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Espinoza v. Montana Department of Revenue: Tax Credits, Religious Schools, and Constitutional Conflict

Megan Eckstein

Oral arguments are scheduled for April 6, 2018, at 9:30 am at the George Dennison Theater on the University of Montana campus, Missoula, Montana. An introduction to the oral argument will begin at 9:00 am.

I. INTRODUCTION

This case presents the issue of whether a tax credit program can reimburse scholarship donors when the resulting scholarships can be used for religious schools under 1) Article X, section 6 of the Montana Constitution and 2) the First Amendment of the United States Constitution.

II. FACTUAL AND PROCEDURAL BACKGROUND

In 2015, the Montana Legislature created a tax credit program supporting scholarships for private schools.¹ The program “provides a one-to-one repayment, credited against a donor’s tax liability, of donations up to \$150 to a school scholarship organization.”² To make the program possible, the Legislature reserved \$3 million in funding in 2016.³ When the funding limit is met for a year, the aggregate amount increases by 10% in the following year.⁴

Taxpayers use the program as follows: first, a taxpayer makes a charitable donation to a Student Scholarship Organization (SSO).⁵ The program then allows the taxpayer to claim a tax credit for up to \$150 on their tax return.⁶ Next, a parent or guardian who wants to send their child to a qualified education provider selects the school of their choice.⁷ Finally, the SSO delivers the scholarship funds directly to the chosen school.⁸

Many potential beneficiaries of this tax credit program are private religious schools.⁹ Article X, section 6 of the Montana Constitution states,

¹ Appellant’s Opening Brief at 1, *Espinoza v. Mont. Dept. of Revenue*, <https://supremecourtdocket.mt.gov/view/DA%2017-0492%20Appellant's%20Opening%20--%20Brief?id={B0C7E45F-0000-C611-84AC-44DAEDCA7391}> (Mont. Feb. 2, 2018) (No. DA 17-0492).

² *Id.*

³ *Id.* at 6.

⁴ MONT. CODE ANN. § 15–30–3111 (Temporary) (2017); see also Education Donations Portal, *FAQ*, montana.gov, <http://svc.mt.gov/dor/educationdonations/SSOHelp.aspx> (last visited Mar. 20, 2018).

⁵ Education Donations Portal, *supra* at note 4.

⁶ *Id.*

⁷ *Id.*

⁸ *Id.*

⁹ Appellant’s Opening Brief, *supra* note 1, at 1.

in pertinent part, that “[t]he legislature . . . shall not make any direct or indirect appropriation or payment from any public fund or monies . . . for any sectarian purpose or to aid any church, school, academy, seminary, college, university, or other literary or scientific institution, controlled in whole or in part by any church, sect, or denomination.”¹⁰

To avoid indirect state funding of religious institutions, the Montana Department of Revenue (Appellants) enacted “Rule 1,” which excludes scholarship tax credit for religious schools from the program.¹¹ Plaintiff-Appellees are low-income families who wanted to apply for aid from SSOs whose donors are eligible for the credit to help their children attend religious private schools.¹² The Plaintiffs sued, alleging that Rule 1 discriminates against families who want to use scholarships created through this program for religious rather than secular private schools.¹³ Montana’s Eleventh Judicial District Court found Rule 1 invalid because “appropriation” under the Montana Constitution does not specifically encompass tax credits.¹⁴ The Montana Department of Revenue appealed.

III. ARGUMENTS

A. Appellant

The Appellant argues that Article X, section 6 of the Montana Constitution does not allow state aid, however indirect, to assist religious education.¹⁵ Appellant argues that payments under this program would be unconstitutional indirect aid because these payments go directly to religious schools, not to families.¹⁶ Appellant also states “the Legislature attached an extraordinary ‘constitutional proviso’ requiring the Department of Revenue to administer the tax credit in compliance with the Montana Constitution’s strict prohibition on aid to religious schools.”¹⁷ Further, the Legislature specifically amended the bill to include the proviso before the governor signed it into law—at the time the bill became law, Appellant contends the Legislature’s intent was to

¹⁰ MONT. CONST. art. X, § 6(1).

¹¹ Appellant’s Opening Brief, *supra* note 1, at 1.

¹² Appellee’s Response Brief at 1, *Espinoza v. Mont. Dept. of Revenue*, <https://supremecourtdocket.mt.gov/view/DA%2017-0492%20Appellee's%20Response%20--%20Brief?id={80901E61-0000-CD18-891B-5F66AC5EE9CE}> (Mont. Jan. 19, 2018) (No. DA 17-0492).

¹³ *Id.*

¹⁴ *Id.* at 4.

¹⁵ Appellant’s Opening Brief, *supra* note 1, at 2.

¹⁶ Appellant’s Reply Brief at 6–7, *Espinoza v. Mont. Dept. of Revenue*, <https://supremecourtdocket.mt.gov/view/DA%2017-0492%20Appellant%20Reply%20--%20Brief?id={202D8B61-0000-C523-B849-3D7D53CF3051}> (Mont. Feb. 12, 2018) (No. DA17-0492).

¹⁷ Appellant’s Opening Brief, *supra* note 1, at 1.

address the problem of unconstitutional indirect aid. Because of this, Appellant created Rule 1.¹⁸

Rule 1 disqualifies educational facilities and personnel associated with religious institutions from the program.¹⁹ It also specifically excludes facilities accredited by religious organizations.²⁰ Appellant clarifies that scholarships and other tax exemptions for religious schools are not impacted; they merely cannot take advantage of the state-funded tax credit program.²¹ Although a legislative poll later determined Rule 1 contrary to legislative intent, Appellant held a public hearing in regard to Rule 1 and concluded that without Rule 1, “the primary effect of the tax-credit program would be to provide aid to religious schools.”²² Appellant cites data suggesting that nearly 90% of program beneficiaries would be religiously affiliated schools and concludes it would be unconstitutional to grant such aid.²³

Appellant also argues Rule 1 does not violate the Free Exercise Clause under the United States Constitution because it does not prohibit general scholarship or tax exemptions for religious institutions.²⁴ Appellant states Rule 1 is a narrowly tailored response to a constitutional conflict with the Montana and United States Constitutions, and does not implicate Plaintiffs’ free exercise rights.²⁵ The religious beliefs of students and donors do not restrict aid to individuals under the program; restriction occurs only if the aid goes to religious institutions.²⁶ As for the Montana Constitution, Appellant states that it “equally protects all Montanans from supporting state funding of religious exercise or education in their name.”²⁷

B. Appellee

Appellee argues that Article X, section 6 of the Montana Constitution does not bar donors for religious school scholarships from the program because the program does not fall under its purview.²⁸ Appellee states the tax credit program does not use “direct or indirect” state funds for religious school aid, but rather “the private donations of individuals and businesses, given freely in exchange for tax credits.”²⁹ Further, even

¹⁸ *Id.* at 6, 32–33.

¹⁹ *Id.* at 8.

²⁰ *Id.*

²¹ *Id.* at 8–9.

²² *Id.* at 10.

²³ *Id.* at 10, 12.

²⁴ *Id.* at 36–37.

²⁵ *Id.* at 38.

²⁶ *Id.* at 39.

²⁷ *Id.* at 40.

²⁸ Appellee’s Response Brief, *supra* note 12, at 11.

²⁹ *Id.* at 12.

if state funds were used, those funds benefit individuals rather than religious institutions.³⁰

Appellee also contends that the Establishment Clause of the United States Constitution is not violated by tax credits for religious education scholarship.³¹ Appellee cites United States Supreme Court decisions that, under the test in *Lemon v. Kurtzman*,³² upheld scholarship programs for students wishing to attend religious schools.³³ Appellee emphasizes that if a program does not have the effect or purpose of advancing religion and only provides neutral aid to education, it does not violate the Establishment Clause.³⁴

Finally, Appellee argues that Rule 1 violates the Free Exercise Clause of the United States Constitution.³⁵ Appellee states that because Rule 1 only allows scholarship students to attend secular schools and excludes religious ones, it is not neutral toward religion.³⁶ Under Rule 1, Appellee contends that students are forced to choose between attending a scholarship-eligible secular private school or attending a school correlating with their religious beliefs.³⁷ Donors funding scholarships for religious schools are not eligible for the tax credit under the program.³⁸ Appellee further urges that the state interest in not paying for religious training “is not implicated by a financial aid program for elementary and secondary students.”³⁹

IV. ANALYSIS

A. Montana Constitutionality

The issue under the Montana Constitution hinges on 1) whether tax credits constitute state aid, and 2) if so, whether such aid constitutes a sectarian purpose or funds religious institutions. If the Court upholds Rule 1, tax credits are a form of state aid, and Rule 1 is necessary to make the program constitutional. If the Court finds that tax credits are not state aid, Rule 1 is unnecessary and invalid. Because the state sets aside funds to make the tax credits possible, and the monetary benefit of this funding runs ultimately to private schools, the Court will probably find Rule 1 necessary to prohibit an indirect state payment to religious schools.

³⁰ *Id.*

³¹ *Id.* at 29.

³² 403 U.S. 602 (1971).

³³ Appellee’s Response Brief, *supra* note 12, at 29–30 (citing *Gaddy v. Georgia Dep’t of Revenue*, 802 S.E.2d 225, 230 (Ga. 2017), where the Court held that despite a similar constitutional provision to Montana’s, tax expenditures were not appropriations; *McCall v. Scott*, 199 So.3d 359, 370 (Fla. 1st DCA 2016), where the court held that tax credits were not state funds, but another kind of support).

³⁴ *Id.* at 30.

³⁵ *Id.* at 33.

³⁶ *Id.* at 34.

³⁷ *Id.* at 35–36.

³⁸ *Id.* at 8–9.

³⁹ *Id.* at 38.

The tax credit program at issue allows a taxpayer or corporation to take a tax credit of up to \$150 when the individual or entity donates to a student scholarship organization.⁴⁰ Such organizations may provide money to students who wish to attend religious schools for their general primary and secondary education.⁴¹ The funds going to those schools—through the scholarships granted to students—come from the donors, who in turn can take a tax credit to offset their own tax liability.⁴²

The issue of whether a tax credit constitutes state aid is complicated and crucial to the present case. Because tax credits are given to individual donors to offset their tax liability, they are never realized in the state treasury, so the Appellee argues these credits are not public funds.⁴³ Appellee further argues that, under the language of Article X, section 6, the tax program does not provide aid to religious schools, but instead to families in a similar fashion to food stamps.⁴⁴ Conversely, Appellant argues the intent of Article X, section 6 was to strictly prohibit any indirect assistance to religious schools, including assistance in the form of tax credits.⁴⁵

While scholarship funds reach the school a student chooses to attend, the state's funds themselves are not used. Rather, tax credits represent potential revenue for the state that it chooses to forego when taxpayers elect to make scholarship donations. These tax credits reduce the state's general tax revenue.⁴⁶ By giving tax credits to scholarship donors whose donations run to eligible schools, this program indirectly aids those schools which, without Rule 1, would include schools affiliated with religious institutions. If the Court finds that tax credits are encompassed by Article X, section 6 in the words "appropriation or payment from any public fund or monies," Rule 1 will likely be upheld under the Montana Constitution. If, however, tax credits do not fit the language of the statute, Rule 1 is inapplicable.

If tax credits do not constitute state aid, the issue of whether the aid runs to religious organizations is not implicated. If tax credits are state aid, they do, however indirectly, appear to provide monetary benefit to private religious schools. The delegates for the Montana Constitutional Convention in 1972 expressed concern about indirect state funding of religious education and specifically placed the word "indirect" in Article

⁴⁰ § 15–30–3111 (Temporary)

⁴¹ Appellant's Opening Brief, *supra* note 1, at 1; Appellee's Response Brief, *supra* note 12, at 1.

⁴² § 15–30–3111 (Temporary); *see also* Mont. Dept. of Revenue, *Student Scholarship Organization Credit*, [mtrevenue.gov, https://mtrevenue.gov/taxes/tax-incentives/student-scholarship-organization-credit/](https://mtrevenue.gov/taxes/tax-incentives/student-scholarship-organization-credit/) (last visited Mar. 15, 2018).

⁴³ Appellee's Response Brief, *supra* note 12, at 14, 20.

⁴⁴ *Id.* at 22–23.

⁴⁵ Appellant's Reply Brief, *supra* note 16, at 16–17.

⁴⁶ *Id.* at 8.

X, section 6.⁴⁷ The Montana constitutional issue in this case thus depends on the categorization of tax credits.

B. Federal Constitutionality

The primary federal issues in this case are 1) whether the tax program, without Rule 1, would violate the Establishment Clause, and 2) whether Rule 1 violates the Free Exercise Clause.

Under the Establishment Clause of the United States Constitution, the legislature shall “make no law respecting an establishment of religion.”⁴⁸ Here, the tax credit program does not explicitly favor religious schools, although absent Rule 1, it could be used to help students pay for tuition at such schools. Appellant posits that without Rule 1, the program would serve to favor religious schools because over half of eligible schools would be religiously affiliated; therefore, the primary effect of the program would be to aid religious schools.⁴⁹ The Montana Legislature provided a constitutional proviso for the tax-credit program.⁵⁰ The intent of the Legislature at the time the bill was drafted appears to comport with Appellant’s rationale for creating Rule 1, although the legislative poll now calls that intent into question.⁵¹ Whether this program, absent Rule 1, compels state funding for religious institutions depends on the nature of the tax credits at issue.

In *Trinity Lutheran Church of Columbia, Inc. v. Comer*, the United States Supreme Court held that a state does not violate the Establishment Clause when it confers a public benefit neutrally to both religious and nonreligious entities.⁵² However, when a state refuses to confer a public benefit to religious entities solely because of their religious nature, absent a compelling state interest, the state violates the Free Exercise Clause.⁵³ The Ace Scholarships amicus brief in support of Appellee states the program is a public benefit program like in *Trinity*.⁵⁴ Appellee argues that absent a state interest “of the highest order,” withholding such a public benefit infringes on the free exercise of religion.⁵⁵ The public benefit program in *Trinity*, which was used to improve a preschool playground, was unrelated to the religious affiliation

⁴⁷ ACLU Amicus Brief at 5, *Espinoza v. Mont. Dept. of Revenue*, <https://supremecourtdocket.mt.gov/view/DA%2017-0492%20Amicus%20--%20Brief?id={303DE05F-0000-C624-A715-77D61F6E8297}> (Mont. Nov. 21, 2017) (No. DA 17-0492).

⁴⁸ U.S. CONST. amend. I.

⁴⁹ Appellant’s Reply Brief, *supra* note 16, at 10–11; *see also* Comm. for Public Educ. & Religious Liberty v. Nyquist, 413 U.S. 756, 776 (1973).

⁵⁰ Appellant’s Opening Brief, *supra* note 1, at 1.

⁵¹ *Id.* at 9–10.

⁵² 137 S. Ct. 2012, 2021 (2017).

⁵³ *Id.* at 2024.

⁵⁴ *Id.* at 2019; Ace Scholarships Amicus Brief at 20–21, *Espinoza v. Mont. Dept. of Revenue*, <https://supremecourtdocket.mt.gov/view/DA%2017-0492%20Amicus%20--%20Brief?id={90D41061-0000-CF12-82B2-5E5EADF62732}> (Jan. 19, 2018) (No. DA17-0492).

⁵⁵ Ace Scholarships Amicus Brief, *supra* note 53, at 20–21.

of the beneficiary.⁵⁶ Of interest in *Trinity* is the concurrence, which states “[p]ublic benefits come in many shapes and sizes.”⁵⁷ At issue here is a scholarship program that includes private schools.

The ambiguity of what constitutes a public benefit makes comparisons between *Trinity* and the instant case murky. Here, the public benefit is a parent’s choice of school for his or her child. This benefit differs from the health and safety concerns of the program in *Trinity*, although the Court did not explicitly make those concerns a requirement.⁵⁸ If the Montana Supreme Court finds that choice of private school is a public benefit, this will expand the scope of what constitutes a public benefit in Montana. Because public schools are more likely to constitute a public benefit, it is unlikely the Court will find that private schools fall into the same category.

The United States amicus brief supporting Appellee states that because students apply for these scholarships to pay for general education rather than religious degrees, Rule 1 discriminates against free exercise of religion.⁵⁹ If the tax credit program is found to constitute state aid, then a more fact-specific inquiry about the prevalence of religious versus general education at specific schools may be appropriate to determine the program’s federal constitutionality.

V. CONCLUSION

Under the Montana Constitution, Rule 1’s constitutionality hinges primarily on the meaning of Mont. Const. Art. X, section 6. More specifically, the Court must decide whether tax credits constitute state funds, and whether, without Rule 1, they would provide indirect state aid to religious schools under this program. Federal constitutionality is tied to the nature of the scholarship program and what—or whom—it ultimately benefits: the public, or religious institutions.

⁵⁶ *Trinity*, 137 S. Ct. at 2014.

⁵⁷ *Id.* at 2027.

⁵⁸ *Id.* at 2018.

⁵⁹ United States Amicus Brief at 15, *Espinoza v. Mont. Dept. of Revenue*, <https://supremecourtdocket.mt.gov/view/DA%2017-0492%20Amicus%20--%20Brief?id={70090B61-0000-CA1C-BE8A-4B82E18C81E4}> (Jan. 18, 2018) (No. DA17-0492).