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April 27, 2010

The Honorable Martin O'Malley
Governor of Maryland
State House
Annapolis, Maryland 21401-1991

RE: House Bill 861

Dear Governor O'Malley:

We have reviewed and hereby approve for constitutionality and legal sufficiency House Bill 861, "Montgomery County – Enterprise Zones – Tax Credits." We write to discuss the implication of the Contract Clause of the United States Constitution on the bill.

House Bill 861 only impacts Montgomery County, a home rule county, and the municipalities within Montgomery County, which is acceptable for property tax legislation. However the bill may change the financial obligations under existing property leases for property located within an enterprise zone. This raises the question of whether the legislation effectuates an improper impairment of contract prohibited under the Contract Clause of the U.S. Constitution which prohibits the states from enacting laws "impairing the Obligation of Contracts,..." U.S. CONST. art I, §10, cl. 1.

Under current law § 9-103 of the Tax-Property Article ("TP") creates an enterprise zone property tax credit for the property located within an area designated as an enterprise zone under § 5-703 of the Economic Development Article ("EC"). The tax credit encourages rehabilitation and redevelopment of underperforming property. The tax credit amount generally is determined by calculating the difference in assessment before and after rehabilitation improvements and, in some locations, it is calculated by an

assessment of the personal property located there. If an owner and the property meet the criteria of TP § 9-103, there is a credit that reduces the property tax obligation on the real property improvements and personal property of the owner.

House Bill 861 authorizes Montgomery County to establish a new tax credit for property located within an enterprise zone that does not currently receive a tax credit under TP § 9-103. The amount of the House Bill 861 tax credit is determined by improvements made to real property by a lessee and by the lessee's personal property located at the real property. This tax credit, like the enterprise zone credit, serves the important government purpose of encouraging redevelopment of underperforming real property by granting a financial benefit to the lessee. The bill achieves this by granting a credit against the real property tax obligations of the owner/lessor, which the lessor is required to reflect in an equal reduction to the lessee's tax obligation if one exists under a lease agreement. House Bill 861 therefore reduces the lessee's financial obligations to the lessor under an existing lease contract if the property becomes eligible for the tax credit after the bill's effective date of June 20, 2010. It is this modification of the financial obligation of lessee to lessor that implicates a possible impairment of contract issue under the Contract Clause of the U.S. Constitution.

Courts consider three factors when considering an impairment of contract claim: "whether there is a contractual relationship, whether a change in law impairs that contractual relationship and whether the impairment is substantial." *Allstate Ins. Co. v. Kim*, 376 Md. 276, 299 (2003) (quoting *General Motors Corp. v. Romein*, 503 U.S. 181, 186 (1992)). Assuming that a lease contract exists and that the lessee's actions entitle the real property to a tax credit under the bill, the legislation triggers a change in the financial obligations of the contract. Therefore, the first two factors of the test employed by the courts are met. However, the benefit of the tax credit flows first to the property owner/lessor who is legally obligated to pay the property tax. The reduction in the lessee's contractual obligation to pay taxes is designed to match the reduction to the lessor's property tax expense. Consequently, there will be no economic impact on the lessor as a result, and the change to the contractual relationship would not be viewed as a significant impairment by the courts. *Allstate*, 376 Md. at 300.

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Accordingly, it is our view that House Bill 861 is constitutional and we recommend it for signature.

Very truly yours,


Douglas F. Gansler
Attorney General

DFG/DF/DML/jlg

cc: The Honorable Richard Madaleno
The Honorable Brian Feldman
The Honorable John P. McDonough
Joseph Bryce
Karl Aro
David M. Lyon