with a higher sales and use tax and broadening of those taxes applications to some services. Gov. John Kasich of Ohio is pursuing a similar effort, although he has proposed a much more comprehensive expansion of the Ohio sales and use tax not just to all services—except those specifically exempted, but also to all digital products. Gov. Jindal's legislation would have ended the Bayou state's corporate and personal income taxes on Jan. 1 and offset the lost revenue with a more than 50% increase in the Louisiana sales and use tax rate to 6.25% from the current 4%. The Governor's plan faced strong opposition from business groups, political opponents, and religious leaders after Gov. Jindal outlined what he testified was a revenue-neutral \$3.6 billion plan before a joint session of the House Ways and Means Committee and the Senate Revenue and Fiscal Affairs Committee last month. That committee's chair, Rep. Joel Robideaux (R-Lafayette), said he supports an end to the income tax, but only if the lost revenues can be recouped elsewhere: "I agree that the repeal of the income tax is a good idea. I also agree it needs to be paid for." The Louisiana Association of Business and Industry opposed the plan over a proposed tax shift of \$500 million a year to businesses.

**State & Local Tax Erosion.** With the Senate non-binding budget amendment to overturn the so-called *Quill* Supreme Court decision and allow states to require out-of-state sellers to collect and remit taxes owed, the assumption in Virginia Governor Bob McDonnell’s landmark transportation law, and the



recently (herein) reported New York decision, the graph to the left (I like to think of this as the Geringer-Enzi graph) shows the strong erosion of state and local sales and use tax revenues as sales surge to the internet. Maybe, as Jonathan Lippman, Chief Judge of the State of New York and Chief Judge of the Court of Appeals, in his opinion on a 4-1 decision last month rejecting the constitutional challenges of both Amazon and Overstock to New York’s Internet tax law wrote: “The world has changed dramatically in the last two decades, and it may be that the physical presence test is outdated. An entity may now have a profound impact upon a foreign jurisdiction solely through its virtual projection via the Internet.” In his opinion, the judge wrote that the New York statute “plainly satisfies the substantial nexus requirement,” noting: ... “we believe

that a brigade of affiliated websites compensated by commission are the equivalent of a ‘deluge of catalogs’ and a ‘phalanx of drummers,’ (*Quill Corp. v. North Dakota* (504 US 298, at 308, 1992), especially given the fact that New York residents were compensated for referrals that resulted in purchases.”



**Pensionary Blues.** San Bernardino Mayor Pat Morris this week warned that his city has neither the means nor the support to make up for the payments it has missed to the California Public Employees’ Retirement System, or CalPERS. Even though the city plans to resume payments to the pension fund beginning July 1, the mayor warned it is unlikely the city will ever be able to catch up on missed payments: “There is no way in the world that we can make CalPERS whole...There is going to have to be a workout.” The city stopped making payments to CalPERS for its employees’ pensions after it filed for bankruptcy last August 1<sup>st</sup>. In addition, the city also has missed \$3.9 million in bond payments. The city has about \$90 million of outstanding pension obligation bond debts, according to budget documents, and another \$200 million owed to holders of securities issued by the city’s now-dissolved redevelopment agency. U.S. Bankruptcy Judge Meredith Jury postponed discussion on motions from CalPERS and several city employee unions for a relief of automatic stay to sue the city outside of bankruptcy court to a May 7 hearing. Judge Jury (you have to admit this is a great name!) also postponed further discussion of the city’s eligibility to be in bankruptcy; rather the hearing in the U.S. Bankruptcy court this week centered on discussion of the city’s efforts and ability to provide creditors with financial documents related to cash flow and the city’s liquidity problems. Mayor Morris, after the hearing, expressed confidence the city will be deemed eligible to be in bankruptcy: “We are broke...The judge said it in very clear and well-shaped words,” noting that agreeing to an adjustment plan in bankruptcy court is the only way the city can solve its financial problems.

**Sibling Rivalry?** Illinois Gov. Pat Quinn this week announced plans to launch a social impact bond (SIB) program, an alternative financing mechanism that taps private investment to fund social services goals. SIBs originated in Britain, but New York City, Fresno, Ca., and Massachusetts are in various stages of using the model, which enables a local government or state to leverage upfront funding from investors under a so-called “pay for success contract,” with the private capital directed to fund a targeted social program goal. Potential programs cover a spectrum of services and programs from reducing youth crime and recidivism to addressing homelessness, healthcare needs, and improving education. Repayment is

performance based with the rate of investor return dependent on meeting a targeted goal or the savings achieved. Gov. Quinn described the innovative effort as key at a time when Illinois faces historic financial challenges and is strained by massive unfunded pension obligation and billions in unpaid bills: “The social innovation model is a unique way to invest in our community priorities without dipping into the pockets of Illinois residents...Illinois is one of two states to pioneer this creative program that will tackle major social problems and strengthen our communities.” The Kennedy School’s Social Impact Bond Technical Assistance Lab with support from the Rockefeller Foundation will receive \$275,000 from the Dunham Fund to establish the initiative in Illinois. The issuance of a request for information to explore potential initiatives in targeted policy areas is the next step. Social impact bond programs are slowly gaining attention as governments look for new ways to attract private investment. New York City and Goldman, Sachs & Co. used a SIB model to establish the Adolescent Behavioral Learning Experience with the goal of reducing the likelihood of youth recidivism. The initiative is managed by MDRC, a non-profit in New York. What the city pays MDRC hinges on program success. If the program falls short of reducing re-incarceration by 10%, the city will pay nothing. Goldman would break even with a 10% goal.

**Pensionary Tidings.** The ability to manage pension costs, as well as all other cost pressures, is a factor in our analysis of management. We believe management of pension benefits and funding frameworks is particularly meaningful in our analysis when the government has some level of authority over both sides of the equation - determining benefits and paying for them, as is typically the case in [single employer] and [agent multi-employer] plans. Fitch recognizes that state constitutions and statutes in some cases preclude meaningful flexibility in altering benefits, but we continue to see a surprising number of plan changes even within those constraints. The level of rigor with which management attempts to increase plan affordability has varied greatly, and where this level is high, liabilities have often changed accordingly. Other governments have chosen to postpone difficult decisions. (See: [Local Government Pension Analysis](#) Fitch Ratings, April 2013.)



**Assessed Values Looking Good.** Rising housing prices have demonstrated a steady upswing into 2013, a positive sign for local governments facing ongoing budgetary pressures: the S&P Case Shiller 20-city composite index, which measures the value of U.S. residential real estate in 20 metropolitan areas, shows home values in January were up 8.1% from the year before - the greatest increase since the summer of 2006 when the housing market was at its peak. According to data published by the U.S. Bureau of Labor Statistics, state and local governments gained a net 7,000 jobs in March 2013. Most of the gains were recognized by states, which added 9,000 jobs compared to a loss of 2,000 local government jobs. Since peaking in August 2008, state and local governments have lost 718,000 jobs, or approximately 3.6% of their total. With the sustained increase in home prices, it appears that the future might be looking up. Every city in the index showed a year over year improvement in home pricing. Every city also saw month-over-month increases for January.

## Innovation

**Mapping the Brain.** The President, in his budget he submitted this week, proposed \$100 million in funding for a decade-long scientific effort to examine the workings of the human brain and to build a comprehensive map of its activity. The project will include federal agencies, private foundations, and teams of neuroscientists and nanoscientists (but, it appears, none of the wise readers of this column...) in a concerted effort to advance the knowledge of the brain’s billions of neurons and gain greater insights into perception, actions and, ultimately, consciousness. Scientists with the highest hopes for the project believe the effort is critical as a way to develop the technology essential to understanding diseases like [Alzheimer’s](#) and [Parkinson’s](#), as well as to find new therapies for a variety of mental illnesses. In addition, the proposal holds the potential of paving the way for advances in artificial intelligence. In his

State of the Union address, the President told Congress brain research is an example of how the government should “invest in the best ideas.” “Every dollar we invested to map the human genome returned \$140 to our economy — every dollar... Today our scientists are mapping the human brain to unlock the answers to Alzheimer’s. They’re developing drugs to regenerate damaged organs, devising new materials to make batteries 10 times more powerful. Now is not the time to gut these job-creating investments in science and innovation.”

**Demographically Musing** The United States, the third most populous country globally, accounts for about 4.5% of the world’s population. The U.S. population—currently estimated at 308.7 million persons—has more than doubled since its 1950 level of 152.3 million. More than just being double in size, the population has become qualitatively different from what it was in 1950~ the Congressional Research Service.

### *Quotes of the Week*

*“Under the surface of all but some recently restored segments, fissures are spreading, cracks are widening and the once-solid road bed that carries about a quarter-million cars a day is turning to mush ...With the older base layers under the asphalt, the surface is not able to absorb the pounding the way it used to referring to the Beltway around Washington, D.C.),...It is at that 50-year age point, which is too close to [the end of its life]. It’s a good example of the challenges we’re going to be facing not only in Maryland but other places in the country.” ~ Doug Simmons, Deputy Highway administrator in Maryland.*

#### **Stockton**

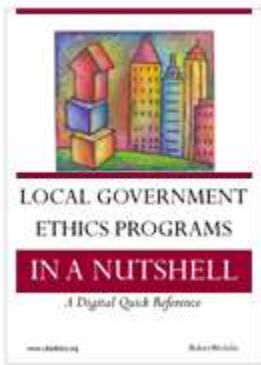
“First, it concluded the City was in a state of what it called “service delivery insolvency.” That means a Municipality’s ability to pay for all the costs of providing services at the level and quality that are required for the health, safety and welfare of the community.” ~ Judge Christopher Klein, U.S. Bankruptcy Judge in the transcript from April 1<sup>st</sup>, *City of Stockton*, U.S. Bankruptcy Court, #12-32118-C-9, Reporter’s Transcript.

#### **Federalism Writ Large**

“[W]hat chapter 9 brings to the table that is not in state law is the exclusive power of the Congress under the Constitution to make uniform laws concerning bankruptcy. And uniform laws concerning bankruptcy mean impairment of contracts. The contracts clause of the United States Constitution says that no state may make a law impairing the obligation of contracts. And that limitation does not apply to Congress. And, for the reasons I explained in that decision, the asymmetry is absolutely intentional on the part of the founders, the framers of the Constitution, because bankruptcy is nothing but the impairment of contracts. This does not mean that there’s not potentially a serious issue involving CalPERS. But at this point, I do not know what that is. I do not know whether spiked pensions can be reeled back in. There are very complex and difficult questions of law that I could see out there on the horizon, but no plan of adjustment can be confirmed unless -- no plan of adjustment can be confirmed over the rejection by a particular class unless that plan does not discriminate unfairly and is fair and equitable with respect to each class of claims that is impaired under or has not accepted a plan.” ~ Judge Christopher Klein, U.S. Bankruptcy Judge in the transcript from April 1<sup>st</sup>, *City of Stockton*, U.S. Bankruptcy Court, #12-32118-C-9, Reporter’s Transcript.

## Ethically Speaking & Public Trust

### Local Government Ethics



Robert Weschler, the Research Director at *City Ethics*, has produced a Handy Dandy Guide on local ethics (pictured at left side), or, in other words, a short introduction to local government ethics: what it is and what it is not, a summary of the basic concepts, and a description of the key elements of a local government ethics program. Having taught and overseen the production of several George Mason Guides on Ethics for Local leaders, I like this publication because it is a nice summary for local government leaders and employees, government attorneys, public administration students (and professors—hmmm...), journalists, ethics commission members, and ethics reformers. It is a good way to for citizens and taxpayers—and anyone that cares about public trust in government--to understand what local government ethics is all about.

### Little Legalities



### Bankruptcy, Constitutional, Preemption, Procedural & Other Key Decisions or Cases

**Federalism & Piggybacks.** The Minnesota Supreme court has ruled that because Minnesota does not piggyback on federal passive activity loss rules and because the state limits the amount of operating loss carryover that can be taken to the amount taken in the same year on the taxpayer's federal return, nonresident S-corporation shareholders were not entitled to take passive activity losses against Minnesota source income in excess of the operating losses claimed in the same year on their federal return. The court rejected the taxpayers' argument that the federal "passive activity deduction" was essentially incorporated into Minnesota law because the state uses federal adjusted gross income in the formula allocating income between Minnesota and non-Minnesota sources. And while the loss could be taken as an NOL carryover, state law required that the deduction of such carryovers on the state return in a given year not exceed the deduction taken on the taxpayer's federal return in that same year. So, if the taxpayer had taken a greater amount of federal NOL deduction in prior years than it could take to offset Minnesota source income, it would not be able to "roll-up" that "unused" loss into the current year for state purposes. *John Billion v. Commissioner of Revenue*, Supreme Court of Minnesota, A11-2337, 3/20/3013.

**Taxes & Exes.** A New Mexico hearing officer has held that the ex-wife of the owner of a sole proprietorship was not responsible for taxes assessed against the husband's business. The ex-wife had not participated in the business while the couple was married. The assessment was sent to the address for the business and the wife received it. She informed the taxation and revenue department how to contact her

ex-husband, but the department had apparently not attempted to pursue him. Under state law, a person is a taxpayer if they are responsible for withholding, payment or collection of any tax. The hearing officer found that the wife had not been responsible for the business or its taxes while married to her husband and the assessments issued against the business could not be deemed to have been issued to her. Nor did the hearing officer find that the wife was a person liable for the payment of the tax since she had not engaged in business, as required by statute. The taxation and revenue department argued that the business was nevertheless the community property of the couple and its liabilities must be treated as community liabilities. But the hearing officer noted that it was not clear on the record when the business was formed or if it was formed during the marriage and therefore no presumption of community property applied. The hearing officer also concluded that while the tax liabilities arose during the marriage, the marital settlement agreement designated these liabilities as belonging to the husband. *In the Matter of the Protest of Mariah Affentranger to Assessment Issued Against D & M Recovery*, New Mexico Taxation and Revenue Department Decision and Order, Docket/Court: 13-07 /11/2013.

**Constitutional notice is not retroactive to 1925 tax sale.** The Louisiana Supreme court has held that the U.S. Supreme Court's ruling in *Mennonite Board* (1983), holding that a tax sale without proper notice is null and void, cannot apply retroactively to a 1925 sale and that any defect in that sale would be cured by the five-year preemptive period of the state constitution. The court noted that the U.S. Supreme Court has never stated whether the requirements announced in *Mennonite* are to apply retroactively and there is a divergence of opinion among the few state courts which have considered the question. Generally, constitutional decisions of the Supreme Court are given retroactive application. But in recent years, the court has recognized limitations, especially in civil cases, due the need for finality. Currently, the great weight of case law holds a new rule of constitutional law is applied to future cases and those cases pending on direct review at the time the Court rendered its decision. And since a suit to annul a tax sale was preempted after five years under the state A contract is a simulation when, by mutual agreement, it does not express the true intent of the parties. A simulation is absolute when the parties intend the contract to produce no effects between them. A simulation is relative when the parties intend that their contract shall produce effects between them, though different from those recited in their contract. N. Stephan Kinsella, "Civil Law to Common Law Dictionary," Louisiana Law Review, 1994. "*Peremption*" is a rare legal term used mainly in civil law jurisdictions which refers to a form of prescription or a period of time over which a legal right runs. Dictionary of Modern Legal Usage, 2nd. constitution, there was no right existing at the time of *Mennonite* for the challenger of title here to pursue. One justice concurred in the decision, but noted that the term "fully retroactive" as used in supreme court precedent was misleading has not been used to suggest that res judicata or other procedural barriers such as statutes of limitations are nullified. There is, said the dissent, no amount of retroactivity, full or otherwise, that can revive an expired claim. *Quantum Resources Management, L.L.C. v. Pirate Lake Oil Corp.*, Supreme Court of Louisiana, 2012-C-1472, 3/19/2013.

**School district does not owe severance tax on oil and gas interests, but does owe administrative fees.**

In consolidated cases, the Mississippi Supreme court has ruled that a school district is not liable for oil and gas severance taxes on its oil and gas royalty interests since, as a political subdivision of the state, a school district is not a "person" subject to tax. For the same reason, the court found that the normal statute of limitations would not run against the school district, but that equitable doctrines such as waiver and/or estoppel might apply. In contrast, the court concluded that administrative expense taxes could be imposed upon school districts since such assessments are really fees and are expressly applicable to the state and its subdivisions. The royalty interests in this case predated Mississippi's statehood and, from their beginnings, were held in trust for the benefit of public schools. The state has actual title and has delegated general supervisory authority over to the Secretary of State, but management is handled by local county boards of education, which are, in effect, trustees. The court had previously held that severance taxes are levied upon the royalty interest owners (in a case where it ruled that the tax could not be imposed on interests held by the United States). The court had also previously held that, where a statute attempts to

impose liabilities upon the state or its political subdivisions, the statute is “inapplicable to them, unless they are included expressly or by necessary implication.” Because “person,” as used in the statutes here, did not include the state or its subdivisions, and because there was no reason that they should be included, the tax would therefore not apply. The court specifically rejected the argument that since “trusts” are persons, the interests here would be taxable, finding this construction strained. The court also rejected claims that the state constitution provides for payment of severance taxes on state held interests, concluding instead that its provisions neither subjected those interests to tax nor excluded them. The state constitution did, however, specifically provide that statutes of limitation in civil causes shall not run against the state or any subdivision. But the court remanded the case to determine if equitable doctrines would limit the period subject to refund under the circumstances. Unlike the severance taxes at issue, the court found that the school district was required to pay administrative expense taxes on its royalty interests because those assessments were fees, not taxes. They were used exclusively to pay the expenses and other costs in connection with the functioning of the State Oil and Gas Board and the administration of the oil and gas conservation laws. They also explicitly apply to the state and its political subdivisions. *Jones County School District v. Mississippi Department of Revenue*, Supreme Court of Mississippi, 2011-CA-00712-SCT, 3/7/2013.

**Tax increase violates “just and equitable” clause of state constitution.** In consolidated cases, proving the point that even broad discretion can be abused, the supreme court of North Carolina has ruled that a local tax increase amounting to between 60,000 - 100,000-plus-percent exceeds state constitutional limits. The tax was imposed on promotional cyber-sweepstakes. The prior tax for the companies running the sweepstakes was a flat \$12.50 per year. The new tax was \$5,000 per business location plus \$2,500 per computer terminal within each business location. In comparison, of the forty-four categories of privilege license taxes imposed, the second highest was \$500. The taxpayers claimed that the tax violated the Just and Equitable Tax Clause of the state constitution. That provision dictates that the “power of taxation shall be exercised in a just and equitable manner...” The court noted that while the provision has been recognized as limiting the power of lawmakers, it had never before been recognized to create a substantive claim. The local government argued that such a claim would not be justiciable, but the court disagreed. It distinguished cases involving common law challenges, where claims had been limited to obvious abuse of legislative discretion by levying “unreasonable and prohibitory” taxes. The court noted that the constitutional provision did not incorporate the common law standard. And even under that broader standard, the court had previously concluded that the taxing power could not be used to prohibit otherwise legal endeavors. So while this might be a difficult line to draw in nuanced cases, “the case at bar is hardly nuanced,” said the court. Here, the tax increase was “wholly detached from the moorings of anything reasonably resembling a just and equitable tax.” First, there was the percentage increase itself. Then there was the tax imposed on these businesses versus other businesses. In this case, there was no reason even to remand the case, the court concluded, since it could be decided as a matter of law on these facts alone. (Also noting that would likely seldom be the case.) *IMT, Inc. The Internet Business Center v. City of Lumberton*, Supreme Court of North Carolina, No. 127A12, 3/8/2013.

**Separate subject rule.** The Missouri Supreme court has upheld a lower court ruling that legislation violated the state constitution’s one-subject rule and must be struck in its entirety because it was explicitly contingent on other legislation that had not yet passed. The legislation as initially drafted related to science and innovation. It passed, but by its language, was made contingent upon enactment of a separate piece of legislation relating to taxation, which did not pass. The court noted that the single subject rule serves to “facilitate orderly procedure, avoid surprise, and prevent ‘logrolling.’” Conditioning one bill on another, said the court, clearly injects at least one additional subject. It created a situation where, the court concluded, the two bills could not reasonably be read separately. Upon reading the entire first bill, neither members the public nor the legislature could have been fully aware of the matters contained in the second bill. Therefore, putting the contingency in the title of the first bill was not sufficient serve the notice purpose. As for whether the legislation could be saved, in part, by severing, the court concluded that this

was not even a close case. There was no doubt that the legislation would not have passed without the contingent provision, in part, because it repeatedly failed to pass in prior years. Moreover, a contingency is part of the substance of the entirety of a piece of legislation in a way that a discrete provision might not be. One justice filed a separate concurring opinion, suggesting that the doctrine of severance be abolished so as not to encourage improper behavior in the legislature. Here, noted the concurrence, the governor had even signed the bill into law while acknowledging that it was explicitly contingent upon the passage of another bill. This case presented a “stellar opportunity” therefore, said the concurrence, to abolish severance and send a message that the court would not save a constitutionally defective law. *Missouri Roundtable For Life, Inc. v. Missouri*, Supreme Court of Missouri, SC92455, 3/19/2013.

**“Return” for bankruptcy discharge purposes includes certain late-filed returns.** In consolidated cases, a bankruptcy court has rejected arguments by the Massachusetts department of revenue that late-filed returns were not “returns” and thus not discharged under the code. The taxpayers here filed returns late, but at least two years before they filed for bankruptcy. Both taxpayers declared the tax liabilities as part of the bankruptcy proceedings. The court noted that the code previously did not clearly address this question at all, leading to a judicially applied test (the “*Beard* test”), under which a “return” must: 1) purport to be a return; 2) be executed under the penalty of perjury; 3) contain sufficient data to allow calculation of the tax; and 4) represent an honest and reasonable attempt to satisfy the requirements of the tax law. Under this test, a number of courts held that federal tax returns filed post-assessment were not “returns” since they had no legal effect. The code had been amended, however, to define “return” to mean “a return that satisfies the requirements of applicable non-bankruptcy law (including applicable filing requirements).” The code now further provides that the term includes a return prepared pursuant to IRC §6020(a) (that is, by the IRS on information provided by the taxpayer and signed by the taxpayer) or similar state law, or a written stipulation to a judgment or a final order, but does not include a return made pursuant to IRC §6020(b) (that is, by the IRS based on other information for a non-filer) or a similar State or local law. The state revenue department argued that a late-filed return is not a “return” because it does not satisfy state filing requirements. The court found, however, that this would render needless the provision of the code, arguably the most frequently resorted-to subsection that requires a return or notice be made or given at least two years before the bankruptcy petition is filed. (Although arguably, the provision would still be necessary for states that consider late-filed returns to be compliant with filing requirements.) More importantly, it would not be necessary for current law to distinguish late-filed IRS-prepared-*taxpayer*-filed returns (and their state analogs) from late-filed IRS-prepared-and-filed-returns (and their state analogs), if all late-filed returns were non-dischargeable. Nor was the court willing to agree that the changes in the law were as substantial as the department claimed, given the lack of legislative history. Instead, the test was still whether or not the returns served a tax purpose under Massachusetts law (that is, were made pre-assessment). *Brown et al. v. Dep’t of Revenue*, U.S. Bankruptcy Court, D. Mass., Nos. 11-4150; 11-4149, 3/11/2013.

**Unpreempted.** A New York administrative law judge has ruled that a sale of property by the IRS was not exempt from transfer tax as a “conveyance given in connection with a tax sale.” The exemption did not define what was meant by “tax sale.” But here, the ALJ found that the sale in question did not fit the normal understanding of that term. The sale was made by contract with the IRS for what the government already held in fee, as directed by judicial order in a case of criminal forfeiture. While the record did not contain documentation of the grounds for the forfeiture, the ALJ noted that the IRS had issued a Certificate of Discharge of Property from Federal Tax Lien prior to the sale, apparently making it unlikely that it was forfeited to satisfy that lien. *In the Matter of the Petition of 182-188 Columbus Avenue LLC*, New York Division of Tax Appeals, Administrative Law Judge Determination, 823746, 3/14/2013.

**Disability Denial.** The Rhode Island Supreme Court overturned the superior court and rejected that court’s decision in favor of the Rhode Island Employee Retirement System, which had denied the petitioner’s application for accidental disability benefits—a decision, which the superior court based its

decision on the basis that it “lacked jurisdiction.” Petitioner, a sergeant with the police department, applied for accidental disability benefits for post traumatic stress disorder and anxiety disorder. The Employees’ Retirement System of Rhode Island (retirement board) denied Petitioner’s application. The superior court affirmed the retirement board’s decision on the basis of his conclusion that the court lacked jurisdiction over the case because Petitioner failed to timely file her appeal and because the facts would not justify equitable tolling of the deadline for filing an appeal. The Supreme Court quashed the judgment of the superior court, noting: “...we have never indicated that strict construction in this context is an impenetrable bar to concepts of equity,” and remanded with directions that Petitioner’s appeal be considered as timely pursuant to the doctrine of equitable tolling, holding that, under the circumstances of this case, the trial court abused its discretion in declining to toll the deadline. *Rivera v. Employees’ Ret. Sys. of R.I.*, Rhode Island Supreme Court, No. 2011-166-M.P. April 8, 2013.

## **Property Tax Decisions**

### **Industrial Development Board agreements are sufficient to exempt development from property tax.**

The Louisiana appellate court has ruled that under applicable state law, ownership of the improvements on land developed for public housing passed to the local industrial development board (IDB) and were therefore exempt from property tax. The improvements were built on land owned by the local housing authority and leased to the developer under a 99-year lease. The developer brought the IDB into the deal. The IDB is authorized and empowered by law to issue taxable and tax-exempt revenue bonds for certain projects, making them exempt from tax. The developer conveyed ownership of the improvements to the IDB, which then immediately entered into a sub-leases with the developer, including an agreement by the developer to make payments in lieu of taxes (PILOTs). The assessor claimed that the contracts between the developer and the IDB constituted a “simulation” under Louisiana civil law. While the lower court found that the transactions here were “not your run of the mill transfer of property where one owner sells everything, land and improvements to another,” nevertheless, the court concluded it was a transaction pursuant to the IRB’s enabling legislation for a qualifying purpose. Recognition of the transfer was therefore consistent with the intent of that legislation. The appellate court agreed and concluded that the exemption should apply. *St. Bernard I, LLC v. Williams*, Court of Appeal of Louisiana Fourth Circuit, 2012-CA-0372, 3/13/2013.

**Mistaken assumption versus hypothetical condition.** The Connecticut Supreme court has ruled that imputing interest on entrance fees paid to a continuing care retirement community (even though no interest was earned on those amounts) was a permissible fiction for valuing the property. Because uniform standards of appraisal practice permit the use of hypothetical conditions when necessary, the use here did not result in a per se finding of excessive valuation. The expert hired to by town to appraise the property in this case noted in his testimony that he treated the entrance fees as money lent to the operators of the facility to obtain, in essence, a life estate—that is—the interest to be valued. This assumption did not constitute an illegal assessment method simply because no Connecticut court had officially blessed it. While the owner might disagree that the hypothetical condition was necessary to reach the valuation of its property, said the court, it still had the burden to demonstrate that reliance on the hypothetical condition was illegal. So a showing that the entrance fees did not actually earn interest would not suffice, since this hypothetical condition was not an arbitrary falsification of the facts on which the appraisal was based. Neither did it mean that the valuation determined could not be the true and actual value as required by law. Three justices dissented. The dissent read the record below as establishing that the appraiser for the town simply made an incorrect assumption (that Connecticut law required entrance fees be escrowed, and therefore would earn interest), which the owner endeavored to correct but which the appraiser resisted after the mistake was pointed out. *Redding Life Care, LLC v. Town of Redding*, Supreme Court of Connecticut, SC 18921, 3/12/2013.

**Planning to use vacant land and preserving it in the mean time is insufficient for charitable use.** The Massachusetts appellate tax board has denied a charitable use exemption to the owners of vacant property

because they failed to use the property at all. The property was held by a non-profit, tax exempt organization run by a husband and wife. They claimed that the property was going to be used for the purpose of preserving habitats and providing shelter and other services to dogs and other domestic and wild animals. The couple took care of some animals in kennels near their residence, but were not able to show that they had taken any steps to prepare the vacant property for the purpose of housing domestic animals—no written plans, applications for permits, blueprints, estimates or quotes from builders or contractors, or other documentary evidence. In short, there was virtually no evidence that activities aiding the health or welfare of either animals or people took place on the property. (Except for a single picture of a “bat house” on the property, that is.) The owners also contended that by taking steps to preserve the land as a shelter for wildlife, it advanced the organization’s charitable mission. Preservation, however, has not been found to be a sufficient “occupation” of property within the meaning of the Massachusetts exemption statute. *Give Them Sanctuary, Inc. v. Board of Assessors of the Town of Monson*, Massachusetts Appellate Tax Board, F310589; F310590, 3/11/2013.

**Low-income housing property exempt despite being held in ownership structure by for-profit (taxable) interests.** The North Carolina appeals court has ruled that a low-income housing property was entitled to a charitable use exemption, despite being held in an LLC having a 99.9% for-profit ownership. The organization that ran the property was the beneficiary of a federal tax credits. Because this would have jeopardized its ability to administer HUD rent subsidies for tenants, however, it created a separate entity to collect tax credits for the developments. That entity was a tax-exempt non-profit corporation. To leverage the benefits of the tax credits, that tax-exempt entity then partnered with for-profit investors who helped finance the developments in exchange for the credits. This was accomplished through an LLC in which the tax-exempt entity was a .1% managing member, and the for-profit investors were 99.9% interest holders. The LLC held title to the developments but the tax-exempt member had a first right of refusal to purchase the property after 15 years. The assessor denied tax-exempt status to the property here arguing that it was not owned by a qualifying entity. State statutes provide an exemption to “a nonprofit organization providing housing for individuals or families with low or moderate incomes [if used for the purpose] and *the owner* is not organized or operated for profit.” The court noted that the statute does not define “ownership” and that it had previously held that “legal title is not determinative as to the question of ownership.” However, the court admitted, existing case law did not provide a readily-applicable standard for defining “ownership” in the absence of legal title. Therefore, the court decided to establish a test for determining ownership for purposes of tax exemption when an otherwise-qualifying entity has an ownership interest in less than 100%. The test balanced four factors—the entity's control of the venture's operations; the entity's status as trustee of LLC property; the possibility of an increased actual ownership interest in the future; and the intent of the participating parties. Here the court found important that the tax-exempt entity managed the affairs of the LLC and was the sole manager in charge of making operational decisions. Also, as manager, the exempt entity would have to account to the LLC and hold as trustee for it any profit or benefit derived. Because the entity had a right of first refusal to purchase the 99.9% ownership interest at the end of the set term, and had exercised that right in other similar circumstances, it was likely the entity would become sole owner. Finally, it was clear the parties intended that the property be run in such a way as to qualify for and receive federal low-income tax credits. The assessor argued that the holder of a 99.9% ownership interest in an LLC, which in turn owns property, would generally be treated as the owner of the property, despite these factors. But the court found that the 99.9% member in this case did not seek a typical goal of ownership, that is, profit-sharing. In fact, the for-profit member wanted merely to utilize tax credits and serve the charitable purpose of providing low-income housing. *In the Matter of Appeal of Blue Ridge Housing of Bakersville LLC*, Court of Appeals of North Carolina, COA12-941, 3/19/2013.

**Religious use exemption limited when property is used for retail/commercial purposes.** The Tennessee court of appeals has ruled that church property used to provide a bookstore, café and fitness center is not entitled to a full property tax exemption for religious use. State statutes provide that “no

property shall be totally exempted, nor shall any portion thereof be pro rata exempted, unless such property or portion thereof is actually used purely and exclusively for religious, charitable, scientific or educational purposes.” The board of review therefore determined that the bookstore and café were not exempt and that the fitness center was entitled to a fifty percent exemption (since it was also used for a commercial, public use in addition to church-oriented uses). The church characterized the bookstore, café and fitness center areas as “third spaces” that benefitted both church members and non-members who might feel uncomfortable or “threatened” in a traditional church environment. The church’s pastor urged that third spaces have “become a huge need for many urban dwellers for whom family and community are now distant abstractions” and that they “exist to meet a primal spiritual need: human connection with our fellow believers in the midst of an increasingly impersonal urban space.” He argued that third space facilities were the “natural outgrowths of our ancient faith” that have been “retooled...for postmodern urban culture.” The board and the trial court, however, determined that these spaces were operated primarily as retail or commercial facilities and were not directly incidental to, or an integral part of, the recognized purposes of a church. The appeals court agreed, concluding that while incidental and other limited uses of church property would not limit the exemption, property owned and used by a church is not automatically exempt from taxation merely because the use may be characterized as promoting the institution's purpose in some way. That was particularly true, said the court, where the use is a revenue-generating one. The bookstore and café were simply retail establishments housed within the walls of the church, complete with paid staff, inventory control, retail pricing, and a wide array of merchandise for sale to the general public. Similarly, the fee-based membership fitness center, complete with paid professional classes under a fee splitting arrangement with instructors, was operated, in large part, as a commercial entity. It was necessary to limit tax exemptions in these cases, the court pointed out, to achieve the recognized public purpose of avoiding unfair competition between taxable and tax-exempt enterprises. The court also rejected claims that failure to grant the exemption would create unconstitutionally entanglement of the state in church matters, violating the Establishment Clause. Limiting the exemption was not tantamount to regulating religious beliefs or doctrine or essential religious conduct, the court concluded. The argument that courts must accept a religious organization’s characterization of the use of its property as religious or run afoul of the Establishment Clause was untenable. While the court accepted the premise that providing “third spaces” is part of the church’s outreach ministry, it simply could not be said that the operation of retail and commercial enterprises was reasonably necessary to accomplish that mission. The court also rejected the argument that limiting tax exemption would violate the Free Exercise Clause. The court noted that this clause does not prevent governments from enacting facially neutral and uniformly applicable laws that have the incidental effect of burdening a religious practice. The rule applied here neither burdened religious practice nor discriminated against any religious doctrine or belief. Similarly, the court held that limitation of the exemption did not violate Tennessee’s Religious Freedom Restoration Act. It was clear that the state’s compelling interest in ensuring a fair distribution of the tax burden was sufficient to overcome any incidental burden on religious practice. Finally, the court also rejected arguments by the church that it violated equal protection to deny exemption for the facilities at issue here when exemption might be granted to similar property used by other charitable institutions (i.e. universities). The court noted that equal protection does not require that things which are different in fact be treated the same under law. For example, the use of a wellness center by a hospital might further the hospital’s charitable purpose in a way that would not further a religious purpose. *Christ Church Pentecostal v. Tennessee State Board of Equalization*, Court of Appeals of Tennessee Nashville, M2012-00625-COA-R3-CV, 3/21/2013.

### Sales, eSales, and Use Tax Decisions

**Bottoms Up!** The Alabama court of appeals has rejected claims by a purveyor of alcoholic beverages that a tax on “the gross receipts...from...all...alcoholic beverages and drinks containing alcohol...sold,” did not apply to the gross receipts attributed to the non-alcoholic components of mixed drinks. The taxpayer asserted that its internal policy and procedure dictated that each mixed drink contain 1.25 ounces of

alcohol, and, it maintained, the taxes were due only on the alcohol portion of the mixed drinks. The taxpayer also argued that the tax violated due process and equal protection, because, as an upscale establishment, the taxpayer was required to charge higher prices, and, consequently, to pay more taxes. The court disagreed. It determined that the plain meaning of “alcoholic beverage” (and “drinks containing alcohol”) is a beverage containing alcohol and that no business has a right to pay the same dollar amount of tax where it chooses to charge more than its competitors. *Cocina Superior, LLC v. Jefferson County Department of Revenue*, Court of Civil Appeals of Alabama, 2110807, 3/15/2013.

**Plush-toy prizes.** The Texas Supreme court has ruled that purchases of “plush toy” prizes used to stock coin-operated amusement machines were exempt as purchases for resale. The sale-for-resale provision in state law includes items resold as an integral part of a service, provided the service is one of the listed “taxable” services referenced by the provision. Amusement services are listed “taxable” services. It was not relevant, the court therefore concluded, that a separate provision exempted amusement services sold through coin-operated vending machines. The court here determined the only requirement was that the toys be transferred “as an integral part” of the listed service, and found the toys were more than just integral—they were indispensable. The court also rejected the argument that the toys were not being resold, because they were not conveyed each and every time a customer played the game. The court wrote the economic reality of the game is such that customers simply would not part with their money but for the possibility of winning a toy: to require that, in the language of the statute the court wrote, “The purchaser” always receive a toy, put too much weight on “the commonest article of speech.” The fact that some players would not win a toy was also not enough to support the claim that the toys were consumed by the operator of the games, since all the toys were eventually given away. *Combs v. Roark Amusement & Vending, L.P.*, Supreme Court of Texas, 11-0261, 3/8/2013.

## GRANTS

### **Corporation for National and Community Service**

94.023 VISTA Logistical Support of Training

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lwl!1177068566?oppld=228885&mode=VIEW> Eligibility: State and local governments, Institutions of Higher Education (IHEs); Due date: 4/30/13

### **Department of Health and Human Services**

93.172 Genomic Medicine Pilot Demonstration Projects (U01)

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lwl!1177068566?oppld=228753&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 7/17/13

93.941 Improving HIV Prevention and Treatment Outcomes Among HIV-Infected Persons by Integrating Community Pharmacists and Clinical Sites into a Model of Patient-centered HIV Care

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lwl!1177068566?oppld=228813&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/15/13

93.103 Bioequivalence of Generic Bupropion (U01)

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lwl!1177068566?oppld=228859&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/31/13

93.121 NIDCR Small Research Grants for Secondary Analysis of FaceBase Data (R03)

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lwl!1177068566?oppld=228893&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 9/7/16

93.103 Collection of Dose Adjustment and Therapeutic Monitoring Data to Aid Narrow Therapeutic Index Drug Classification (U01)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=228882&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/17/13

93.103 Development of Bio-relevant In-vitro Assay to Determine Labile Iron in the Parenteral Iron Complex Product (U01)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=228878&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/24/13

93.103 Food Protection Task Force Improvement Project  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=228876&mode=VIEW>; Eligibility: State and local governments; Due date: 7/1/13

93.310 Undiagnosed Diseases Gene Function Research (R21)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=228915&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 6/14/13

93.226 AHRQ Patient-Centered Outcomes Research (PCOR) Mentored Research Scientist Development Award (K01)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229075&mode=VIEW>; Eligibility: Local governments, IHEs; Due date: 7/12/16

93.103 Evaluation of Dissolution Methods for Complex Parenteral Dosage Forms (U01)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229074&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/24/13

93.153 Ryan White HIV/AIDS Program Part D Grants for Coordinated HIV Services and Access to Research for Women, Infants, Children, and Youth (WICY) Limited Competitive Service Areas (Georgia, Louisiana, and Western Pennsylvania)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229077&mode=VIEW>; Eligibility: State and local governments; Due date: 5/3/13

93.226 AHRQ Patient-Centered Outcomes Research (PCOR) Mentored Clinical Investigator Award (K08)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229076&mode=VIEW>; Eligibility: Local governments, IHEs; Due date: 7/12/16

93.224 Service Area Competition - Additional Area (SAC-AA) – Tyler, Texas; Roxbury, Massachusetts; and Bristol, Florida  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229100&mode=VIEW>; Eligibility: State and local governments; Due date: 5/1/13

93.855, 93.856 Indo-U.S. Vaccine Action Program (VAP) Small Research Grant Program (R03)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229055&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/7/16

93.217 FY13 Announcement of Anticipated Availability of Funds for Family Planning Services Grants (Republic of Palau)  
<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229113&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/3/13

93.067 Technical Assistance in Support of HIV Prevention, Care and Treatment Services in the Republic of Cote d'Ivoire under the President's Emergency Plan for HIV/AIDS Relief (PEPFAR)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=222354&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 4/22/13

93.393, 93.396 The Role of Microbial Metabolites in Cancer Prevention and Etiology (U01)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229273&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 11/14/14

93.110 State Systems Development Initiative Grant Program

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229277&mode=VIEW>; Eligibility: State governments; Due date: 5/6/13

93.095 Assistant Secretary for Preparedness and Response Grants to Support Scientific Research Related to Recovery from Hurricane Sandy

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229214&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/20/13

93.072 2013 Lifespan Respite Care Program: Building Integrated and Sustainable Lifespan Respite Care Programs

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229294&mode=VIEW>; Eligibility: IHEs; Due date: 5/20/13; Matching requirement

93.847 Addressing Health Disparities in NIDDK Diseases (R01)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229473&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/7/16

93.394, 93.395, 93.396 Academic-Industrial Partnerships for Translation of in vivo Imaging Systems for Cancer Investigations (R01)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229373&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/7/16

93.121 FaceBase 2: Craniofacial Development and Dymorphology Data Management and Integration Hub (U01)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229394&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 8/22/13

93.262 Occupational Safety and Health Research (R01)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229513&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 6/5/13

93.121 FaceBase 2: Craniofacial Development and Dymorphology Dataset, Tool, and Resource Development (U01)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229393&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 8/22/13

93.918 HIV Early Intervention Services (EIS) Program Limited Competitive Service Areas (Brooklyn, NY, and Boston, MA)

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229096&mode=VIEW>; Eligibility: State and local governments; Due date: 5/3/13

#### **Department of Homeland Security**

97.091 Homeland Security BioWatch Program

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229013&mode=VIEW>; Eligibility: State and local governments; Due date: N/A

#### **Department of the Interior**

15.669 USFWS/NPLCC Funding Announcement #1

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfK2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNL>

[X4R!1177068566?oppld=229333&mode=VIEW](http://www.grants.gov/search/search.do;jsessionid=DlwBRjfk2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229333&mode=VIEW); Eligibility: State and local governments, IHEs; Due date: 5/9/13

15.669 USFWS / NPLCC Funding Announcement #2

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfk2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229334&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/6/13

16.588 OVW FY 2013 STOP Violence Against Women Formula Grant Program

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfk2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229098&mode=VIEW>; Eligibility: State governments; Due date: 5/1/13; Matching requirement

16.526 OVW FY 2013 Technical Assistance Program

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfk2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229099&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/14/13

#### **Department of Labor**

17.270 Face Forward Serving Juvenile Offenders Grants

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=228734&mode=VIEW>; Eligibility: State and local governments; Due date: 5/10/13

17.805 Urban and Non-Urban Homeless Veterans, Reintegration Program (HVRP) for Program Year (PY) 2013, July 1, 2013 through June 30, 2014

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=229053&mode=VIEW>; Eligibility: State and local governments; Due date: 5/3/13

#### **Department of Veterans Affairs**

64.034 U.S. Paralympics Integrated Adaptive Sports Program

<http://www.grants.gov/search/search.do;jsessionid=DlwBRjfk2QGNzNvRwvMn288vbW2pKvx192HkBRvnppSGblnNLX4R!1177068566?oppld=229454&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 7/31/13

#### **Social Security Administration**

96.007 Retirement Research Consortium

<http://www.grants.gov/search/search.do;jsessionid=GDTRRvvp6hzPGsr381VKpQ6fgf0znpzJMHbwyfw9Jvrr1nnQ5lw!1177068566?oppld=228693&mode=VIEW>; Eligibility: State and local governments, IHEs; Due date: 5/31/13  
Matching requirement