

How "Rational" is Rational? Taxation, Fairness and Equal Protection

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The U.S. Supreme Court has agreed to hear the appeal in a case featured in the prior issue of this magazine, *Armour v. Indianapolis*, 946 N.E.2d 553 (Ind. 2011), *cert. granted*, 2011 U.S. LEXIS 8180 (U.S. Nov. 14, 2011) (No. 11-161), the grant being somewhat overshadowed by the announcement that the Justices will review three of the challenges to the federal Affordable Care Act this Term, as well.

The issue in *Armour* is whether the Equal Protection Clause precludes a local taxing authority from refusing to refund payments made by those who had paid special assessments in full as a lump sum, while forgiving the obligations of taxpayers, also assessed for the same improvement, who opted to pay using an installment plan. The case arose when the City of Indianapolis switched from one method of funding public improvements by levying special assessments ("Barrett Law"), to another. Special assessments were levied against the benefitting landowners, with the taxpayer being given the choice of paying the entire assessment up front, or paying in monthly installments, with interest, over a ten-, twenty-, or thirty-year period. With regard to the parcels assessed in *Armour*, 142 owners elected, in July 2004, to pay the sewer assessment in installments, and 31 paid the lump sum ($9,278). Less than a year later, the City decided to switch to a "STEP" method of financing, based on a hook-up fee and bonds. Barrett Law funding, the City felt, imposed financial hardships on middle- and low-income property owners who were often most in need of sanitary sewers due to failing septic systems. As part of the transition, the City passed a resolution to forgive all outstanding assessment balances on the 40-plus Barrett Law projects owing as of November 1, 2005.

The plaintiffs, who had paid their Barrett Law assessments in full, petitioned the City for a refund in an amount equal to the assessments discharged for those property owners who had paid the most under an installment plan. When this was denied, they sued pursuant to 42 U.S.C. § 1983, alleging that the City had violated their constitutional right to equal protection under the Fourteenth Amendment. The general rule is that a law attacked on equal protection grounds will be upheld if it survives rational basis review, unless the classification is drawn along suspect lines or infringes the exercise of fundamental constitutional rights, in which case it must survive heightened judicial scrutiny. The plaintiffs were successful in the lower courts, but, on appeal to the Indiana Supreme Court, that court held in favor of the City.

The court determined, at the onset, that the City's resolution did not involve a suspect classification or exercise of fundamental constitutional rights, so the rational-basis standard was applied (i.e., the law had to be rationally related to a legitimate government interest). This was the "most deferential standard of review," with the court declining to invalidate a law or policy simply because it might be seen as unwise, unfair, or because "more reasonable" or "more effective" policy choices could have been made. The Equal Protection Clause did not require substantive equality among taxpayers if there was a rational basis for differing treatment; here, the resolution satisfied rational basis review because "[p]roviding relief or support for citizens facing financial hardship [was] clearly a legitimate interest," and "it was reasonable for the City to believe that property owners who had already paid their assessments were in better financial positions than those who chose installment plans." (The court expressly rejected the plaintiffs' argument that the City was required to submit evidence that those whose debts were discharged *were* actually middle- or low-income property owners.) Moreover, the City could have "reasonably believed that the benefits of simplifying sanitary sewer funding outweighed the effort of continuing a collection system for thousands of taxpayers." The fact that it chose to draw the line at November 1, 2005, was "a matter of discretion appropriately exercised by the City." In addition, the decision not to issue refunds to those who had already paid implicated another legitimate government interest—the "preservation of limited resources."

The U.S. Supreme Court has addressed property tax assessments, equal protection, and discrimination in previous decisions: *Allegheny Pittsburgh Coal Co. v. Webster County Comm'n*, 488 U.S. 336 (1989), and *Nordlinger v. Hahn*, 505 U.S. 1 (1992). In *Allegheny Pittsburgh*, the state constitution required that taxation be uniform throughout the state, and that all real and personal property be taxed in proportion to its value. For a ten-year period, however, a county assessor assessed (and taxed) the property of the plaintiff companies at rates that were between eight to 35 times the rates that were applied to neighboring comparable properties. Chief Justice Rehnquist, writing for a unanimous Court, held that the assessments violated the Equal Protection Clause. The Clause "tolerates occasional errors of state law or mistakes in judgment when valuing property for tax purposes," but "the constitutional requirement is the seasonable attainment of a rough equality in tax

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26. *Id.*
27. *See e.g.,* TEX. GOV'T CODE § 552.352(b), (c); Miss. Code § 43-15-21.
28. *See e.g.,* 20 U.S.C § 1232g; 45 C.F.R. § 164 (2010); MODEL CODE OF PROF'L CONDUCT R. 1.6 (2003).
29. *See* TEX. GOV'T CODE § 551.143.
30. *See* Op. Tex. Att'y Gen. No. DM-95 (1992).
31. *See* Op. Tex. Att'y Gen. No. JC-307 (2000).
32. Wood v. Battle Ground Sch. Dist., 27 P.3d 1208 (Wash. Ct. App. 2001).
33. Texas Workforce Commission, *Texas Business Today*, "Employee Social Networking: It's Time to Address the Issue," 4-6 (Spring 2009).
34. *See* City of Seattle, *City of Seattle Blogging Policy*, http://www.seattle.gov/pan/BloggingPolicy.htm (last visited Oct. 24, 2011).
35. *See* Doe v. Cahill, 884 A.2d 451 (Del. 2005). ML

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treatment of similarly situated property owners." Further, the "fairness of one's allocable share of the total property tax burden can only be meaningfully evaluated by comparison with the share of others similarly situated relative to their property holdings."

Nordlinger v. Hahn, 505 U.S. 1 (1992), involved a California constitutional amendment that imposed limits on the rate at which real property was taxed, on the rate at which assessments were increased annually, and which reassessed property up to its current appraised value upon new construction or a change in ownership. Stephanie Nordlinger discovered that she was paying about five times more in taxes than her neighbors, who owned comparable homes within the same residential district. She sued, claiming the assessment system treated newer owners less favorably, in violation of equal protection. (Longer-term owners paid lower taxes reflecting historic property values, while newer owners paid higher taxes reflecting more recent values.) The Supreme Court ruled the acquisition-value assessment scheme did not violate the Equal Protection Clause. As in *Armour*, the case revolved around the "rationally related" test. Significantly, the scheme did not discriminate between old and new owners with respect to either the tax rate or the annual rate of adjustment in assessments. The only distinction—the basis on which their property was initially assessed—satisfied rational review as it furthered a legitimate state interest in local neighborhood preservation, continuity, and stability by discouraging a rapid turnover in ownership of homes and businesses. In addition, "a new owner at the time of acquiring his property does not have the same reliance interest warranting protection against higher taxes as does an existing owner." The Court distinguished *Allegheny Pittsburgh* as "not controlling," as it was "the rare case where the facts precluded any plausible inference that the reason for the unequal assessment practice was to achieve the benefits" of the state-established tax scheme.

IMLA will be following this case; a decision is expected by June 2012. ML

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Decisions by the Divisional Court under the MCIA are relatively few and far between. For this additional reason, the majority decision, while it stands, should be regarded as a major warning light to councillors who might even think about entering into a financial transaction with their municipality. In the words of the majority judgment:

> "The question that must be asked and answered is 'does the matter to be voted upon *have a potential* to affect the pecuniary interest of the municipal councillor?'"... As soon as Robert Tuchenhagen saw himself as a potential buyer, he had become a person with a pecuniary interest. The e-mail he sent on July 2, 2008 indicated that he might be interested in bidding on the property. At that point, he was no longer looking at this only from the perspective of a member of Council with the public responsibilities that entails. From the moment he decided he might make a bid, he began examining the situation to see how it could advantage his private interests. He had acquired a pecuniary interest...
>
> Robert Tuchenhagen had been a member of the City Council for almost twelve years. He should have been aware of the need to avoid placing himself in a position of conflict. It is difficult to understand how, when, on July 2, 2008, he advised the Realty Department that he might be interested in making a bid, he would not see that he was demonstrating a personal pecuniary interest that would conflict with that of the municipality and the electors he served.

With respect to the defence of inadvertence, the court held as follows:

> This [his active role at Council prior to acquiring a pecuniary interest] was only exacerbated when, on July 21, 2008, he arranged to view the property as part of his consideration as to whether to make a bid and then, at the meeting of the Committee of the Whole that evening, failed to declare an interest. This is not inadvertence; it is fairly characterized as being willfully blind or reckless.

As to the significance of the decision, and the danger signals raised, in the words of the dissenting judgment:

> ...this extraordinarily broad interpretation of what constitutes an indirect pecuniary interest (the conclusion of the majority of the Divisional Court) appears to be without precedent and takes the conflict provisions to new heights. This extremely broad, novel interpretation of the scope of the MCIA, which is a penal statute, should also be a factor in determining whether the saving provisions [inadvertence or error in judgment – MCIA, s. 10(2)] should apply.

Be forewarned!