LAW OFFICES

CROSBY GUENZEL LLP

FEDERAL TRUST BUILDING
134 SOUTH 13TH STREET, SUITE 400
LINCOLN, NEBRASKA 68508
TELEPHONE: (402) 434-7300
FACSIMILE: (402) 434-7303

WRITER'S E-MAIL: SGS@CROSBYLAWFIRM.COM
WRITER'S DIRECT DIAL NO. (402) 434-7324

THEODORE L. KESSNER
WILLIAM D. KUESTER
STEVEN G. SEGLIN
ROCKY C. WEBER
DAVID A. JARECKE
WILLIAM R. KUTILEK
RICHARD L. RICE
THOMAS E. JEFFERS

ROBERT C. GUENZEL (RETIRED)

ROBERT B. CROSBY (1911-2000)
THOMAS R. PANSING (1917-1973)
DONN E. DAVIS (1929-1998)

September 5, 2003

Jay Holmquist, General Manager
Nebraska Rural Electric Association
800 South 13th Street
P.O. Box 82048
Lincoln, NE 68501

Re: Gross Revenue Payments to Counties

Dear Jay:

QUESTION PRESENTED

It is my understanding that public power districts ("PPDs or PPD") recover the cost of the gross revenue payments made to counties by charging its customers either through the rate base or a line item charge on a customer's bill (the "Customer Charges"). The payments to a county are required to be made pursuant to *Neb. Rev. Stat.* § 70-651.03 and are based on 5 % of the gross revenues derived from the retail sales of electricity within incorporated cities or villages.

Some cities and villages are questioning whether it is lawful for PPDs to impose the Customer Charges. Some are claiming that the Customer Charges are an illegal tax or that they are exempt from paying it because they are recipients of federal funding from Housing and Urban Development ("HUD"). This memorandum will address these questions.

BRIEF ANSWER

It is not unlawful for PPDs to impose the Customer Charges. The Customer Charges are not a tax. We can find no provision in federal law that exempts recipients of HUD funding from paying the Customer Charges.

DISCUSSION

I. GENESIS OF THE GROSS REVENUE PAYMENT.

The origin of the gross revenue payment as well as the in lieu of property tax payment is found in Article VIII, § 11 of the Nebraska Constitution, which provides:

> Every public corporation and political subdivision organized primarily to provide electricity or irrigation and electricity shall annually make the same payments in lieu of taxes as it made in 1957, which payments shall be allocated in the same proportion to the same public bodies or their successors as they were in 1957.
>
> The legislature may require each such public corporation to pay to the treasurer of any county in which may be located any incorporated city or village, within the limits of which such public corporation sells electricity at retail, a sum equivalent to five (5) per cent of the annual gross revenue of such public corporation derived from retail sales of electricity within such city or village, less an amount equivalent to the 1957 payments in lieu of taxes made by such public corporation with respect to property or operations in any such city or village. The payments in lieu of tax as made in 1957, together with any payments made as authorized in this section shall be in lieu of all other taxes, payments in lieu of taxes, franchise payments, occupation and excise taxes, but shall not be in lieu of motor vehicle licenses and wheel taxes, permit fees, gasoline tax and other such excise taxes or general sales taxes levied against the public generally.
>
> So much of such five (5) per cent as is in excess of an amount equivalent to the amount paid by such public corporation in lieu of taxes in 1957 shall be distributed in each year to the city or village, the school districts located in such city or village, the county in which such city or village is located, and the State of Nebraska, in the proportion that their respective property tax mill levies in each such year bear to the total of such mill levies.

This Constitutional provision imposes two main requirements on a PPD. First, PPDs are required to make "the same annual payments in lieu of taxes as it made in 1957." Second, PPDs are required to pay the county treasurer of any county containing a city or village to which a PPD sells at retail, "a sum equivalent to 5% of the annual gross revenue derived from retail sales of electricity within such city or village" less an amount [if any] equivalent to the 1957 in lieu of tax payment in respect to property within such city or village." The gross receipts received by a county are to be distributed by the county treasurer among the city or village, to the school districts therein, the county and the state in proportion to their respective mill levies.

The above two payments are in lieu of any tax on a PPD including franchise payments and occupation or excise taxes, except that a PPD is not exempt from paying "motor vehicle taxes or general sales taxes levied against the public generally."

Neb. Rev. Stat. §§ 70-651.01 and 70-651.03 implement the enabling language of art. VIII, § 11 of the Nebraska Constitution. Section 70-651.01 provides:

> Every public power district or public power and irrigation district owning property with respect to which it made payments in lieu of taxes in the 1957 calendar year, shall, so long as it continues to own such property, continue to pay annually the same amounts in the same manner. The directors of any such district shall not have any personal liability by reason of such payments made either before or after September 28, 1959.

Section 70-651.03 provides:

> Beginning in 1960, every public corporation and political subdivision of the state, which is organized primarily to provide electricity or irrigation and electricity, and which sells electricity at retail within incorporated cities or villages, shall on or before April 1, of each year, pay to the county treasurer of the county in which any such incorporated city or village may be located, a sum equivalent to five percent of the gross revenue derived by it during the preceding calendar year from retail sales of electricity within such incorporated city or village, less an amount equivalent to the amount paid by such public corporation in lieu of taxes in the 1957 calendar year with respect to its properties in such city or village.

In *Nebraska P. P. Dist. v. Hershey School Dist.,* 207 Neb. 412, 414-415, 299 N.W. 2d 514 (1980), the Nebraska Supreme Court discussed the historical background of Article VIII, § 11 of the Nebraska Constitution as follows:

> The original enabling act providing for the creation and operation of public power districts in Nebraska was enacted in 1933. Thereafter, protests arose over the loss of tax revenue, which would be sustained, by the state and its various governmental subdivisions if tax exempt public power districts acquired the taxable properties of privately owned electrical facilities. The Legislature then enacted statutes which required any public power district which acquired property of an existing privately owned utility to may payments "in lieu of taxes" to the various taxing entities in amounts equal to those paid by the private utility in the year immediately preceding the purchase or acquisition. Payments in lieu of taxes on real property purchased from other than a private utility were required on the same basis for the year of acquisition, but for subsequent years the appropriate county board of equalization was to determine the amount to be paid in lieu of taxes on such real estate "as equity and justice may require." See Neb. Rev. Stat. §§ 70-651 and 652 (Reissue 1958) (repealed 1959).
>
> In the years that followed, case law in Nebraska and elsewhere raised substantial questions as to whether mandatory payments in lieu of taxes constituted an indirect attempt to tax public property which was otherwise tax exempt from taxation under the Constitution. In order to settle the issues, an amendment to the Constitution was proposed and adopted in 1958.

> In 1959, the Legislature implemented the constitutional amendment and provided that every public power district owning property with respect to which it made payments in lieu of taxes in 1957 shall continue to pay annually the same amounts in the same manner so long as it continues to own such property. . ."

A. What constitutes a tax. In *Nebraska P. P. Dist*, supra, the Court also addressed the question of what constitutes a tax. The Court answered this question by quoting from Black's Law Dictionary 1307 (5th ed. 1979) as follows:

> An enforced contribution of money or other property assessed in accordance with some reasonable rule or apportionment by authority of a sovereign state on persons or property within its jurisdiction for the purpose of defraying public expenses.

Id. at 418. The Court went on to say that "[t]he essential characteristics of a tax are that it is not a voluntary payment but an enforced contribution and, in its essential characteristics, is not a debt." *Id.*

Accordingly, it appears that both the in lieu of tax payments and the 5% of gross revenues payment required by *Neb. Rev. Stat.* §§ 70-651.01 and 70-651.03 fit the definition of a tax since they are enforced contributions imposed by a sovereign state for the purpose of defraying public expense.

II. AUTHORITY OF PPDs TO IMPOSE THE CUSTOMER CHARGES.

The only statutory guidance as to whether a PPD may impose the Customer Charges is found in *Neb. Rev. Stat.* § 70-655, which provides in part:

> [a PPD has the authority] "to fix, establish, and collect adequate rates, tolls, rents, and other chares for electrical energy . . .including services...furnished , or supplied . . . which . . .shall be fair reasonable and nondiscriminatory, and so adjusted as in a fair and equitable manner to confer and distribute among the users and consumers of commodities and services furnished or sold by the district the benefits of a successful and profitable operation and conduct of the business of the district. . ."

In *McGinley v. Wheat Belt P.P. Dist.,* 214 Neb. 178, 188, 332 N.W.2d 915 (1983), the Nebraska Supreme Court had the occasion to examine the authority of a PPD to establish rates under *Neb. Rev. Stat.* § 70-655. In its discussion of such authority, it commented on an argument raised by Wheat Belt, which has a bearing on the questions in this memorandum. Wheat Belt argued that *Scottsbluff v. United Tel. Co. of the West,* 171 Neb. 229, 106 N.W. 2d 12 (1960) was authority for Wheat Belt establishing two different subclasses of irrigation customers and assessing the bulk of the ratchet imposed by Tri-State against the members of one of the rate classes. The Court responded to this argument as follows:

> We believe Wheat Belt misreads the decision. In the *United Tel. Co.* case, the city of Scottsbluff enacted an ordinance imposing an occupation tax on the telephone company based upon service in Scottsbluff. The telephone company surcharged *all* of its customers in Scottsbluff a pro rata portion of the Scottsbluff-imposed occupation tax. The city objected and argued, in effect, that the telephone company was required to absorb the tax imposed in Scottsbluff. In approving the action of the telephone company, we merely said that if the city of Scottsbluff wished to raise funds by taxing the telephone company in its city, it was not discriminatory to require *all* of the users in the taxed area to pay the cost of the tax so imposed.

Although the *United Tel. Co.* case does not involve a public power district, it decides factual and legal questions very similar to the ones raised in this memorandum. Moreover, the holding in *United Tel. Co.* was approved by the Supreme Court in *Wheat Belt,* which was a case where the authority of a PPD to establish rates under *Neb. Rev. Stat.* § 70-655 was at issue. Consequently, it is fair to cite the *United Tel. Co.* case as authority for a PPD to impose the Customer Charges among the users in the taxed area. This would validate the Customers Charges to users within a city or village as line item charges on electric bills. The question of whether a public utility may allocate the cost of a tax among all of its users is not answered in *United Tel Co.* Nonetheless, it appears reasonable to argue that the same rationale would apply to validate the charges to all users. This is the case since the taxes which PPDs are required to pay by the Constitution and the statutes referred to above are a part of a legislative policy which requires PPDs to pay them as part of their overall operations. Considering the fact that the distribution of the gross revenue payments to a county under *Neb. Rev. Stat.* § 70-651.03 are not limited to governmental bodies within a city or village, but are to be distributed to other political subdivisions located within the county and the state, it would seem reasonable for PPDs to allocate the cost among all of its ratepayers by including the Customer Charges in its rate base.

Consequently, it appears that PPDs may chose the manner in which they recover the costs of the taxes imposed upon them by the Constitution and statutes referred to above. PPDs may recover the Customer Charges either through the rate base or by line item charges on electric bills sent to customers located within the city or village.

III. EXEMPTIONS.

There are certain exemptions which should be considered in determining whether the customer charges are lawful.

A. Nebraska Constitution. Article VIII§ 2 provides in part as follows:

(1) The *property of the state and its governmental subdivisions* shall constitute a separate class of property and *shall be exempt from taxation to the extent such property is used by the state or governmental subdivision for public purposes* authorized to the state or governmental subdivision by this Constitution or the Legislature. To the extent such property is not used for the authorized public purposes, the Legislature may classify such property, exempt such classes,

and impose or authorize some or all of such property to be subject to property taxes or payments in lieu of property taxes except as provided by law;

***

(2) the Legislature by general law may classify and exempt from taxation property owned by and used *exclusively* for *agricultural and horticultural societies* and property owned and used *exclusively* for *educational*, *religious*, *charitable*, or *cemetery purposes*, when such property is not owned or used for financial gain or profit to either the owner or user;

***

(10) *no property shall be exempt from taxation except as permitted by or as provided in this Constitution*;

The Nebraska Supreme Court, in *Nebraska P. P. Dist., v. Hersey School Dist., supra,* reaffirmed the finding that a public power district is a governmental subdivision of the state within the meaning of art. VIII, § 2, and that all of its property is exempt from taxation, except for the motor vehicle and sales tax. In this case, the Court found that *Neb. Rev. Stat.* § 79-1370 (Cum. Supp. 1980) was an unconstitutional tax in violation of art. VIII, § 2. This statute required public electric entities including public power districts to make mandatory payments to school districts if a certain number of students attending public schools resulted from the employment of workers engaged in the construction of any electric generating facility.

This same rationale, however, cannot reasonably be applied to the Customer Charges since such charges are not a tax. They are not enforced contributions imposed by a sovereign state for the purpose of defraying public expenses (See II. A.above).

In addition, a city or village, is not exempt from the Customer Charges. As a user of electric power, a city or village may be charged a portion of the Customer Charges, the same as any other customer within the city or village. This is so because Customer Charges are not a tax imposed on a city or village in violation of art. VIII, § 2.

B. Statutes. *Neb. Rev. Stat.* §§ 77-202.01 though 77-202.07 provide a complete and comprehensive act dealing with the matter of tax exemptions. *Indian Hills Community Church v. County Bd. Of Equalization*, 226 Neb. 510, 412 N.W.2d 459 (1987). Thus, it is appropriate to review §§ 77-202.01 *et seq.* in order to determine whether there is any support for the argument that certain cities or villages may qualify for an exemption from Customer Charges.

Sections 77-201 to 77-212 do not contain any language, which could reasonably be construed as an exemption for a city or village from paying the Customer Charges. Moreover, *Neb. Rev. Stat.* § 77-202 does not enumerate any tax exemption for a city or village as a result of receiving federal funds, regardless of whether such funds originates with Housing and Urban Development (HUD) or some other federal agency. It is well-settled principle that all property in

this state, not expressly exempt therefrom, is subject to taxation. *Adams v. United States Nat'l Bank of Omaha*, 147 Neb. 1, 22 N.W.2d 297 (1946); *Int'l Harvester Co. v. Douglas Co.*, 146 Neb. 555, 20 N.W.2d 620 (1945) (The Legislature has carried out the constitutional mandate that no property in this state shall be exempt from taxation, except as to certain authorized items, and has implemented the general provision of the revenue act that all property in this state, not expressly exempt, shall be subject to taxation). Simply put, there is no explicit constitutional or statutory authority under Nebraska law that supports a claim by a city or village that the receipt of federal HUD funds qualifies them for tax exemption status.

1. Charitable exemption. The "charitable" tax exemption provided under *Neb. Rev. Stat.* § 77-202(1)(d) is not applicable to the questions raised in this memorandum because the property to be exempted under this subsection of the statute must be owned by either an "educational, religious, charitable, or cemetery organization."

Clearly, a city or village is not a "charitable" organization within the meaning of the above statute. Furthermore, the Nebraska Supreme Court has established the long-standing principle that low-income housing is not a charitable use of property and that such property is not exempt from taxation as being owned and used exclusively for charitable purposes. *Pittman v. Sarpy Co. Rd. of Equalization*, 258 Neb. 390, 603 N.W.2d 447 (1999). As such, a city or village does not fall under the "charitable" tax exemption category.

2. Government property exemption. *Neb. Rev. Stat.* § 77-202(1)(a) provides a tax exemption for property owned by the state and its governmental subdivisions, to the extent that such property is used or being developed for use by the state or a governmental subdivision for a public purpose. However, in order for a city or village to be entitled to a property tax exemption under Art. III, § 2 of the Nebraska Constitution or § 77-202, the electric service that a PPD provides must be considered "property." There can be no property tax exemption if there is no "property" to which the exemption applies.

A city or village may contend that once the electricity enters a public building, which is tax-exempt according to the "governmental property" exemption, the electricity likewise becomes "governmental property" which then qualifies for tax exemption status as to that "property." However, this argument is not tenable since a city or village is being charged not only for the delivery of the electricity, but for all of the costs that a PPD incurs in the delivery of the electricity. As a general rule, Chapter 70 Article 6 singles out the generation of electricity for treatment separate from the treatment afforded tangible personal property. *Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue*, 248 Neb. 518, 537 N.W.2d 312 (1995). (The generation of electricity is a service, not the manufacture of tangible personal property). The electricity that a city or village purchases from a PPD is a service, not property. Tax exemption provisions are to strictly construed, and their operation will not be extended by construction. *Omaha Pub. Power Dist. v. Nebraska Dep't of Revenue, supra*; *Nebraska State Bar Found. v. Lancaster Cty. Bd. of Equal.* 237 Neb. 1, 465 N.W.2d 111 (1991); *Indians Hills, supra.* An exemption from taxation is never presumed. *Id.* Property, which is claimed to be exempt, must clearly come within the provision granting exemption from taxation. *Id.* Finally, the burden of proving exemption from taxation is on the party claiming such exemption. *Id.*

Based upon the foregoing authorities, it becomes apparent that a city or village cannot be afforded a tax exemption from the Customer Charges for two reasons. First the "property" which a city or village may argue is exempt, is not property at all, rather, it is the generation of electricity, which is a service. Second, there is no explicit statutory provision in Nebraska law granting an exemption from taxation for receiving federal HUD funds.

C. Federal Law. 42 U.S.C. § 1437d(d) governs contracts with a city for HUD financing. It provides in relevant part, that:

> Every contract for contributions with respect to a low-income housing project shall provide that no contributions by the Secretary shall be made available for such project unless such project (exclusive of any portion thereof which is not assisted by contributions under this Act) is exempt from all real and personal property taxes levied or imposed by the State, city, county, or other political subdivision; . . . . If any such project is not exempt from all real and personal property taxes levied or imposed by the State, city, county, or other political subdivision, such contract shall provide, in lieu of the requirement for tax exemption and payments in lieu of taxes, that no contributions by the Secretary shall be made available for such project unless and until the State, city, county, or other political subdivision in which such project is situated shall contribute, in the form of cash or tax remission, the amount by which the taxes paid with respect to the project exceed 10 per centum of the shelter rents charged in such project.

This federal statute governs a contractual relationship between HUD and a city and places certain limitations on a city if it chooses to become eligible for HUD funding. The statute, in the first instance provides that federal funds are not available unless the project is exempt from all real estate and personal property taxes levied or imposed by the State, city, county, or other political subdivision. The statute also provides that if the project is not tax exempt, then no contributions made by HUD can be used to pay such taxes and that such city shall contribute funds to pay the taxes if such taxes exceed 10% of the shelter rents charged in such project. The statute does not prohibit a state or political subdivision from imposing real or personal property taxes against property used by a city for low-income housing. It merely states that HUD funds cannot be used to pay such taxes and that a city must contribute the funds to pay such taxes if they exceed 10% of the shelter rents.

As a practical matter, if a city owns the land provided for a HUD project, the real estate would be exempt from taxation under Article VIII, § 2 of the Nebraska Constitution to the extent it is used for public purposes. In any event, this federal statute affords no basis for a city or village to claim that a PPD cannot impose the Customer Charges or that it cannot recover such charges from a city or village as customers of a PPD, even if the city is receiving federal funding from HUD.

CONCLUSION

Based upon the foregoing analysis, there does not appear to be any basis for concluding that PPDs cannot impose the Customer Charges. PPDs may recover the cost of the Customer Charges in either their rate bases or by line item charges in electric bill to customers located within a city or village. In addition, there appears to be no basis for concluding that the Customer Charges are illegal taxes or for exempting cities or villages as electric customers from paying the Customer Charges.

Very truly yours,

CROSBY GUENZEL LLP

By
Steven G. Seglin

SGS:rrk