Dexter A. Johnson
LEGISLATIVE COUNSEL

900 COURT ST NE S101
SALEM, OREGON 97301-4065
(503) 986-1243
FAX: (503) 373-1043
www.oregonlegislature.gov/lc

# STATE OF OREGON
## LEGISLATIVE COUNSEL COMMITTEE

February 26, 2018

Senator Brian Boquist
900 Court Street NE S311
Salem OR 97301

Re: Constitutionality of HB 4080 -1 or -6 amendments

Dear Senator Boquist:

You asked whether House Bill 4080 as amended by either the -1 or -6 amendments[1] is constitutional under the Oregon and United States Constitutions. We conclude that it is likely that the -1 amendments violate the Free Exercise Clause of the United States Constitution, but that the -6 amendments do not violate either the Oregon or United States Constitution.

As you know, Oregon imposes both personal income taxes and corporate excise or income taxes, under ORS chapters 316, 317 and 318. Personal income taxes and corporate excise and income taxes use as a starting point the definition of "taxable income" as defined in the federal Internal Revenue Code (IRC). ORS 316.012, 317.010 and 318.031. Many other elements of Oregon tax law and other state law tie to IRC references and definitions. Each regular session, the Legislative Assembly updates the connection date to the IRC. House Bill 4080 is the 2018 iteration of this bill, generally moving the connection date from December 31, 2016, to December 31, 2017. The federal Tax Cuts and Jobs Act of 2017 (P.L. 115-97) (the Act), was passed by Congress and signed into law by the President on December 22, 2017, so changes to the IRC by the Act will generally be incorporated into Oregon law by passage of HB 4080.

Section 529 of the IRC was enacted in 1996 and has authorized states to establish programs that allow taxpayers to establish tax-preferenced savings accounts to save for higher education expenses. If a state established a program that met section 529 requirements, the earnings from a taxpayer established account would not be subject to federal income tax. Oregon established such a program in chapter 746, Oregon Laws 1999. Under Oregon's section 529 program, earnings from a qualified account would not be subject to state income tax. In addition, however, the Legislative Assembly enacted an additional incentive by allowing a subtraction from taxable income for deposits into a qualified account, of up to $2,000 per tax year ($4,000 per tax year, in the case of joint tax return filers). ORS 316.699. This additional subtraction reflects a determination by the Legislative Assembly to create a greater tax incentive than federal law provides; hence the state tax subtraction is independent of federal law. If withdrawals are made from a section 529 savings account that are not qualified withdrawals, the amount of the state tax subtraction must be added back to taxable income in the year the nonqualified withdrawal is made. ORS 316.680 (2)(j).

[1] The -9 amendments to HB 4080 are substantially identical to the -6 amendments. Accordingly, our analysis of the -6 amendments applies equally to the -9 amendments.

Section 11032 of the Act expanded the kinds of tuition for which the qualified withdrawals from a section 529 savings account could be made, to include "expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school[.]" Expenses for books, curricular materials, tutoring outside of the home, and other costs associated with a homeschool or a private school are also included in qualified expenses under the Act. House Bill 4080, by merely changing the connection date to federal tax law, would incorporate the Act's section 529 plan changes into Oregon law.

Article I, section 5, of the Oregon Constitution, provides that "[n]o money shall be drawn from the Treasury for the benefit of any religeous [sic], or theological institution[.]" Historically, the Oregon Supreme Court has interpreted Article I, section 5, very broadly to prohibit any direct or indirect benefit from being conferred on religious institutions, including church supported schools. *Dickman v. School Dist.*, 232 Or. 238, 247 (1961) (holding unconstitutional a state statute that required school districts to supply textbooks free of charge to students attending private schools, including religiously affiliated schools). Applying this reasoning to the tax benefits of section 529 plan contributions that are conferred by state law (e.g., the $2,000 subtraction for contributions) after the provisions of the Act are adopted for state purposes, it is certainly arguable that the subtraction for deposits into a section 529 savings account and the exemption from state tax of earnings from the account would violate Article I, section 5, if withdrawals from a section 529 account were used for tuition, books or related expenses for attending a religious school. The reason is because the tax subtraction under ORS 316.699 and the exclusion from state income tax of earnings of a section 529 account are economically equivalent to transferring money from the State Treasury for the benefit of a religious institution, which is proscribed by Article I, section 5.

The determination of whether Article I, section 5, would permit state tax benefits to accrue for the expanded allowed uses of section 529 savings account withdrawals under the Act must, however, be tempered by a recent United States Supreme Court decision: *Trinity Lutheran Church of Columbia, Inc. v. Comer*, 137 S. Ct. 2012 (2017). At the outset, it is important to note that Oregon constitutional provisions must comport with rights and freedoms guaranteed by the United States Constitution and must give way to the extent the United States Supreme Court determines that a federal constitutional right guarantees an action that is prohibited by a provision of the Oregon Constitution. At issue in *Trinity Lutheran* was a Missouri state program that provided reimbursement grants to schools that purchased playground surfaces made from recycled tires. Because of limited grant funds, the Missouri program awarded grants to schools on a competitive basis based on criteria. One express policy in the Missouri program was that a grant application was automatically denied if the applicant was a church or was owned or controlled by a church. *Trinity Lutheran*, 137 S. Ct. at 2017. The reason for the express policy was due to Article I, section 7, of the Missouri Constitution, which provides that "no money shall ever be taken from the public treasury, directly or indirectly, in aid of any church, sect or denomination of religion. . . ." *Id.* Thus, the Missouri constitutional provision is almost identical to Article I, section 5, of the Oregon Constitution.

The First Amendment of the United States Constitution includes both the Establishment Clause ("Congress shall make no law respecting an establishment of religion") and the Free Exercise Clause ("Congress shall make no law . . . prohibiting the free exercise [of religion]").[2] The United States Supreme Court has "recognized that there is 'play in the joints' between what the Establishment Clause permits and what the Free Exercise Clause compels." *Trinity Lutheran*, 137 S. Ct. at 2019; *quoting Locke v. Davey*, 540 U.S. 712, 718 (2004). The *Trinity Lutheran* Court confirmed that denying a generally available benefit solely on account of

[2] The actual text of the First Amendment is, in part, "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof".

religious identity imposes a penalty on the free exercise of religion that can be justified only by a state interest of the highest order, but also noted that the Court has frequently rejected Free Exercise Clause challenges when the law in question has been neutral and generally applicable without regard to religion. *Trinity Lutheran*, 137 S. Ct. at 2019-2020. The Court found that the policy of automatically prohibiting a church school from participating in a program solely because of its status as a religious institution violated the Free Exercise Clause and accordingly held the Missouri requirement unconstitutional. *Trinity Lutheran*, 137 S. Ct. at 2025.

The -1 amendments to HB 4080 exclude from the definition of "qualified withdrawal" from a section 529 savings account, those withdrawals from the account "to pay tuition in connection with enrollment at an elementary or secondary religious school." The effect of a nonqualified withdrawal from a section 529 savings account is to add back to taxable income the amount of the withdrawal that is attributable to amounts previously subtracted from taxable income. ORS 316.680 (2)(j). Thus, the -1 amendments expressly exclude from a program otherwise available—the section 529 savings account program—those who would like to participate in the program—those who pay tuition at religious schools—solely because of religious affiliation. We conclude that, under *Trinity Lutheran*, the -1 amendments would violate the requirements of the Free Exercise Clause and therefore would be unconstitutional if enacted.

By contrast, the -6 amendments make no reference to religious schools and simply require an addback to taxable income for withdrawals from a section 529 savings account to pay expenses to an elementary or secondary school. The amount that must be added back is the amount of the withdrawal attributable to contributions that were subtracted from federal taxable income under ORS 316.699 and the amount of the withdrawal attributable to previously untaxed earnings and gains. Because the amendment does not distinguish between public and private schools and does not single out religious schools, the -6 amendments would be constitutional under a *Trinity Lutheran* analysis.[3]

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Very truly yours,

Dexter A. Johnson
Legislative Counsel

[3] Public schools may charge tuition for students who are not residents of the school district in which the school they attend is located. ORS 339.115 (1). Many public schools charge activity fees and materials fees. Withdrawals to pay these fees would be qualified withdrawals at the federal level, under section 11032 of the Tax Cuts and Jobs Act of 2017.