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Louisiana Homestead Exemption Waiver Will Not Yield Intended Federal Income Tax Break*

Susan Kalinka**

On July 13, 1999, Governor Mike Foster signed into law Louisiana House Bill No. 897 (now Louisiana Acts No. 1266), enacting sections 47:315.4 and 47:1711 of the Louisiana Revised Statutes.¹ Under Louisiana law, a homeowner is entitled to a homestead exemption, allowing exclusion from real property taxation of up to \$75,000 of the assessed value of the home.² New Louisiana Revised Statutes 47:1711 allows Louisiana homeowners to waive their homestead exemption, paying additional real property taxes as a result of the waiver. Louisiana Revised Statutes 47:315.4, in turn, allows a homeowner who has waived the homestead exemption to receive a refund of local sales and use taxes in an amount equal to the additional tax paid as a result of the homestead exemption waiver.

The newly enacted law is likely to mislead taxpayers into claiming deductions on their federal income tax returns that will not be allowed. The legislation has been advertised as offering homeowners in Louisiana a reduction in their federal income tax liability.³ Taxpayers generally may claim a deduction for state and local real property taxes on their federal income tax return.⁴ In contrast, state and local sales and use taxes are not deductible unless the taxes are paid or incurred in connection with a trade or business or an income-producing activity. However, any additional real property tax paid as a result of a homestead exemption waiver under Louisiana Revised Statutes 47:1711 will not be deductible for federal income tax purposes.

If homeowners take advantage of the homestead exemption waiver and claim a federal income tax deduction for the additional real property tax paid as a result of the waiver, they will be liable to the federal government for deficiencies in taxes and interest. Claiming the deduction may even expose a taxpayer to liability for federal tax penalties, as well.⁵

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** Susan Kalinka, J.D., is the Harriet S. Daggett-Frances Leggio Landry Professor of Law at the Paul M. Herbert Law Center, Louisiana State University, in Baton Rouge, Louisiana. The author would like to thank Dean Thomas C. Galligan, Jr. and Vice Chancellor Glenn G. Morris for their comments on earlier drafts of this article. The views expressed herein are the opinions of the author and not necessarily the opinions of those who commented on earlier drafts.

1. 1999 La. Acts No. 1266. The legislation also amends and reenacts La. R.S. 47:301(10)(a)(iii) and 47:301(18)(a)(iii) (Supp. 1999). This article discusses only the newly enacted La. R.S. 47:315.4 and 47:1711 (Supp. 1999).

2. La. Const. art. VII, § 20; La. R.S. 47:1703(A) (Supp. 1999).

3. See, e.g., Carl Redman, Business, *Homeowner Tax Breaks Pass*, *The Advocate*, June 19, 1999, at 8A.

4. Code Sec. 164(a)(1).

5. Code Sec. 6662.

I. NO FEDERAL INCOME TAX DEDUCTION

Section ("Code Sec.") 164(a)(1) of the Internal Revenue Code allows a deduction for state, local and foreign real property taxes. A real property tax is deductible only if: (1) the levy is imposed on the taxpayer;⁶ (2) the levy is imposed on interests in real property and raised for the general welfare;⁷ and (3) the levy is a "tax."⁸

The IRS and the courts will not allow Louisiana taxpayers to deduct the additional real property tax paid as a result of waiving the homeowner's exemption because the additional amount paid fails to meet all three of the foregoing requirements. The additional real property tax paid pursuant to Louisiana Revised Statutes 47:1711 fails to meet the first requirement because the additional payment is not "imposed on the taxpayer." Louisiana Revised Statutes 47:1711 provides an elective procedure whereby the taxpayer voluntarily waives the homestead exemption. Thus, the tax is not "imposed"; instead, it is a voluntary payment. Moreover, a taxpayer who waives the homestead exemption suffers no economic burden (and, therefore, no "imposition") because the taxpayer is allowed to offset the amount paid pursuant to the homestead exemption waiver by seeking a credit against local sales and use taxes under Louisiana Revised Statutes 47:315.4.

The second requirement for deductibility is not satisfied because additional amounts paid as a result of a waiver of the homestead exemption will not be used for the general welfare. Because a homeowner who waives the homestead exemption is entitled to a refund of local sales and use taxes in the amount paid pursuant to the waiver, the new legislation will not "raise" any amounts for the general welfare.

Finally, the additional tax paid pursuant to a homestead exemption is not a "tax" as defined by federal tax law. Under federal law, a tax is an enforced contribution, exacted pursuant to legislative authority in the exercise of the taxing power and imposed on the public for the purpose of raising revenue to be used for public or governmental purposes, not as a payment for some special privilege granted or service rendered.⁹ The question of whether a particular contribution, charge or burden is to be regarded as a tax for federal tax purposes depends on its real nature, regardless of whether it is denominated a "tax" under state law.¹⁰

The "tax" paid pursuant to Louisiana Revised Statutes 47:1711 is not a tax because it is not an enforced contribution. A homeowner is not required to waive the homestead exemption. As explained above, the tax also is not imposed for the purpose of raising revenue. The new legislation is revenue neutral; no revenue is raised as a result of a homestead exemption waiver because the waiver entitles a taxpayer to receive a refund of local sales and use taxes in the same amount as the additional property taxes that were paid.

6. Reg. § 1.164-1(a); *V.M. Cramer*, 55 TC 1125, Dec. 30, 697.

7. Reg. § 1.164-3(b).

8. Rev. Rul. 79-180, 1979 CB 95.

9. Rev. Rul. 79-180, 1979-1 CB 95 and Rev. Rul. 77-29, 1977-1 CB 4.

10. Rev. Rul. 79-180, 1979-1 CB 95 and Rev. Rul. 58-141, 1958-1 CB 101.

In Rev. Rul. 79-180,¹¹ the IRS ruled that a real property tax imposed on renters by the state of New York (the "renters tax") was not deductible by renters as a real property tax under Code Sec. 164. The New York law generally imposed a tax, designated as a real property tax, on persons who rented real property for residential purposes and paid \$150 or more a month in rent. The New York law, however, did not relieve the owner of the real property from the obligation of paying the taxes due on the owner's property or vitiate the sale of the real property for unpaid taxes.

Under the New York renters tax law, the owner of the real property was deemed to be an agent of the collecting officer for purposes of collecting the property tax due from each renter. The payments by the renter to the owner were to be made in two separate amounts, consisting of basic rent (the rental amount less the amount of real property tax designated for the rental unit) and the real property tax due from the rental unit. Tax payments to the owner discharged the renter's liability for the taxes so paid, regardless of any subsequent disposition of the money made by the owner. If a renter failed to pay or was delinquent in paying the real property tax, the owner nevertheless was responsible for paying the tax.

The New York law prohibited the owner of the real property from charging a renter who was subject to the real property tax an amount in any rental period in excess of the rent reserved in the lease or the maximum rent permitted under rent controls and regulations, reduced by the renters tax allocated to the renter. Thus, the total amount paid to a real property owner by a renter subject to the tax equalled the amount of rent reserved under the lease or the maximum amount of rent permitted under rent controls and regulations.

In Rev. Rul. 79-180, the IRS concluded that the New York renters tax was not a tax because it did not impose on the renter any economic burden that did not exist prior to the enactment of the state law. Instead, "the renters tax merely divided the separately determined rental amount into a so-called rental payment and a so-called real property tax."¹²

Similarly, the new legislation imposes no economic burden on a homeowner. A homeowner in Louisiana who does not waive the homestead exemption is entitled to a homestead exemption for purposes of paying real property taxes and must pay the full amount of any local sales and use taxes. If the homeowner waives the homestead exemption pursuant to Louisiana Revised Statutes 47:1711, the amount of the homeowner's local sales and use taxes may be reduced by the additional amount paid as a result of the homestead exemption waiver.

II. INTERNATIONAL TAX PROVISIONS

The international tax provisions of the Internal Revenue Code (the "Code") and the regulations thereunder also support the disallowance of a deduction for additional real property taxes paid as a result of a homestead exemption waiver

11. 1979-1 CB 95.

12. *Id.*

under Louisiana Revised Statutes 47:1711. The international tax provisions are important because they provide a statutory and regulatory definition of the term "tax" for U.S. income tax purposes. Code Sec. 901 allows a taxpayer to claim a credit against federal income taxes for foreign income, war profits and excess profits paid or accrued during the tax year. A foreign levy is not creditable, regardless of whether a foreign government designates the levy as a tax, unless the levy is a "tax" under U.S. tax principles.¹³ Notwithstanding any assertion of a foreign country to the contrary, a foreign levy is not made pursuant to a foreign country's authority to levy taxes, and, thus, is not a tax, to the extent that a person subject to the levy receives (or will receive), directly or indirectly, a "specific economic benefit."¹⁴ A specific economic benefit includes a service, a fee or other payment or a reduction or discharge of a contractual obligation.¹⁵ The additional tax paid by a homeowner pursuant to Louisiana Revised Statutes 47:1711 confers a specific economic benefit upon the homeowner by permitting the homeowner to reduce the amount of local sales and use taxes owed by the homeowner.

Code Sec. 901(i) provides that a foreign income, war profits or excise profits tax is not a tax for purposes of the Internal Revenue Code to the extent that the amount of the tax is used, directly or indirectly, by the country imposing the tax to provide a subsidy by any means to the taxpayer and the subsidy is determined, directly or indirectly, by reference to the amount of the tax or the base used to compute the tax. The term "subsidy" includes any benefit conferred, directly or indirectly, by the foreign country to the taxpayer.¹⁶ The additional real property tax paid pursuant to Louisiana Revised Statutes 47:1711 is a subsidy, not a tax, because Louisiana Revised Statutes 47:315.4 allows the taxpayer to reduce local sales and use taxes in the amount of the additional property tax paid pursuant to the homestead exemption waiver.

III. LTR 9109030

It has been suggested that IRS Letter Ruling ("LTR") 9109030¹⁷ supports the deductibility of the additional taxes that would be paid pursuant to a homestead exemption waiver under Louisiana Revised Statutes 47:1711. In LTR 9109030, the IRS ruled that condominium owners were allowed to deduct as real property taxes their proportional share of service payments paid in lieu of the local property taxes. LTR 9109030 is one of several IRS rulings permitting taxpayers to deduct amounts paid in lieu of real property taxes.¹⁸ Under these rulings, an amount paid in lieu of a real property tax is deductible as a real property tax if the payment is calculated

13. Reg. § 1.901-2(a)(1) and Reg. § 1.901-2(a)(2)(i).

14. Reg. § 1.901-2(a)(2)(i).

15. Reg. § 1.901-2(a)(2)(ii)(B).

16. Reg. § 1.901-2(e)(3)(ii).

17. LTR 9109030 (Nov. 30, 1990).

18. See, e.g., Rev. Rul. 71-49, 1971-1 CB 103; LTR 9150056 (Sept. 12, 1991); LTR 9029057 (Apr. 25, 1990); and LTR 8919002 (Jan. 31, 1989).

through a rate based on valuation, is imposed with respect to interests in real property and is used for public or governmental purposes.

The service payments required of the condominium owners in LTR 9109030 were imposed on interests in real property, were collected at the same time that real property taxes were collected and were computed on the basis of the existing net tax rate generally applicable to real property located in the city. The amounts paid by the condominium owners were used by the city to pay principal and interest on municipal bonds, the proceeds of which were used to construct improvements for the area in which the condominiums were located. The improvements included a retaining wall, rehabilitation of surface walkways, elevated walkways, public plazas, new sidewalks, street lighting and streetscape improvements. The IRS concluded that the service payments made by the condominium owners were designated for a public purpose rather than for some privilege, service or regulatory function, or for some other local benefit tending to increase the value of the property upon which the payments were made.

The deductible service payments that were made by the taxpayers in LTR 9109030 in lieu of their obligation to pay real property taxes cannot be compared to the Louisiana real property tax that will be paid by homeowners in lieu of local sales and use tax under Louisiana Revised Statutes 47:1711. Unlike the service payments in LTR 9109030, the additional payments of real property tax under Louisiana Revised Statutes 47:1711 are not designated for a public purpose. Instead, the payments are designated for repayment to the homeowner as a refund of local sales and use taxes. Moreover, the condominium owners in LTR 9109030 were required to pay the service fee. In contrast, a homeowner is not required to waive the homestead exemption under Louisiana Revised Statutes 47:1711. Finally, the additional real property tax paid by a homeowner who waives the homestead is not paid in lieu of an otherwise deductible state tax, but in lieu of sales and use taxes that are not deductible for federal income tax purposes unless paid or incurred in connection with a trade or business.

Not only does the new Louisiana legislation fail to provide intended federal tax benefits, but it imposes a heavy burden on local taxing authorities. As a result of the new legislation, local taxing authorities must now spend time and money establishing procedures for determining whether a homeowner has actually waived the homestead exemption and whether the homeowner has, in fact, paid local sales and use taxes collected by the single tax collector for the parish in which the taxpayer filed the waiver.¹⁹ The legislation provides no method for implementing the waiver and refund program. Given the lack of federal tax or other benefits to be achieved by waiving a homestead exemption, it is uncertain how many homeowners will elect to take advantage of the new law.

IV. CONCLUSION

The new law is likely to create problems for a Louisiana homeowner who claims a federal income tax deduction for additional real property taxes paid as a

19. La. R.S. 47:315.4 (Supp. 2000).

result of a homestead exemption. In addition, the legislation will impose unnecessary burdens on local governments.

In fact, the new legislation is unconstitutional. Article III, section 2 of the Louisiana Constitution provides in part:

No measure levying or authorizing a new tax by the state or by any statewide political subdivision whose boundaries are coterminous with the state, increasing an existing tax by the state or by any statewide political subdivision whose boundaries are coterminous with the state, or legislating with regard to tax exemptions, exclusions, deductions, or credits shall be introduced or enacted during a regular session held in an odd-numbered year.²⁰

Louisiana Revised Statutes 47:315.4 and 47:1711 constitute legislation with regard to tax exemptions and credits. These statutes were introduced and enacted in 1999, an odd-numbered year. Accordingly, the bill was passed in violation of the Louisiana Constitution. If Louisiana Revised Statutes 47:315.4 and 47:1711 are not ruled unconstitutional, it is hoped that the legislation will be repealed during the next legislative session.

20. La. Const. art III, § 2(A)(3).