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Mr. Mike Kadas, Director
Montana Department of Revenue
Sam W. Mitchell Building
125 North Roberts, 3rd Floor
Helena, Montana 59601

Re: Proposed New Rule 1 Qualified Education Provider (SB 410)

Dear Director Kadas,

I'm writing to you about the Department of Revenue's Proposed New Rule 1 Qualified Education Provider (Rule 1). The Department of Justice believes that Rule 1 is neither authorized nor required by the Montana Constitution, and in fact would unnecessarily put the Montana Constitution in potential conflict with the United States Constitution. Therefore, we advise you not to adopt it.

As an initial matter, our recommendation not to adopt Rule 1 is based on the Attorney General's authority to decide when and how to defend State law. *See Western Tradition P'ship v. AG of Mont.*, 2012 MT 271, ¶ 17, 367 Mont. 112, 118, 291 P.3d 545, 550 ("As an executive officer of the State of Montana, the Attorney General determines when to prosecute or to defend cases in which the State has an interest. Thus, if a challenge is brought to a state statute, the Attorney General has discretion to decide whether or not to defend its constitutionality."). We believe Rule 1, should it be adopted and then challenged in federal court, would not be defensible.

BACKGROUND

Rule 1 is one of several proposals designed to implement Senate Bill (SB) 410, which provides tax credits for elementary and secondary students who attend private schools that are "qualified education provider[s]". Senate Bill 410 is very similar to tax credit plans in other states. *See, e.g., Arizona Christian Sch. Tuition Org. v. Winn*, 131 S. Ct. 1436, 563 U.S. 125 (2011) (describing Arizona's school tuition organization tax credit,

similar to SB 410). Rule 1 proposes to exclude from the definition of "qualified education provider" any "church, school, academy, seminary, college, university, literary or scientific institution, or any other sectarian institution owned or controlled in whole or in part by any church, religious sect, or denomination." Rule 1(a). The Rule also excludes "an individual who is employed by a church, school, academy, seminary, college, university, literary or scientific institution, or any other sectarian institution owned or controlled in whole or in part by any church, religious sect, or denomination when providing those services." Rule 1(b). In essence, the Rule proposes a wholesale exclusion of religious, or "sectarian," entities from being included in SB 410's tax credit plan.

The Department of Revenue states that two provisions of the Montana Constitution—article V, section 11(5), and article X, section 6(1)—require the exclusion of religious entities from the scope of SB410. As detailed below, we believe that the Department of Revenue's interpretation of the Montana Constitution is incorrect.

ANALYSIS

I. THE DEPARTMENT OF REVENUE LACKS AUTHORITY TO ADOPT RULE 1 BECAUSE TAX CREDITS ARE NOT AN "APPROPRIATION" UNDER MONTANA LAW.

The Montana Constitution does not authorize, much less require, the wholesale exclusion of religious entities from being considered qualified education providers under SB 410. There have been very few cases analyzing the scope of article V, section 11(5) and article X, section 6(1) of the Montana Constitution. But these provisions generally prohibit the State from making any "direct or indirect appropriation or payment of public monies" to a religious entity or for a "sectarian" purpose. Both provisions speak of an "appropriation" of state funds.

It is significant that SB 410 involves tax credits for contributions to school scholarship organizations that may incidentally benefit religious entities, rather than direct grants from the public fisc to religious entities. Tax credits are not appropriations because they do not spend money from the State treasury. Judge Sherlock of the First Judicial District addressed this precise question in *MEA-MFT v. McCulloch*, 2012 Mont. Dist. LEXIS 20, *5 (Mont. Dist. Ct. 2012). As Judge Sherlock noted, the Montana Supreme Court has defined an "appropriation" as:

> [A]n authority from the law-making body in legal form to apply sums of money out of that which may be in the treasury in a given year to specified objects or demands against the state. It means the setting apart of a portion of the public funds for a public purpose, and there must be money in the fund applicable to the designated purpose to constitute an appropriation.

Id. at * 4-5 (quoting *State ex rel. Bonner v. Dixon*, 59 Mont. 58, 78, 195 P. 841, 845 (1921)).

Judge Sherlock held that "the money, whether it is in the form of a tax credit or tax refund, is not set aside for a 'public purpose.'" Further, it is not set aside for 'specified objects or demands against the state.' Rather, the money is a tax refund or credit that a taxpayer may or may not claim. In the case of the credit, it is money that was never in the general fund, and in the case of a refund, it would be money that the state is not entitled to keep. *Id.* at *5 (Mont. Dist. Ct. 2012).[1] Thus, the court held that the tax credit at issue in that case was not an appropriation.

Although the Montana Supreme Court has not directly addressed the issue of tax credits, it has rejected the notion that funds given to an individual who uses them to pay for services at a private institution is an "appropriation." In *Montana State Welfare Bd. v. Lutheran Social Servs*, 156 Mont. 381, 480 P.2d 181 (1971), the plaintiffs asked the Court to declare that funds could not be given to indigent expectant mothers for medical and foster home expenses if the mother used a private adoption agency (many of which were religious). The State Welfare Board argued that the funds were an illegal "appropriation" that violated various provisions of the State constitution. But the Court rejected the idea that funds given to an individual were an appropriation at all: "We hold that payment of public assistance to indigent expectant mothers is not an unconstitutional 'appropriation', 'loan', 'donation', or 'grant' in violation of the Montana Constitution, simply because such persons may request the counseling and assistance of private adoption agencies." *Id.* at 390. Indeed, the Court found that to hold otherwise would violate the Equal Protection Clause. *Id.*[2]

The same rationale applies here. No funds are appropriated to private schools under SB 410. In fact, the relationship between the State and the private entity is even more attenuated here than it was in *Lutheran Social Services*. Under SB 410, individuals who donate money for tuition assistance to students are given a tax credit, not direct financial

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[1] For your convenience, a copy of *MEA-MFT v. McCulloch* is attached.

[2] The Court also found that the Department of Public Welfare's regulation was beyond the scope of the law that it was administering, and thus void for that reason too. Although we don't address that argument here, Rule 1 could potentially be invalid for going beyond the scope of what the Legislature intended in enacting SB 410.

aid. That the donation may eventually end up as tuition paid at a private religious school is a result of the individual's choice, not an appropriation by the government. As Judge Sherlock noted *MEA-MFT v. McCulloch*, a tax credit program cannot reasonably be considered an "appropriation" by the State.

The United States Supreme Court has also recognized the distinction between tax credits and government expenditures. In *Arizona Christian School Tuition Organization v. Winn*, the Court held that the plaintiffs lacked taxpayer standing to make an Establishment Clause challenge to an Arizona tax credit plan very similar to Montana's SB 410. The Court noted that when the government "collects and spends taxpayer money, governmental choices are responsible for the transfer of wealth." 131 S. Ct. at 1447. But that is much different than a tax credit program like SB 410, where no money is being appropriated by the government. "While the State, at the outset, affords the opportunity to create and contribute to [a school tuition organization], the tax credit system is implemented by private action and with no state intervention." *Id.* at 1448. The Court rejected the plaintiffs' argument that tax credits "should be treated as if it were government property even if it has not come into the tax collector's hands." *Id.* The Court analogized tax credits to charitable tax deductions. "Like contributions that lead to charitable tax deductions, contributions yielding [student tuition organization] tax credits are not owed to the State and, in fact, pass directly from taxpayers to private organizations." *Id.*[3]

The United States Supreme Court has likewise rejected the notion that tax exemptions are a form of appropriation. "The grant of a tax exemption is not sponsorship since the government does not transfer part of its revenue to churches but simply abstains from demanding that the church support the state." *Walz v. Tax Com. of New York*, 397 U.S. 664, 675 (1970).

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[3] Incidentally, the Arizona Supreme Court also rejected the argument that Arizona's tax credit plan resulted in an "appropriation" to a religious entity:

> "An appropriation 'set[s] aside from the public revenue . . . a certain sum of money for a specified object, in such a manner that the executive officers of the government are authorized to use that money.'" *Rios v. Symington*, 172 Ariz. 3, 6-7, 833 P.2d 20, 23-24 (1992) (quoting *Hunt v. Callaghan*, 32 Ariz. 235, 239, 257 P. 648, 649 (1927)). It does not follow, however, that reducing a taxpayer's liability is the equivalent of spending a certain sum of money. An appropriation earmarks funds from 'the general revenue of the state' for an identified purpose or destination. *Black & White Taxicab Co. v. Standard Oil Co.*, 25 Ariz. 381, 399, 218 P. 139, 145 (1923). Furthermore, we disagree with petitioners' characterization of this credit as public money or property within the meaning of the Arizona Constitution. Therefore, we are unwilling to hold that a proscribed appropriation or application occurs by operation of this statute."

Kotterman v. Killian, 193 Ariz. 273, 287, 972 P.2d 606, 620 (1999).

The same logic applies to tax credits, and indeed, with more force. Tax credits go to individuals who may or may not divert money to a religious entity. A tax exemption, on the other hand, is a direct benefit conferred on a religious entity. Yet nothing suggests that Montana's various exemptions to churches and other religious institutions violates the Montana Constitution. Indeed, the Montana Constitution specifically allows it. *See* Mont. Const., art. VIII, § 5(1). It would make no sense to suggest that a tax credit—which is granted to a private party for a donation that may or may not be directed to a religious entity—violates the State constitution, while a direct tax exemption by the State to a church does not.

In fact, the State evidently already grants tax credits that benefit religious entities, such as the College Contribution Credit, Mont. Code Ann. § 15-30-2326, and the Qualified Endowment Credit, Mont. Code Ann. § 15-30-2328, both of which the Department of Revenue administers. But the Department has not prohibited tax credits for donations that may incidentally benefit religious entities in these examples. It should follow the same policy in administering SB 410. Indeed, if the Montana Constitution were interpreted to prohibit these tax credits, other neutral governmental benefits as basic as fire and police protection could conceivably be denied to religious entities as well. *See,* e.g., *Am. Atheists, Inc. v. City of Detroit Downtown Dev. Auth.,* 567 F.3d 278, 291-92 (6th Cir. 2009) (noting that a myopic reading of the Establishment Clause could invalidate a host of benefits to religious groups, including fire and police protection, as well as city sidewalks and sewer hookups; benefits which have long been approved by the Supreme Court). The Montana Constitution obviously does not require such an absurd application.

In sum, because SB 410's tax credit plan cannot reasonably be considered an "appropriation" under article V, section 11(5) and article X, section 6(1), the Montana Constitution does not authorize—much less require—the Department of Revenue to exclude religious entities from being included as qualified education providers under SB 410.

II. IF THE MONTANA CONSTITUTION WERE READ AS BROADLY AS THE DEPARTMENT OF REVENUE SUGGESTS, IT WOULD LIKELY VIOLATE THE UNITED STATES CONSTITUTION.

If the Montana Constitution were read so expansively as to *prohibit* tax credits for donations that benefit religious entities in a neutral program like SB 410, it would very likely be in irreconcilable tension with the United States Constitution.

Federal court have held that to categorically exclude religious entities from a neutral generally available benefit violates the religion clauses of the First Amendment, as well as Equal Protection under the Fourteenth Amendment. As the Tenth Circuit noted, "the State's latitude to discriminate against religion . . . does not extend to the wholesale exclusion of religious institutions and their students from otherwise neutral and generally available government support." *Colorado Christian Univ. v. Weaver*, 534 F.3d 1245, 1255 (10th Cir. 2008); *see also Badger Catholic, Inc. v. Walsh*, 620 F.3d 775, 780 (7th Cir. 2010) (excluding groups that engaged in prayer or religious instruction from neutral government benefits "evinced hostility to religion" and was unconstitutional); *Church of Lukumi Babalu Aye v. City of Hialeah*, 508 U.S. 520, 532 (1993) (holding that the Free Exercise Clause prohibits discriminating against "a particular religion or . . . religion in general"); *Burlington N. R.R. v. Ford*, 504 U.S. 648, 651 (1992) (recognizing that laws that discriminate on the basis of religion are inherently suspect); *Lutheran Social Services*, 156 Mont. at 39 (prohibiting grants to individuals because they chose to use private adoption agency may violate Equal Protection).

The Supreme Court has allowed exclusion of religion from a benefits program, but in a much different context than SB 410. In *Locke v. Davey*, 540 U.S. 712 (2004), the Supreme Court found that it did not violate the Constitution for Washington State to exclude theology degrees from a state scholarship program. But Washington's exclusion was limited to "not funding the religious training of clergy." *Id.* at 722 n.5. The Court noted that the "entirety" of the program went "a long way toward including religion in its benefits," by providing scholarship money for students to attend religiously affiliated schools, take religion courses, and even take devotional theology courses. *Id.* at 724-25. In other words, the Court did not sanction the wholesale exclusion of religion from the scholarship program, and indeed, the program's general inclusion of religion is likely what saved it. *Id.*

It is unclear how expansively the Montana Supreme Court would interpret article X, section 5, but it would be very unlikely to interpret it to categorically deny tax credits that may incidentally benefit religious entities. A State's interest "in achieving greater separation of church and State than is already ensured under the Establishment Clause . . . is limited by the Free Exercise Clause." *Widmar v. Vincent*, 454 U.S. 263, 276 (1981). As a result, many states have interpreted provisions like article X, section 5 of the Montana Constitution to apply coequally with the federal Establishment Clause of the United States Constitution, despite differences in the language of the state and federal provisions. *See, e.g., American Atheists*, 567 F.3d at 301 (6th Cir. 2009) (noting that despite differences in language, Michigan had applied its no-aid clause as no more restrictive than the federal Establishment Clause); *Alabama Educ. Ass'n v. James*, 373 So. 2d 1076, 1081 (Ala. 1979) (same). Doing so avoids unnecessary friction with the

federal Constitution.

While the Montana Supreme Court may or may not interpret article X, section 5 as narrowly, it is very unlikely to interpret it so broadly as to categorically exclude religious entities from SB 410's tax credit plan, especially when doing so would present grave difficulties in reconciling the Montana Constitution with the United States Constitution.

CONCLUSION

Rule 1's rationale—that the Montana Constitution requires categorical exclusion of religious entities from SB 410's tax credit program—is in error because the tax credit envisioned by SB 410 is not a direct or indirect appropriation by the State to a religious entity. Moreover, there is a substantial likelihood that Rule 1 would be held unconstitutional if challenged under the United States Constitution because it categorically excludes religious entities from an otherwise neutral benefits program without sufficient reason. If the Department adopts Rule 1, it is likely that its constitutionality would be challenged in federal court. The Attorney General believes that it would not be defensible.

If you have any questions or would like to discuss this matter further, please do not hesitate to contact me.

Sincerely,

Dale Schowengerdt
Solicitor General