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THE CONSTRUCTION OF "TAXABLE PROPERTY" IN MUNICIPAL DEBT LIMITATION STATUTES

INTRODUCTION

A significant geopolitical phenomena of post World War II America has been mass migration to metropolitan areas. As a result of this population shift local governments find themselves confronted with a host of problems created by mass habitation within confined geographical limits. Consequently, cities, counties, and other political units are forced not only to expand those services which are traditionally provided by local government but they must also undertake an increasing range of functions.[1] To meet these demands local governments require greater financial resources. Many of the services and facilities which must be supplied require large capital outlays, forcing local governments to seek more extraordinary revenue.[2] But in attempting to borrow capital, local governments confront constitutional and statutory obstacles in the form of limitations upon the power to incur debt. This Comment will discuss debt limit provisions and the devices employed to avoid their effect. Particular problems in interpreting such provisions will then be analyzed in a hope that a fresh perspective will emerge from which a recommendation may be made for a workable local government debt limitation.

MUNICIPAL DEBT LIMITATIONS AND EVASIVE DEVICES

The power to incur debt is not an inherent power of local government. This explains why borrowed funds are termed "extraordinary revenue." A local government obtains the power to borrow only when it is conferred by state constitutions, statutes, and municipal charters.[3] A power which is conferred is a power which may be controlled, and one of the more important controls upon

1. *See*, H.L. LUTZ, PUBLIC FINANCE ch. v, 64-68 (1924); 15 E. McQUILLIN, MUNICIPAL CORPORATIONS § 39.02 4-7 (3d ed. 1950) [hereinafter cited as E. McQUILLIN].

2. Extraordinary revenue includes: (1) loans, (2) bond issues and (3) trust funds or bequests. This is contrasted to "ordinary" revenue, which consists of the proceeds of taxes, any monies earned by the government acting in its proprietary capacity, and funds obtained from licenses, fees, and penalties. 15 E. McQUILLIN, *supra* note 1, § 39.03 pp. 8-9.

3. *E.g.*, Howard v. Brighton, 143 Misc. 265, 257 N.Y.S. 41 (Sup. Ct. 1931); Appeal of Palmer, 307 Pa. 426, 161 A. 543 (1932); 15 E. McQUILLIN, *supra* note 1, § 39.07. Thirty-eight states have constitutional provisions relating to municipal borrowing. Connecticut, Delaware, Florida, Maryland, Massachusetts, Mississippi, New Hampshire, New Jersey, Rhode Island, Tennessee and Vermont do not. Of these six deal with the matter in statutes. *See* Bowman, *The Anachronism Called Debt Limitation*, 52 IOWA L. REV. 863 n.18 (1967).

municipal indebtedness is a limitation on the amount of debt which may be incurred. Debt limit provisions are found in either statutory[4] or constitutional[5] form in almost every jurisdiction, and in some jurisdictions in both forms.[6] Generally, limits are placed on both funded or bonded indebtedness, and unfunded or "floating" indebtedness.[7]

The most common debt restriction limits the debt incurrable to a fixed percentage of the value of taxable property within the political unit.[8] Usually the limit is applied directly to any debt incurred.[9] In some states two percentages are applied. The first is applied to limit incurrence of any debt, with a larger debt limited by a second percentage which is permitted only upon approval of the electorate.[10] A third system coordinates a debt to property ratio with a limit based on the current revenue of the local government. That is, debt is restricted to an amount equal to current annual revenues, with a larger debt permitted only upon approval by the electorate, with the maximum fixed at a percentage of taxable property.[11]

The genesis of local government debt limitations was the financial crises which municipalities experienced following the economic depression of the mid-1870's.[12] Rooted in an atmosphere of ex-

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4. *See, e.g.*, CAL. GOV'T CODE §§ 29909, 43604; ILL. ANN. STAT. ch. 113, § 44 (Smith-Hurd 1954); IOWA CODE ANN. § 407.1 (1949).

5. *See, e.g.*, IOWA CONST. art. XI § 3; N.Y. CONST. art. VII § 5; PA. CONST. art. IX § 8.

6. Where there are local government borrowing provisions in both the constitution and statutes of the same state the constitutional provision takes precedence if there is a conflict. Such provisions in a municipal charter are subject to both constitutional or statutory provisions. 15 E. MCQUILLIN, *supra* note 1, § 41.06.

7. Municipal indebtedness consists either of funded debts or floating debts. The term "funded debts" includes all municipal indebtedness evidenced by bonds payable at a time beyond the current fiscal year of their issue, with periodical payment of interest, and where provision is made for payment by future taxation.

15 E. MCQUILLIN, *supra* note 1, § 39.17 p. 28.

8. *E.g.*, ILL. ANN. STAT. ch. 113, § 44 (Smith-Hurd 1954):

> Except as hereinafter provided in this Act no county . . . township, school district or other municipal corporation . . . shall become indebted in any manner or for any purpose to an amount, including existing indebtedness, in the aggregate exceeding two and one-half percentum (2½%) on the value of the taxable property therein, to be ascertained by the cost assessment for state and county taxes, previous to the incurring of such indebtedness.

PA. CONST. art. IX, § 8:

> The debt of any county, city, borough, township, school district, or other municipality or incorporated district, except as provided herein, and in section fifteen (15) per centum upon the assessed value of the taxable property therein . . . ;

9. *E.g.*, PA. CONST. art. IX, § 8; VA. CONST. art. VIII, § 127.

10. *E.g.*, NEB. CONST. art. XIII, §§ 1, 2.

11. *E.g.*, OKLA. CONST. art. X, § 26 (extra, up to 5% of assessed valuation).

12. Long term municipal indebtedness did not become common in

treme fiscal caution and in an era which did not foresee modern demands on local government, debt limit provisions have of late been assailed by legal scholars[13] and lawyers. Characteristically, the scholars attack the policy of these provisions, while the lawyers maneuver to avoid their effect. Consequently, most of the recent litigation in this area has involved devices employed to circumvent debt restrictions.

The first technique devised to avoid municipal debt limitations was the special district.[14] A special district is a quasi-govern-

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America until after 1820. In its earliest states little thought was given to restricting the incurrence of debt for two reasons: (1) since cities could not borrow without specific legislative authorization for each incurrence, state legislatures had direct control over the amount of indebtedness each municipality could incur, and (2) the prevailing public opinion was that governmental borrowing was a financial practice that should be used only in the most exceptional cases.

Internal capital improvements were made exclusively by state governments until the Panic of 1837 forced many debt-burdened states into default. Thereafter, public opinion became sufficiently aroused by the poor financial positions of the state governments that constitutional amendments were passed limiting the power of many states to contract indebtedness. Thus, when the post-Civil War expansion of railroads occurred, entrepreneurs turned to local governments for capital subsidies, and market for their stock because the state governments were barred from participating by the earlier reforms. When the Panic of 1873 caused many municipalities to default on their obligations, the trend to restrict the borrowing power of local units of government gained popular backing. In retrospect it seems likely that the movement might not have been fully supported had it not been for the waste and corruption that flourished within city governments that abused the credit system. The public demanded that the situation be remedied; the logical remedy appeared to be deprivation of the power to incur debt. This pattern—economic prosperity, internal capital expansion, debt incurrence, recession, default—was repeated following both World War I and the Great Depression, although to a less dramatic extent. It seems that we are still now experiencing a post World War II debt expansion.

Comment, *Constitutional Restrictions Upon Municipal Indebtedness*, UTAH L. REV. 462, 463 (1966) (footnotes omitted). *See also*, KNEIR & FOX, READINGS IN MUNICIPAL GOVERNMENT AND ADMINISTRATION 189-95 (1936); FAULKNER, AMERICAN ECONOMIC HISTORY 272-74 (8th ed. 1960).

13. *See*, Bowers, *Limitations on Municipal Indebtedness*, 5 VAND. L. REV. 37 (1951); Bowman, *The Anachronism Called Debt Limitation*, 52 IOWA L. REV. 863 (1967); Magnusson, *Lease Financing by Municipal Corporations as a Way Around Debt Limitations*, 25 GEO. WASH. L. REV. 377 (1957); Rogers, *Municipal Debt Restrictions and Lease-Purchase Financing*, 49 A.B.A.J. 49 (1963); Comment, *Constitutional Restrictions Upon Municipal Indebtedness*, 1966 UTAH L. REV. 462 (1966).

For an interesting parallel to the current local government debt problem and its historical development in this country, see, Holmes, *Local Authority Borrowing*, 108 SOL. J. 910 (1964). The author illuminates the problems which have arisen in England now that local authorities there have begun to borrow through the issuance of bonds. He suggests that this is creating a situation similar to that in the United States in the 1870's (note 14, *infra*) and that the central government may have to control local unit borrowing.

14. Kennebec Water Dist. v. Waterville, 96 Me. 234, 52 A. 774 (1902) one of the very early cases holding that a public authority had a separate

mental unit especially created to perform one function, or a limited range of functions, and embracing either partially or completely the same geographical area as an existing municipal unit.[15] Debt limit provisions have usually been held to apply to each unit of government separately, including special districts. A special district may thus incur debt to the full percentage of the value of taxable property within its boundaries[16] without affecting the debt limit of the political entity which created it.[17] Since the debt is repaid through taxes or charges levied by the special district, the net effect is that the same property may be used to determine the debt limits of several taxing bodies.[18]

Another means of avoiding a debt restriction is to prevent obligations which are incurred from being characterized as debts. A common example is the special assessment.[19] A debt is incurred for a special project and repaid by an assessment upon property which will benefit from the project.[20] In this way, general funds of the political unit are not committed to the obligation.[21] Similar to the special assessment is the pledging of revenues from an income-producing property to pay the debt incurred in obtaining the property.[22]

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debt limit relied on the special district theory. 15 E. McQUILLIN, *supra* note 1, §§ 41.12-13. This device is still very popular. *See* Bowman, *The Anachronism Called Debt Limitation*, 52 IOWA L. REV. 863, n.29 (1967).

15. The most common example is a school district.

16. Albuquerque Metropolitan Arroyo Flood Control Authority v. Swinburne, 74 N.M. 487, 394 P.2d 998 (1964); Fort Howard Paper Co. v. Town Board of Ashwaubenon, 266 Wis. 191, 63 N.W.2d 122 (1954). But approval of special districts has not been universal. *See*, State *ex rel.* Board of Education of Cleveland City School Dist. v. Morris, 135 Ohio St. 23, 18 N.E.2d 980 (1930). In Rappoport v. Department of Public Health and Hospitals, 227 Ind. 508, 88 N.E.2d 150 (1940), the court invalidated a special district which is found to have been created for the sole purpose of increasing a city's borrowing power beyond the constitutional limit.

17. Chisena v. Central High School Dist. No. 2, 136 N.Y.S.2d 598 (Sup. Ct. 1954).

18. Such piling of district upon district, geographically oriented, necessarily results in a corresponding multiplication of taxes for individuals residing in an area where such overlap exists. This heavy tax burden is inconsistent with the ostensible motivation for original indebtedness limitation—attaining the goals of sound fiscal policy.

Bowman, *supra* note 13, at 870.

19. For an excellent discussion of this device, see Antieau, *The Special Assessments of Municipal Corporations*, 35 MARQ. L. REV. 863, 873-80 (1967); Comment, *Constitutional Restrictions Upon Municipal Indebtedness*, 1966 UTAH L. REV. 462 (1966).

20. This arrangement may be effectuated by the creation of a district or authority which builds the improvement and handles the details of issuing bonds to obtain capital and retiring them.

21. Thus the debt is held not to be a general obligation of the local unit. Cyr and Evans Contracting Co. v. Graham, 2 Ariz. App. 196, 407 P.2d 385 (1915); Pasadena v. McAllaster, 204 Cal. 267, 267 P. 873 (1927).

22. *See generally*, 15 E. McQUILLIN, *supra* note 1, § 41.31; Foley, *Reve-*

The special district and special assessment are valid devices to circumvent debt limitations because the local government is not obligated to repay the debt. But a less valid device is contingent obligation financing which involves a leasehold agreement or executory contract. The leasehold agreements customarily provide for yearly rental payments which are credited towards purchase of the property leased. At the end of the leasehold period, the property is conveyed to the government. The rental payments are considered current expenses; therefore, the cost of the proprty is not incurred as a debt.[23] With executory contracts a local unit's obligation to pay becomes effective only upon performance by the other party. As performance is on a periodic basis, payment is also periodic. Executory contracts are analogous to leasehold agreements in that the payments are considered recurring current expenses and the total amount due on the contract never becomes a debt.[24]

INTERNAL PROBLEMS IN DEBT LIMIT PROVISIONS

While most recent debt limit litigation concerns legal maneuvering to avoid their effect, problems of interpreting debt limit legislation also have arisen. One such problem is determining what is "taxable property" under a debt limit provision. The question of what constitutes taxable property or debt limit base has been posed in three factual settings. In each of these, the courts have grounded their holdings on one of two basic theories. The words are either defined to include any property which is or may be taxed for any purpose whatsoever; or they are interpreted to include only property which will actually be taxed to repay the debt. A full analysis of these two positions requires an examination of their application in the three factual settings which have raised the issue.

The first was presented to the Supreme Court of Iowa in *Zobel v. Schau.*[25] That case involved property which was taxed, but not for local government purposes. Thus, the tax revenue obtained from such property would not contribute to the repayment of municipal debts. In *Zobel,* monies and credits which were taxable

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nue Financing of Public Enterprises, 35 MICH. L. REV. 1 (1936); Williams and Nehemis, *Municipal Improvement as Affected by Constitutional Debt Limitations,* 37 COL. L. REV. 177 (1937).

23. The theoretical means to this end is the common law idea that future rents do not constitute a debt. *See, e.g.,* State *ex rel.* Rogers v. Milligan, 269 Wis. 565, 66 N.W.2d 326 (1955) *contra,* Brewster v. Deschutes, 137 Ore. 100, 1 P.2d 607 (1931).

24. Hillard v. Mobile, 253 Ala. 676, 47 So. 2d 162 (1950); Salisbury Water Supply Co. v. Town of Salisbury, 341 Mass. 42, 167 N.E.2d 320 (1960). For a good discussion of this area see, Magnusson, *Lease-Financing by Municipal Corporations as a Way Around Debt Limitations,* 25 GEO. WASH. L. REV. 377 (1957).

25. 150 N.W.2d 628 (1967).

only for the purpose of retiring Korean War veterans bonus bonds, were held to be taxable property within the meaning of the state's constitutional and statutory debt limit provisions. The court followed two early Iowa cases which had interpreted the debt limit provision as including all property taxed as "taxable property" regardless of whether the property was taxed to repay the debt. Consequently, while the tax revenue which was yielded would not contribute to the payment of the debt, the amount of permissible debt would be partially computed on the basis of these monies and credits.

The *Zobel* setting was presented to the Supreme Court of Pennsylvania in the early case of *Elliot v. City of Philadelphia.*[26] The taxpayer contended that "taxable property" meant only property taxed by the city, and that the city should not have included the value of securities taxed by the state in ascertaining the municipal debt limit. The court agreed, holding that "taxable property" included only property taxed by the city for city purposes. It would seem the court was looking at what property would bear the tax burden of the debt to decide what property should be used to determine the debt limit. But this explanation is insufficient since three-quarters of the tax revenue yielded by the state tax on these securities was returnd to the city treasury. Thus, these securities would bear a portion of the debt burden.[27]

Zobel and *Elliot* represent opposing views on whether property which is taxed but does not contribute tax revenues to the local government is "taxable property" for debt limit purposes. "Taxable" can mean taxable by any governmental unit as in *Zobel*, or taxable by the government unit which is going to incur the debt as in *Elliot.*

A second situation which has posed the taxable property problem concerns whether tax exempt property should be included in determining the debt limit. In *Williams v. School Dist. No. 32,*[28] the question was whether property within the school district, but exempt from taxation because temporarily owned by the county, should be included in determining the school district's debt limit.[29] The property had been purchased by the county at a sale to recover delinquent taxes. Only if the original owners repurchased the property would the school district receive the taxes owed to it at the time of the sale, and the taxes which accrued during the period the county held the property.[30] The court held that the property was not "taxable property" for debt limit purposes, as it

26. 229 Pa. 215, 78 A. 107 (1910).
27. 229 Pa. at 217, 78 A. at 108.
28. 56 Wyo. 1, 102 P.2d 48 (1940).
29. WYO. CONST. art. XVI, § 5.
30. The provisions which governed this situation were found in W.R.S. 1931, §§ 115-2341 to 115-2342 (now WYO. STAT. ANN. §§ 39-241 to 39-242 (1957)).

might not pay its full share of taxes, and thus might not bear its full portion of the debt burden. It would be inequitable to the taxpaying property owners in the school district to subject them to a greater debt burden, and therefore a greater tax burden, by including property which might not share any of this burden in determining the amount of indebtedness.[31]

Similarly, in *Monroe County v. County Debt Commission*,[32] the county finance officer did not include the value of certain tax exempt property in determining the county's debt limit. This property could have been taxed according to the constitution of the state but the legislature had chosen to exempt it.[33] The court held that the constitutional debt limit,[34] which was an amount equal to two per cent of the taxable property within the county, was two per cent of property which was actually being taxed at the time the debt was incurred. The property might have been taxed if the legislature decided to repeal the statute, but that was at best a future possibility. The reasoning in *Monroe* was similar to *Williams*: only property which would definitely bear the debt burden should be used to determine the debt limit.

In *L.L.F. Realty Co. v. Fuchs*[35] the Appellate Division of the Supreme Court of New York took a position opposed to the *Williams* and *Monroe* courts. The facts in *Fuchs* were closely analogous to those in *Williams*. In determining the debt limit of the city, the city council of Long Beach had included properties the city treasurer had bid in at a tax sale. The city would receive full tax revenues from these properties only if they were repurchased by the original owner. The court held that the real estate in question was "subject to taxation" and "taxable property" according to the statutory and constitutional debt limit provisions,[36] as the exemption was a matter of discretion on the part of the city.[37] The city could, at any time, change its policy and tax these properties.[38]

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31. 56 Wyo. at 3, 102 P.2d at 53.

32. 247 S.W.2d 507 (Ky. App. 1952), *Annot.* 30 A.L.R.2d 899 (1953).

33. KY. REV. STAT. ANN. § 132.200 (1955) (now KY. REV. STAT. ANN. § 132.200 (1963)).

34. KY. CONST. § 158.

35. 75 N.Y.S.2d 356, 273 App. Div. 111 (1947).

36. N.Y. CONST. art. VII, § 5; N.Y. LOCAL FINANCE LAW § 104.6 *subd.* d.

37. CHARTER OF THE CITY OF LONG BEACH, Chapter 635, (Laws of 1922 as amended).

38. Williams and Monroe County represent the majority rule where the issue is whether property specially or temporarily exempt from taxation is "taxable property." *See*, State v. Birmingham R.R. Co., 182 Ala. 475, 62 So. 77 (1913); State *ex rel.* Harrington v. Pompano, 136 Fla. 730, 188 So. 610 (1938); Campbell v. Red Bud Consol. School Dist., 186 Ga. 541, 198 S.E. 225 (1938); McKinney v. McClure, 206 Iowa 285, 220 N.W. 354 (1928); Hanson v. Omaha, 154 Neb. 72, 46 N.W.2d 896 (1951); Buffalo v. Le Couteulx, 15 N.Y. 451 (Ct. App. 1857). *Contra*, Pacific Gas & Elec. Co. v. Shastra Area Pub. Util. Dist., 135 Cal. App. 2d 463, 287 P.2d 841 (Dist.

A third situation which presents the taxable property problem is whether real or personal property, or both, are to be used in computing the debt limitation. In many of the older cases the applicable provision required only "property" to be the taxable standard. Thus, the courts were forced to decide whether real or personal or both types were contemplated. Traditionally, local governments received their revenues from real property taxes; thus it was usually contended that "property" in such debt limit provisions meant only real property. For example, in *McLeland v. Marshall County*[39] the court held that personal property in the form of monies and credits was to be included in the term "property" for debt limitation purposes. Although this holding was based on a statutory definition of "property,"[40] some of the tax revenue received from the monies and credits would go to the county by way of the state treasury, presumably contributing to the general county funds from which the debt would be repaid. The *McLeland* court, however, did not rely on this to support its decision.[41]

In *Hicken v. Board of Education*[42] the same question was raised, but here the Minnesota court had legislative support in answering it. The statutory debt limit provision explicitly stated that "all property assessed" was to be the basis of the debt limit.[43] Since personal as well as real property was assessed,[44] the unambiguous and inclusive nature of the provision led the court to conclude that "property" meant both personal and real property.[45] The court also noted that a portion of the tax revenue assessed on monies and credits went into the defendant school board's general funds, buttressing their decision with the implication that this property would contribute to payment of the debt.[46]

In *Levy v. McClellan*[47] the Minnesota court considered a constitutional debt limit provision[48] that specifically provided that real estate was to be the basis of the debt limit. The issue before the court was whether "special franchises" were real estate. The state had created these franchises and had power to classify them in any manner it pleased. As the state had classified them as real estate[49] the court held that they were to be considered as

Ct. App. 1955); L.L.F. Realty Co. v. Fuchs, 273 App. Div. 111, 75 N.Y.S.2d 356 (1947).

39. 199 Iowa 1232, 201 N.W. 401 (1924).

40. IOWA CODE 1897, § 48. No comparable definition exists today in Iowa's statutes.

41. 199 Iowa 1232, 1241, 201 N.W. 401, 409 (1924).

42. 153 Minn. 120, 189 N.W. 709 (1922).

43. MINN. GEN. STAT. 1913, § 1862.

44. MINN. GEN. STAT. 1913, §§ 2316-2328.

45. 153 Minn. 120, 189 N.W. 709, 710 (1922).

46. *Id.*

47. 196 N.Y. 178, 89 N.E. 569 (Ct. App. 1909).

48. N.Y. CONST. art. VII, § 10 (1872).

49. N.Y. GENERAL TAX LAW (Laws 1896 p. 796 c. 908) § 2.

such for debt limit purposes. The categorization of the franchises was for tax purposes, and they would bear their share of the debt burden.[50]

Groendyk v. Fowler[51] is an interesting analogy to this line of cases. A statute provided that "property" owners were to vote on a franchise to be given to a telephone company to erect telephone poles.[52] If the franchise was approved the poles would be erected on the real estate of those voting. The basic issue was whether personal property owners, who would not be affected by the outcome of the vote, should have the same right to vote as real property owners whose property would bear the burden of the franchise. Rather than analyze the problem posed, the court turned to a statutory definition of the term "property"[53] which included both real and personal property, and held that both personal property as well as real property owners could vote on the granting of the franchise. The *Groendyk* case presents by analogy the two approaches which have been taken to the problem of whether "property" means both real and personal property in debt limit provisions. Courts may take the strict legal definition of "property" from common law and statute, as was done in *Groendyk* and most of the debt limit cases; or they may look to the property that will bear the debt burden.

A case which followed the latter approach is *Appeal of William H. Brown*,[54] in which the Supreme Court of Pennsylvania held that "offices, posts of profit, occupations and trades" which were taxed by the county were "property" under a taxable property debt limit provision. The rationale was that the tax revenues yielded by these things would help repay the debt; therefore their value should be used to determine the amount of debt, whether they were classified as "property" or not.

INTERPRETING DEBT LIMIT PROVISIONS

Two basic approaches to the taxable property problem emerge from the three settings in which it has been posed. When the question is whether "property" means only real property or real and personal, it is decided by defining "property" according to a formal legal definition, or by looking to whether the property will

50. In *Levy*, as in *Hicken*, 153 Minn. 120, 189 N.W. 709 (1922), and *McLeland*, 199 Iowa 1232, 201 N.W. 401 (1924), the fact that the property included to determine the debt limit would, through taxes, pay part of the debt was not the decisive factor in the court's decision. On the contrary, this element was given very little weight by these courts.

51. 204 Iowa 598, 215 N.W. 718 (1927).

52. IOWA CODE 1924 § 5905.

53. IOWA CODE 1924 § 63.

54. 111 Pa. 72, 2 A. 77 (1885). *See*, McLeland v. Marshall County, 199 Iowa 1232, 201 N.W. 401 (1924); Williams v. School Dist. No. 32, 56 Wyo. 1, 102 P.2d 48 (1940).

bear the debt burden. When the question is whether property which is specially exempt from taxation should be included as taxable property, the decision turns on whether "taxable" means potentially taxable or actually taxed. When the issue is whether property taxed only by the state can be included to determine the local debt limit the courts have held either that "taxable" means taxable by any government, or only by the government which will incur the debt.

The courts which hold that any property which is or may be taxed by any level of government is taxable property for debt limit purposes, apply a broad interpretation which views the words in their common dictionary sense. The effect is to increase the permissible amount of debt. The argument against this construction was offered in *Williams v. School Dist. No. 32.*[55] There the court found that a basic inequity may result if property which will not share its burden of the debt, is used to make the debt larger for that property which will be taxed to repay it. When property exempt from taxation is included in determining the debt limit, some courts have raised this objection on the grounds that there was a violation of due process.[56] Their rationale is that such an interpretation imposes a confiscatory and unequal tax on property not exempted. But this argument has been rejected by most of the courts which have considered the question.[57] A party is not deprived of his property without due process of law merely because a tax imposes an unequal burden on that party as compared to another.[58] Due process with respect to taxation requires only that taxes be levied as equitably as possible, since complete equality in taxation is impossible.[59] Furthermore, the property involved in these cases is completely exempt from taxation, and any due process problem turns on whether it should be taxed at all. No matter how the debt limit is determined and no matter how great the debt is, taxed property will bear all of the burden and exempt property will bear none of it.

A point in favor of the broad or permissive approach is that where property which is not taxed may be taxed at some time after the indebtedness is incurred, a more restricted definition prevents

55. 56 Wyo. 1, 102 P.2d 48, 54 (1940).

56. Pacific Gas & Elec. Co. v. Shastra Area Pub. Util. Dist., 135 Cal. App. 2d 463, 287 P.2d 841 (Dist. Ct. App. 1955); State *ex rel.* Harrington v. Pompano, 136 Fla. 730, 188 So. 610 (1938).

57. *See,* Pacific Gas & Elec. Co. v. Shastra Pub. Util. Dist., 135 Cal. App. 2d 463, 287 P.2d 841 (Dist. Ct. App. 1955); McLeland v. Marshall County, 199 Iowa 1232, 201 N.W. 401 (1924). *But see,* State *ex rel.* Harrington v. Pompano, 136 Fla. 730, 188 So. 610 (1938), where this argument was accepted because the properties which were being taxed to repay the debt were outside of the political unit which had incurred the debt and was levying the tax to repay it.

58. Kelly v. Pittsburgh, 104 U.S. 78 (1881).

59. Pacific Gas & Elec. Co. v. Shastra Area Pub. Util. Dist., 135 Cal. App. 2d 463, 287 P.2d 841 (Dist. Ct. App. 1955).

a local government from incurring the amount of debt justified by its ability to repay.[60] Likewise, where property is not taxable by local government, but where a portion of the taxes levied on it eventually goes to the local government, the broad approach creates a debt in line with the total resources of the government.

The most serious argument raised against construing debt limit provisions broadly is that it contravenes legislative or constitutional intent.[61] This argument posits that the purpose of the legislatures and framers of state constitutions was to limit the debt of local government to precisely that percentage of the value of *taxed* property mentioned in the debt limit provision. A loose interpretation of the words "taxable property" permits property which is not *taxed* to be included in determining the debt limit, making the debt a larger percentage of the value of *taxed* property than is mentioned in the provision.

The intent of debt limit provisions is to enforce financial responsibility upon local government by relating the amount of debt which may be incurred to the value of property.[62] This method was chosen because property was the chief source of revenue for local government at the time these debt limit provisions were first enacted. It still is today. The goal was to directly relate the debt to the ability to repay by relating the debt to the source of repayment.

It is submitted that if this view of the purpose of debt limit provisions is accepted, construction of these provisions limiting the meaning of "taxable property" to property which will be taxed to repay the debt is correct. A relation of debt to the source of repayment, that is, property which will provide revenue for the local government, will be maintained according to the standard expressed by the provision. Following this view, the possible inequities to taxpayers, which so often arise with regard to debt limit provisions, would be eliminated. Only property which pays the debt will determine the size of the debt. A firm standard would be provided for resolving the problems of what type of tax, state or local and what type of property, real or personal, is connoted by the phrase "taxable property." That standard is whether the property so taxed provides the political unit with the means of repaying the debt.

There are, however, serious objections to this approach. As

60 This is especially true where a long term debt is incurred, since the property may be producing tax revenues for the larger portion of the time the debt is outstanding.

61. *See, e.g.*, Williams v. School Dist. No. 32, 56 Wyo. 1, 102 P.2d 48 (1940).

62. Fairbanks, Morse & Co. v. Wagoner, 81 F.2d 209 (10th Cir. 1936); Decatur v. Peabody, 251 Mass. 82, 146 N.E. 360 (1925); McGuire v. Philadelphia, 245 Pa. 287, 91 A. 622 (1914); Banks v. Lehi, 74 Utah 321, 279 P. 878 (1929); *see*, 15 E. McQUILLIN, *supra* note 1, § 41.02.

mentioned above,[63] the local government would not be permitted to incur the full amount of debt justified by its ability to repay if property which is not subject to taxation at the time the debt limit is determined becomes subject to taxation at a later time. Another problem with a narrow construction of debt limit provisions is that property values tend to inflate along with the rest of the economy. Property may well be worth considerably more in two or three years than it is today.[64] Because much local government debt is bonded over a long term, the value of property taxed at the time bonded indebtedness is incurred may be much smaller than the value as averaged out over the period in which the debt is retired. Considered in this perspective the debt may actually be a smaller percentage of the value of property which is taxed than the percentage authorized by the debt limit provision.

CONCLUSION

While the constitutional and legislative intent may have been to limit debt according to the value of property taxed to repay the debt, construing debt limit provisions in this manner will leave the basic problem still unsolved. Local governments need to borrow more than these provisions allow, and efforts to circumvent the provisions will continue. The net effect is a lessening of control over local government borrowing and a debt which is determined by the willingness of the courts to accept the evasive schemes of bond counsel.

How, then, can fiscal responsibility be enforced upon local governments while still allowing the flexibility necessary to meet their changing financial needs? The principle behind taxable property debt limit provisions is to relate debt limit to the tax base. This would seem to provide a workable enough standard: the amount of permissible debt rises and falls with the value of the source of tax revenue. Also, since creditors evaluate debt risk on the basis of the debtor's anticipated revenues, taxable property or tax base debt limits would be grounded in sound financial theory.

What is lacking in debt limit provisions is flexibility in terms of changing needs. If debt limit provisions were put in only statutory form, with a provision requiring *periodic legislative review*, the problem could be mitigated. At the specified intervals the legislature would be forced to re-examine and re-evaluate the financial situation of local governments and adjust the debt limit accordingly by increasing or decreasing the percentage basis of the limit. The flexibility and responsiveness to financial realities achieved would eliminate resorting to legal manipulations to ob-

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63. See p. 628 *supra*.
64. The current national annual rate of inflation is 6% (based on Labor Department figures for 1968).

tain borrowing power. The public would have accurate knowledge of the amount of debt being incurred, without having to pierce legislative smoke screens. Most important, the financial necessities of local government could be balanced with financial responsibility.

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