

IN THE OREGON TAX COURT
MAGISTRATE DIVISION
Income Tax

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|------------------------|---|-----------------|
| KATHLEEN F. MCKINLEY, |) | |
| |) | |
| Plaintiff, |) | TC-MD 040133F |
| |) | |
| v. |) | |
| |) | |
| DEPARTMENT OF REVENUE, |) | |
| State of Oregon, |) | |
| |) | |
| Defendant. |) | DECISION |

Plaintiff appeals the denial of the disabled child tax credit claimed on her Oregon income tax returns for the years 2000, 2001, and 2002. Hearings were conducted by telephone May 25, 2004, and June 28, 2004. The parties agreed to have the case decided on their oral arguments in those hearings and written submissions. Kathleen F. McKinley appeared for herself. Nancy Grigorieff, auditor, appeared for Defendant.

I. STATEMENT OF FACTS

The facts are not in dispute. Plaintiff's daughter was born with spina bifida, a neural tube defect that occurs when the spinal column does not close completely. Persons with spina bifida may be partially or completely paralyzed, have bowel or bladder conditions, and/or have hydrocephalus.¹ Plaintiff previously lived in Oregon, where her daughter received special education services and she maintained employment. Plaintiff moved to Vancouver following the 1995-1996 school year, but continued to work in Oregon.

Until 1996, Plaintiff's daughter received Individual Education Plans (IEPs) from the Portland Public School District pursuant to the Individuals with Disabilities Education Act (IDEA). *See* 20 USC § 1412 (2001). Following Plaintiff's move, her daughter received special

¹ Hydrocephalus is a build-up of fluid on the brain that must be relieved by a permanently implanted shunt to drain the fluid. Hydrocephalus may result in varying degrees of mental retardation.

education services from the Evergreen School District. That decision was based upon the information contained in Plaintiff's daughter's Oregon IEP.

Plaintiff works in Oregon and pays Oregon state income tax. Plaintiff filed Oregon nonresident returns for the years 2000, 2001, and 2002, and filed for the disabled child tax credit, provided for in ORS 316.099,² in each of those years. Following receipt of Plaintiff's 2002 return, Defendant requested a copy of her daughter's current Oregon IEP. Plaintiff was unable to provide an Oregon IEP since her daughter has attended Washington schools since 1996. Citing Plaintiff's failure to produce an Oregon IEP, Defendant denied the credit for 2000, 2001, and 2002. Plaintiff subsequently filed this appeal and asks the court to declare the IEP requirement in violation of the Privileges and Immunities Clause of the United States Constitution.

II. ANALYSIS

A taxpayer is entitled to an additional personal exemption credit if the dependent child of the taxpayer is a disabled child. ORS 316.099(3). "Disabled child" is defined as:

"a child from the age of identification of the disability to the age of 18 who has been determined eligible for early intervention services or is diagnosed for the purposes of special education as being autistic, mentally retarded, multidisabled, visually impaired, hearing impaired, deaf-blind, orthopedically impaired or other health impaired or as having emotional disturbance or traumatic brain injury, in accordance with State Board of Education rules."

ORS 316.099(1). It further provides that a "diagnosis obtained for the purposes of entitlement * * * shall serve as the basis" for the disabled child tax credit. ORS 316.099(2). The administrative rule requires the taxpayer to provide the "first sheet of the applicable year's Department of Education form." OAR 150-316.099(2). That substantiation requirement is somewhat different from that required for the severely disabled adult tax credit.

²All references to the Oregon Revised Statutes (ORS) are to 1999. There were no relevant changes to the statutory language during the 2001 legislature.

See ORS 316.771. To substantiate a claim for the severely disabled tax credit, a taxpayer need only provide a letter from a licensed physician or osteopath. *Id.*

The portion of the statute that deals with the special education defines “children with disabilities” as those who are:

“entitled to free appropriate public education * * * and who require special education because they have been evaluated as having one of the following conditions as defined by rules established by the State Board of Education: Mental retardation, hearing impairment including difficulty in hearing and deafness, speech or language impairment, visual impairment, including blindness, deaf-blindness, emotional disturbance, orthopedic or other health impairment, autism, traumatic brain injury or specific learning disabilities.”

ORS 343.035(1).³ That evaluation is conducted by the child’s IEP Team (Team). Under circumstances relevant to this case, the Team would consist of the child’s parent and “two or more professionals, at least one of who[m] is knowledgeable and experienced in the evaluation and education of children with the suspected disability.” OAR 581-015.0053(1)(a). The Team records its determinations in the child’s IEP. See OAR 581-015.0053(4).

The rules also provide the criteria by which a specified condition may be determined. See OAR 581-015.0051. “If a child is suspected of having an orthopedic impairment,” such as spina bifida, the evaluation should consist of a “medical statement or a health assessment statement indicating a diagnosis * * * or a description” of an orthopedic impairment, a standardized motor assessment by a specialist, and assessments to determine the impact of the

³ The IDEA defines a child with a disability as a child:

“(i) with mental retardation, hearing impairments (including deafness), speech or language impairments, visual impairments (including blindness), serious emotional disturbance (hereinafter referred to as “emotional disturbance”), orthopedic impairments, autism, traumatic brain injury, other health impairments, or specific learning disabilities; and

“(ii) who, by reason thereof, needs special education and related services.”

20 USC § 1401(3)(a).

disability on the child's educational performance. OAR 581-015.0051(7). The Team must also determine that the child's disability has an adverse impact and that special education services are required. *Id.*

For the purposes of Oregon income tax and as interpreted by the administrative rule, ORS 316.099 effectively precludes nonresidents from receiving the disabled child tax credit. That result raises the question of whether the IEP requirement violates the Privileges and Immunities Clause of the United States Constitution.

Article IV, section 2 of the United States Constitution provides: "The Citizens of each State shall be entitled to all Privileges and Immunities of Citizens in the several States." US Const, Art IV, § 2. The Clause was intended to "fuse into one Nation a collection of independent, sovereign States" by putting citizens of separate states on equal footing in respect of the advantages conferred by state citizenship. *Toomer v. Witsell*, 334 US 385, 395, 68 SCt 1156, 92 LEd 1460 (1948); *Fisher v. Dept. of Rev.*, 16 OTR-MD 323, 328 (2001). "Indeed, without some provision of the kind removing from the citizens of each State the disabilities of alienage in the other States, and giving them equality of privilege with citizens of those States, the Republic would have constituted little more than a league of States; it would not have constituted the Union which now exists." *Paul v. Virginia*, 75 US (8 Wall) 168, 180, 19 LEd 357 (1868) (quoted in *Toomer*, 334 US at 396), overruled on other grounds in *United States v. South-Eastern Underwriters Ass'n*, 322 US 533, 64 SCt 1162, 88 LEd 1440 (1944).

A right secured under the Privileges and Immunities Clause is the right of a citizen to "remove to and carry on business in another [state] without being subjected in property or person to taxes more onerous than the citizens of the latter state are subjected to." *Shaffer v. Carter*, 252 US 37, 56, 40 SCt 221, 64 LEd 445 (1920)). While recognizing that "absolute equality is impracticable in taxation," the Supreme Court nonetheless applied the reasoning from *Toomer* to

determine whether state tax law violated the Privileges and Immunities Clause. *See Lunding v. New York Tax App. Trib.*, 522 US 287, 296, 299, 118 US SCt 766, 139 LEd 2d 717 (1998) (quoting *Maxwell v. Bugbee*, 250 US 525, 543, 40 SCt 2, 63 LEd 1124 (1919)).

The Privileges and Immunities Clause is not absolute, thus it does not preclude discrimination in all circumstances. *Toomer*, 334 US at 396. The clause only bars discrimination where there is “no substantial reason * * * beyond the mere fact that they [persons being discriminated against] are citizens of other States.” *Id.* To determine whether such reason exists, the court first identifies the state’s objective, but does not “question its worthiness.” *See Fisher*, 16 OTR-MD 328-330. Then the court determines whether “(i) there is a substantial reason for the difference in treatment; and (ii) [whether] the discrimination practiced against nonresidents bears a substantial relationship to the State’s objective.” *Supreme Ct. of New Hampshire v. Piper*, 470 US 274, 284, 105 SCt 1272, 84 LEd 2d 205 (1985) (explaining *Toomer*, 334 US at 396).

In *Piper*, the United States Supreme Court ruled on whether a requirement that lawyers live within New Hampshire to practice within the state violated the Privileges and Immunities Clause. *Piper*, 470 US at 277. Kathryn Piper lived just 400 yards from the New Hampshire border. *Id.* at 275. She successfully passed all requirements to practice in New Hampshire, including sitting for and passing the state bar exam. *Id.* at 276. Rather than admit Piper to the practice within the state, the Board of Bar Examiners informed her that she would be required to establish residency in New Hampshire. *Id.*

Arguing in federal district court, the Supreme Court of New Hampshire gave four reasons for discriminating against out-of-state lawyers. *Id.* at 285. It suggested the residency requirement was necessary because “nonresident members would be less likely (i) to become,

and remain, familiar with local rules and procedures; (ii) to behave ethically; (iii) to be available for court proceedings; and (iv) to do *pro bono* and other volunteer work in the State. *Id.*

Applying the first step from *Toomer*, The United States Supreme Court first held that the state lacked a “substantial reason.” *See Id.* at 285-286. It found that there was no evidence to support the Supreme Court of New Hampshire’s claim that a nonresident lawyer would be less likely than a resident lawyer to remain familiar with local rules. *Id.* It found similarly that there was no reason to believe that out-of-state lawyers would be less likely to behave ethically. *Id.* at 285-286. The Court then found that the remaining reasons, availability for court proceedings and meeting requirements for pro bono work, possessed greater merit, but were unlikely dangers. *Id.* at 286-287.

Then, applying the second step from *Toomer*, the Court held that even if the reasons met the test of substantiality, the discrimination being practiced in New Hampshire did not bear a “substantial relationship to the State’s objective.” *Id.* at 284. To determine whether such a relationship existed, the Court looked for less restrictive means by which the state could achieve its objectives. The Court suggested that members of the bar, regardless of their residency, could be adequately controlled by existing disciplinary measures for unethical conduct, failure to appear at court proceedings, or failure to meet pro bono requirements. *Id.* at 286-287.

In *Lunding*, the United States Supreme Court sought to determine whether New York violated the Privileges and Immunities Clause by denying nonresidents the alimony deduction allowed to the residents. 522 US at 296. With the exception of income paid in alimony, nonresidents were only taxed on the pro rata share of their income attributable to activities conducted in New York. *Id.* at 306. This effectively disallowed a deduction to nonresidents that was allowed to residents. *Id.*

Despite characterizing the state's reasons as "cursory," the Court evaluated those reasons according to *Toomer's* test of substantiality. *Id.* 309-313. The state claimed first that because it could not tax out-of-state income, it need not recognize out-of-state expenses. *Id.* The Court rejected that first justification because such rule could result, in some circumstances, in a nonresident being required to "pay more tax than an identically situated resident." *Id.* at 310. Second, the state claimed that its discrimination was consistent with the state's "income splitting" policy towards marital income. *Id.* The Court rejected the second reason because the discrimination actually operated so that both former spouses would pay income tax if the recipient was a resident and the party paying alimony was a nonresident. *Id.* at 312-313.

The Oregon Tax Court was recently faced with the question of whether disallowing nonresidents' deferral of gains relating to a like-kind property exchange violated the Privileges and Immunities Clause. *See Fisher*, 16 OTR-MD at 327-328. Finding that the taxpayer was a Colorado resident, the Oregon Department of Revenue (Dept. of Rev.) had denied the deferral of gains for income tax purposes. *Id.* at 325.

The Department of Revenue claimed that potentially greater collection difficulties justified its discrimination against nonresidents. *Id.* at 331. Applying the first step from *Toomer*, the tax court did not find the department's justification met the test of substantiality. *Id.* The court noted that the department had offered no evidence of collection difficulties and that the state did not disallow the deferral to residents who later moved from the state, even though such a situation would seem to create identical collection challenges. *Id.*

Applying the second step from *Toomer*, the tax court held that there was no substantial relationship between the discrimination and the state's objective. *Id.* As in *Piper*, the state looked to the availability of less restrictive means. *Id.* The court cited taxpayer's argument that

Defendant could reduce collection difficulties by requiring nonresidents to file annual information returns until the gain was recognized and the tax paid. *Id.*

The parties to this case agree that the Oregon IEP requirement, whether contained in the statute or the administrative rule, has the practical effect of denying the disabled child deduction to nonresident taxpayers. As in *Lunding*, Plaintiff ends up paying higher taxes than an identically situated resident. A nonresident taxpayer, with a disabled child outside any Oregon school district, will not have access to the Oregon Board of Education's IEP process and thus not the Oregon IEP form necessary to substantiate the disabled child credit.

Defendant justifies the IEP requirement by claiming that, despite such discriminatory result, the IEP requirement is necessary to ensure uniform application of standards. Because income tax credits result in dollar for dollar reductions in revenue, Defendant contends all claims for such credits warrant close scrutiny. Following that reasoning, Board of Education guidelines, as executed by local school districts, must somehow be more reliable than alternative methods used to substantiate a disability claim.

Looking to the first step of the *Toomer* analysis, this court must determine whether Defendant's reason meets the test of substantiality. First, the risk of lack of uniformity seems more imagined than real. Indeed, Defendant has offered no evidence that such a danger exists. One of the purposes of the IDEA is "to ensure that all children with disabilities have available to them a free appropriate public education that emphasizes special education and related services designed to meet their unique needs and prepare them for employment and independent living." 20 USC § 1400(d)(1)(A). The IDEA and associated regulations require states and their political subdivisions to meet the requirements of the act in order to receive funds under the act. 34 CFR § 300.110. Second, even though the risk of lack of uniformity would seem the same for

both the disabled child tax credit and the severely disabled adult tax credit, Defendant requires only a physician's letter to substantiate the adult credit.

Defendant's uniformity justification also fails the second step of the *Toomer* analysis, the "substantial relationship" requirement. To determine whether such a relationship exists, the court properly considers the availability of less restrictive means. As in both *Toomer* and *Piper*, Defendant could use less restrictive means to achieve uniformity in its application of standards. Physician's professional opinions are viewed as trustworthy by many institutions and private entities and could be used to substantiate the disabled child tax credit. Indeed, a physician's letter is already an important part of the IEP process and is required substantiation for those claiming the "severely disabled" income tax credit.

An additional less restrictive way exists. Because the IEP process is a product of the federal IDEA, an IEP will be virtually identical regardless of the state of origin. All states must meet the same federal standards; accordingly, out-of-state IEPs should be accepted by the Defendant.

Finally, it is important to note that ORS 316.099 was enacted by the legislature in recognition of the additional costs that parents of disabled children must bear. *See* Testimony of Therese Descamp, Senate Committee on Revenue and School Finance, June 17, 1985 ("HB 2736 is a way to recognize the extra cost both financial and emotional imposed on families of children with severe handicaps"). Those costs do not diminish for Plaintiff because she works in Oregon while living in Washington. However, costs to the state are actually reduced since Plaintiff and her daughter live in Washington.

IV. CONCLUSION

For Defendant's discrimination not to violate the Privileges and Immunities Clause, Defendant must advance a substantial reason for the discrimination and demonstrate a substantial

relationship between the discrimination and the state's objective. ORS 316.099, as enforced by the Defendant and interpreted by administrative rule, violates the Privileges and Immunities Clause of the United States Constitution by denying nonresident parents of disabled children the tax credit available to their resident peers. Defendant has not advanced a substantial reason for the discrimination nor does the discrimination bear a substantial relationship to the state's objective. Now, therefore,

IT IS THE DECISION OF THIS COURT that Plaintiff's claimed disabled child tax credits for the years 2000, 2001, 2002 is allowed.

Dated this _____ day of October 2004.

SALLY L. KIMSEY
MAGISTRATE

IF YOU WANT TO APPEAL THIS DECISION, FILE A COMPLAINT IN THE REGULAR DIVISION OF THE OREGON TAX COURT, BY MAILING TO: 1163 STATE STREET, SALEM, OR 97301-2563; OR BY HAND DELIVERY TO: FOURTH FLOOR, 1241 STATE STREET, SALEM, OR. YOUR COMPLAINT MUST BE SUBMITTED WITHIN 60 DAYS AFTER THE DATE OF THE DECISION OR THIS DECISION BECOMES FINAL AND CANNOT BE CHANGED.

THIS DOCUMENT WAS SIGNED BY MAGISTRATE SALLY L. KIMSEY OCTOBER 29, 2004. THE COURT FILED THIS DOCUMENT OCTOBER 29, 2004. THIS DOCUMENT WAS ENTERED NOVEMBER 1, 2004.