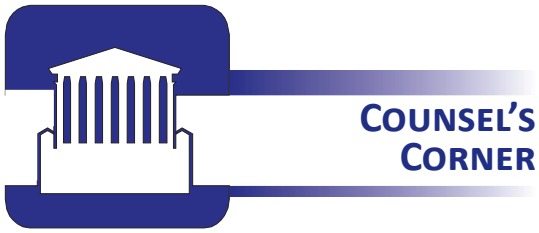

PROPERTY TAX

What's Left of the Equal Protection Clause?

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If recent cases are any indication, the equal protection clause seems all but dead for state and local tax purposes.[1] After the U.S. Supreme Court's thorough declawing of the federal Equal Protection Clause[2] in *Armour v. City of Indianapolis*, 556 U.S. ___, 132 S.Ct. 2073 (2012) ("*Armour*"),[3] the Iowa Supreme Court followed suit in *Qwest Corporation v. Iowa State Board of Tax Review*, 829 N.W.2d 550 (Iowa 2013) ("*Qwest*"). In *Qwest*, Iowa's highest court rejected a telecommunications company's equal protection challenge to a property tax regime that taxes the personal property of incumbent local exchange carriers ("ILECs") but not competitive long distance telephone companies ("CLDTCs") or wireless service providers.

Armour and *Qwest* are not groundbreaking cases from a constitutional perspective. However, the cases reflect the declining roles of the federal and state equal protection clauses in state and local tax litigation and the increasing level of deference courts are giving to state legislatures in matters of taxation. This article discusses *Qwest* and, in light of the Iowa Supreme Court's decision, analyzes whether most equal protection tax challenges are simply perfunctory and whether taxpayers would be better served focusing their litigation efforts elsewhere.

Background

Iowa subjects the property of traditional telephone companies, including ILECs, to central assessment for property tax purposes.[4] Locally assessed taxpayers in Iowa were once subject to tax on their real and personal property, but the Iowa legislature instituted a new regime in 1973 that phased out taxation of personal property.[5] This change did not affect centrally assessed taxpayers, like traditional telephone companies, that continued to pay tax on the value of their real and personal property.

The classification challenged in *Qwest* arose from legislation enacted in 1995 that resulted in differential property tax treatment for ILECs and CLDTCs.[6] For regulatory purposes, not tax purposes, Iowa law permits long distance telephone companies to request classification as CLDTCs if more than fifty percent of their revenues from Iowa intrastate telecommunications services and facilities are received from services and facilities determined to be subject to effective competition.[7] However, once classified as CLDTCs for regulatory purposes, long distance telephone companies are no longer subject to tax on the value of their personal property acquired after January 1, 1996:

> The board shall promptly notify the director of revenue that a long distance telephone company has been classified as a competitive long distance telephone

[1] This article is not intended to address state constitutional uniformity provisions, many of which afford taxpayers greater protections than do federal and state equal protection provisions.

[2] U.S. Const. amend XIV, § 1.

[3] In *Armour*, Indianapolis homeowners challenged a classification based on whether they elected to make lump sum payments or installment payments on assessments for costs related to municipal sewer projects. When the city changed the way it raised funding for sewer improvements in 2005, it enacted an ordinance that forgave all outstanding debts owed by property owners who had been making installment payments on their assessments prior to the change. 132 S.Ct. at 2078-79. At the same time, the city denied refund requests from property owners who had made lump sum payments on their assessments. *Id.* at 2079. The U.S. Supreme Court held that the classification had a rational basis because it allowed the city to avoid certain administrative costs associated with collecting remaining debts from installment payors and issuing refunds to lump sum payors. *Id.* at 2080-82.

[4] Iowa Code Ann. § 433.1 requires the director of revenue to centrally assess "[e]very telegraph and telephone company operating a line" in Iowa.

[5] 1973 Iowa Acts ch. 255, § 1.

[6] 1995 Iowa Acts ch. 199, § 1.

[7] Iowa Code Ann. § 476.1D(10)(a). This statute was meant to encourage competitive carriers to invest in facilities-based infrastructure in Iowa. *Qwest*, 829 N.W.2d at 553.

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> company. Upon such notification by the board, the director of revenue ***shall assess the property of such competitive long distance telephone company . . . in the same manner as all other property assessed as commercial property by the local assessor*** under chapters 427, 427A, 427B, 428, and 441.[8]

"Long distance telephone company" is defined as a company that provides telephone service and facilities between local exchanges, but the term excludes wireless service providers and ILECs. Consequently, both ILECs and CLDTCs are subject to central assessment but only ILECs remain subject to tax on the value of their real *and* personal property. Since they are locally assessed, wireless service providers, like CLDTCs, are not subject to tax on the value of their personal property.[9]

Qwest Tees up Its Constitutional Challenge

Qwest, an ILEC, was the successor to a regional Bell operating company formed during the AT&T divestiture in 1984.[10] Qwest dominated the local telephone service market in Iowa, although competitive local exchange carriers (often referred to as "CLECs") and wireless service providers also held respectable market shares.[11] In 2006, Qwest protested and appealed a billion-dollar valuation of its property to the Iowa State Board of Tax Review (the "Board"). Qwest asserted in its protest that the differential treatment between ILECs, on one hand, and CLDTCs and wireless service providers, on the other hand, violated the federal and state equal protection clauses.

After transfer to the Department of Inspections and Appeals, an administrative law judge ruled against Qwest on both its federal and state discrimination claims.[12] Qwest subsequently brought an action in county district court challenging the alleged discrimination on *state* equal protection grounds only. The district court reversed the administrative law judge's decision, concluding that the differential property tax treatment violated Qwest's equal protection rights.[13] The Board appealed the district court's decision to the Iowa Supreme Court.

Eviscerating the Equal Protection Clause

Iowa's Equal Protection Clause, which is found in article I, section 6 of the Iowa Constitution, guarantees: "All laws of a general nature shall have a uniform operation; the General Assembly shall not grant to any citizen, or class of citizens, privileges or immunities, which, upon the same terms shall not equally belong to all citizens." As the Iowa Supreme Court noted in *Qwest*, the Iowa Equal Protection Clause, like the federal Equal Protection Clause, requires similar treatment for those who are similarly situated.[14] Since the challenged law did not implicate any fundamental rights or create a classification based on an inherently suspect characteristic, the court reviewed the property tax regime under the rational basis test. A classification to which the rational basis test applies will be upheld if it is rationally related to a legitimate state interest.

Setting the stage for its analysis, the court reviewed the seemingly insurmountable burden placed on those who bring equal protection challenges against tax laws by ticking off each of the familiar maxims:

> "[T]he [s]tate does not have to produce evidence, and only a plausible justification is required."
>
> "The challenging party has the heavy burden of showing the statute unconstitutional and must negate every reasonable basis upon which the classification may be sustained."
>
> "The fit between the means and the end can be far from perfect so long as the relationship is not so attenuated as to render the distinction arbitrary or irrational."
>
> "The rational basis standard is easily met in challenges to tax statutes."
>
> "[I]n tax matters even more than in other fields, the legislature possesses the greatest freedom in classification."[15]

Hopeless, indeed.

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8 Iowa Code Ann. § 476.1D(10)(b) (emphasis added).

9 As their name would suggest, wireless service providers do not require the same level of costly land-based infrastructure that ILECs and CLDTCs require. Cell towers are treated as real property for Iowa property tax purposes. *See Qwest*, 829 N.W.2d at 554.

10 Qwest was acquired by CenturyLink, Inc. in 2011.

11 *See id.*

12 *Id.* at 555-56. Qwest appealed the ruling to the Iowa State Board of Tax Review, after which the parties stipulated that the ruling would be treated as the Board's ruling. *Id.* at 556.

13 *Id.* at 556-57.

14 *Id.* at 557-58.

15 *Id.* at 558 (citations and internal quotation marks omitted).

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The court assumed for purposes of its equal protection analysis that ILECs, CLDTCs, and wireless service providers were similarly situated. The court first addressed the differential treatment among ILECs and CLDTCs and concluded that the differential treatment had a rational basis. The legislature's decision to accord preferential property tax treatment to CLDTCs, according to the court, was one way to encourage facilities-based telephone service providers to build-out their infrastructure in Iowa. Such investment, the court inferred, would encourage competition in the wireline telephone service market and decrease prices. The court surmised that the Iowa legislature "could have rationally believed that the ILECs had a powerful built-in competitive advantage based on their existing facilities, whose development had been underwritten by Iowa ratepayers over the past century."[16]

In so holding, the Iowa Supreme Court reasoned that ILECs continue to benefit from what it perceived as vestiges of the rate-regulation and government-sanctioned monopolies that officially ended in the 1990s. CLDTCs, in contrast, were new entrants to the market and, in the court's view, the Iowa legislature could have intended the preferential property tax treatment to level the playing field among ILECs and CLDTCs.[17] Supposition aside, the court also retreated from its original premise that ILECs and CLDTCs were similarly situated. Notwithstanding evidence of strong competition between ILECs and CLDTCs today, the court emphasized Qwest's continued dominance of the wireline telephone service market in support of its conclusion that preferential property tax treatment for CLDTCs was a valid way of leveling the playing field.

The court next evaluated the differential treatment among ILECs and wireless service providers. Once again, arguably in contravention of its original premise that ILECs, CLDTCs, and wireless service providers are similarly situated, the court observed that the legislature could have concluded that ILECs and wireless service providers operated in separate markets and that only the wireless service market was competitive. The court also observed that wireless rates have decreased while wireline rates have increased, which it viewed as further "evidence from which a rational legislator might conclude that the wireless companies operated in a competitive market and Qwest still does not."[18] One wonders whether taxpayers can be similarly situated if they operate in separate markets. Nevertheless, as in the case of the preferential treatment for CLDTCs, the court held that a rational basis existed for giving preferential property tax treatment to wireless service providers as compared to ILECs.

Where Do We Go from Here

After reading *Qwest* and *Armour*, a reasonable conclusion could be that a finding of a rational basis for differential tax treatment is constrained only by a court's imagination. And that conclusion might be right. By requiring an aggrieved taxpayer to negate every reasonable basis upon which a classification may be sustained (forcing the taxpayer to prove a negative), and by simultaneously giving deference to the wisdom of state and local lawmakers, courts appear to have imposed a burden that cannot be met.

Though the results may be unfair at times, this trend in favor of state and local governments likely reflects the courts' acknowledgment of the difficulty in fair and equitable line-drawing in matters of state and local taxation—a task best left to legislators in the eyes of many judges. The trend also likely acknowledges the herculean task that state and local governments face in terms of updating their tax laws to keep pace with a dynamic economy.

While the federal and state equal protection clauses may appear, and likely are, toothless in many respects, they still may have some relevance given the right set of circumstances. A taxpayer that can show systematic and intentional discrimination bordering on bad faith may be able to prove the absence of a legitimate state interest furthered by the discriminatory treatment. Short of such favorable and unusual facts, an equal protection challenge to a state or local tax law is likely to be difficult.

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16 *Id.* at 562.

17 The court also theorized that taxing the value of ILECs personal property could have been "an appropriate way to capture some of their monopoly rent." *Id.* at 563. Again, this theory ignores the fact that government-sanctioned monopolies ended after deregulation of the telecommunications industry.

18 *Id.* at 564.

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