No. 94, Original

IN THE
Supreme Court of the United States
OCTOBER TERM, 1983

STATE OF SOUTH CAROLINA,
Plaintiff,
v.
DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

MOTION OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA FOR LEAVE TO FILE A BRIEF AS AMICI CURIAE IN SUPPORT OF SOUTH CAROLINA'S MOTION FOR LEAVE TO FILE AN ORIGINAL COMPLAINT AND BRIEF AS AMICI CURIAE IN SUPPORT THEREOF

LAWRENCE R. VELVEL
Chief Counsel
STATE AND LOCAL LEGAL CENTER
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445

JAMES M. JOHNSTONE
DENNIS A. DUTTERER *
WILEY, JOHNSON & REIN
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000
Counsel for the Amici Curiae

* Counsel of Record

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

QUESTION PRESENTED

Whether this Court should exercise original jurisdiction to determine if the federal government can constitutionally impose a tax on interest income from state and local general obligation bonds, when such tax will gravely impair the ability of state and local governments to perform essential sovereign functions and to fulfill their role in the Union.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

MOTION OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA FOR LEAVE TO FILE A BRIEF AS AMICI CURIAE IN SUPPORT OF SOUTH CAROLINA'S MOTION FOR LEAVE TO FILE AN ORIGINAL COMPLAINT

Pursuant to Rule 9.6 of the Rules of the Court, the *amici curiae* seek leave to file the attached *amicus* brief in support of South Carolina's Motion for Leave to File an Original Complaint.

The *amici* include organizations which represent state and local governments or their officials located throughout the United States; financial officials of state governments; and the State of West Virginia. The governments represented by or associated with the amici organizations and officials, and the State of West Virginia, collectively issue billions of dollars of general obligation bonds every year. A major question presented in South Carolina's action is whether the federal government may constitutionally impose a tax on the interest paid on such bonds. *Amici* have a critical interest in this constitutional question because the imposition of a tax on general obligation bonds will gravely impair the ability of state and local governments throughout the nation to function effectively in a federal system and to carry out essential sovereign functions.

Amici seek to assist the Court in resolution of the constitutional question by addressing crucial points that have been largely unattended by the parties. *Amici's* brief discusses the serious consequences that will be suffered by state and local governments if interest on state and local general obligation bonds is taxed. Such consequences will result from a dramatic rise in the interest rates paid by state and local governments and the concomitant impairment of their ability to perform their sovereign responsibilities.

Amici's brief also discusses the impact of the Sixteenth Amendment upon the historically established tax immunity of state and local general obligation bonds. It is *amici's* submission that, as shown by its legislative history and subsequent interpretations of this Court, the Sixteenth Amendment did not alter but instead specifically preserved the constitutional tax immunity enjoyed by interest on state and local bonds.

Finally, *amici's* brief also discusses a new jurisdictional hurdle first asserted by the Defendant in his Supple-

mental brief. *Amici* demonstrate that this new hurdle is constitutionally flawed.

The defendant and the State of South Carolina, by letters dated August 29, 1983 and September 16, 1983, respectively have consented to the filing of the attached *amicus* brief.* Such filing will not delay the hearing in this case, but will, we believe, assist the Court in assessing crucially important issues.

CONCLUSION

For the foregoing reasons, this Court should grant leave to file the attached brief *amicus curiae.*

Respectfully submitted,

LAWRENCE R. VELVEL
Chief Counsel
STATE AND LOCAL LEGAL CENTER
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445

JAMES M. JOHNSTONE
DENNIS A. DUTTERER
WILEY, JOHNSON & REIN
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000
Counsel for the Amici Curiae

* The letters of consent have been lodged with the Clerk of the Court.

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases: Page

TABLE OF AUTHORITIES—Continued

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

No. 94, Original

STATE OF SOUTH CAROLINA,
Plaintiff,

v.

DONALD T. REGAN, SECRETARY OF THE TREASURY OF THE UNITED STATES OF AMERICA,
Defendant.

On Motion for Leave to File Complaint

BRIEF OF THE NATIONAL ASSOCIATION OF COUNTIES, THE NATIONAL CONFERENCE OF STATE LEGISLATURES, THE U.S. CONFERENCE OF MAYORS, THE COUNCIL OF STATE GOVERNMENTS, THE MUNICIPAL FINANCE OFFICERS ASSOCIATION, BILL GUNTER, TREASURER OF THE STATE OF FLORIDA, EDWARD V. REGAN, NEW YORK STATE COMPTROLLER AND THE STATE OF WEST VIRGINIA AS AMICI CURIAE IN SUPPORT OF SOUTH CAROLINA'S MOTION FOR LEAVE TO FILE AN ORIGINAL COMPLAINT

INTRODUCTION

In this action a federal statute requires state and local bonds to be registered and imposes a penalty for non-registration. The penalty is loss of the tax exemption for interest on state and local obligations.

The requirement of registration and the penalty of loss of exemption are being imposed upon the general obligation bonds of the State of South Carolina. In South Carolina and elsewhere, general obligation bonds are used to finance essential sovereign activities such as construction of schools, roads, city halls, fire stations, police stations, prisons, water works, sewer systems and other vital facilities.

Amici take no position upon and do not discuss the federally imposed registration requirement. But *amici* do vigorously assail the penalty of forfeiture of tax exemption. *Amici* submit that this penalty is unlawful because interest on general obligation bonds of state and local governments is constitutionally exempt from federal income taxation. It is *amici's* further submission that the federal government's effort to remove this exemption raises a profound threat to the viability of state and local governments—a threat which is greater because attempts have been made to affect the historical exemption for state and local bonds in other contexts[1] and federal officials have made known their desire for a complete abolition of the exemption.[2]

INTEREST OF THE AMICI

Amici include organizations which represent state and local governments or their officials located throughout the United States, financial officials of state governments, and the State of West Virginia. The governments repre-

---

[1] See, e.g., Social Security Amendments of 1983, Pub. L. No. 98-21, § 121, 97 Stat. 65. The Constitutionality of the other statutes affecting this historical exemption has not been examined by this Court.

[2] As noted by Arthur Abba Goldberg, "The CBO [Congressional Budget Office] and the Treasury generally agree on doing away with tax-exempt bonds." Goldberg, A Call to Action: State Sovereignty, Deregulation and the World of Municipal Bonds, 13 The Urban Lawyer 253, 269, n.47 (1981).

sented by and associated with the *amici* organizations and officials, and the State of West Virginia, collectively issue many billions of dollars of general obligation bonds every year. A major issue in this case is whether the federal government may constitutionally impose a tax on the interest paid on such bonds. *Amici* have a critical interest in this constitutional question because the imposition of a tax on general obligation bonds will gravely impair the ability of state and local governments throughout the nation to function effectively in a federal system and to carry out essential sovereign functions. Due to their vital interest in the constitutional issue, *amici* are submitting this brief to assist the Court in its resolution of this action.

SUMMARY OF ARGUMENT

1. The Tenth Amendment prohibits actions of the federal government which impair the ability of state and local governments to fulfill their role in the Union. Because of the need to protect the functioning of these governments, a law violates the Tenth Amendment if a generalized inquiry shows it will have obvious harmful effects on vital state and local activities.

The Amendment is thus violated by a federal tax on the interest on state and local general obligations bonds. These bonds are used to finance essential sovereign functions such as construction of schools, roads, police stations, fire stations, water works, waste disposal systems and other vital facilities. If general obligation bonds were not immune from taxation, the interest costs paid by state and local governments would rise dramatically and many of these governments might thereby be foreclosed from raising the money necessary to build essential facilities. Also, because of the large increase in their interest costs, state and local governments would have much less money remaining to pay for other sovereign functions. A serious threat to the viability of state and local governments

thus emanates from the federal government's claim it may tax the interest on general obligation bonds.

2. The constitutional prohibition against taxation of general obligation bonds was confirmed by the events surrounding the enactment of the Sixteenth Amendment. This is shown by the legislative history surrounding adoption of the Amendment and by decisions of this Court following enactment of the Amendment.

In the nineteenth century this Court, in recognition of the fundamental concept of dual sovereignty, established the doctrine of reciprocal immunity. Under this doctrine the federal and state governments could not tax the interest on each other's bonds. Despite this doctrine, in 1894 Congress enacted a law which taxed interest on state and local bonds.

In 1895 this Court declared the law unconstitutional. The Court ruled the tax on interest from bonds was invalid under the doctrine of reciprocal immunity. Also, it ruled that taxes on income from real and personal property were invalid because they were direct taxes on real estate and personal property, but were not apportioned among the states according to population as required by Article I, Section 2.

The Sixteenth Amendment was thereafter enacted to facilitate the taxation of income on real and personal property by eliminating the requirement that a tax on such income must be apportioned by population. However, the amendment was not intended to affect the doctrine of reciprocal immunity, under which the interest from state and local bonds was exempt from taxation. Rather, the constitutional immunity of such interest was preserved. This was specifically recognized by decisions of this Court following enactment of the amendment.

3. Although the tax immunity for interest on general obligation bonds is protected by the Constitution, the Secretary appears to assert the legality of such taxes by

claiming that the federal government can levy certain other allegedly analogous taxes. The Secretary's alleged analogies are misplaced. The other taxes present different problems and considerations. Also, the constitutionality of several allegedly analogous taxes has not been determined by this Court.

4. This Court has original jurisdiction of South Carolina's claim. Under the factors governing the discretionary exercise of such jurisdiction, the Court should entertain this action.

In applying its discretion the Court considers the policies underlying the Article III jurisdictional grant, and the Court's other judicial responsibilities. It assesses, among other things, the seriousness and dignity of the claim; the availability of another adequate forum; and its responsibilities to the national system. These factors are clearly met here because the state is asserting a well founded constitutional claim relating to fundamental concepts governing the role of the federal and state governments. The policies underlying Article III jurisdiction, and the Court's judicial responsibilities, clearly encompass consideration of such a claim.

The Secretary argues that this Court's jurisdiction is barred by federal statutes, and that the Court should decline jurisdiction as a matter of discretion. This argument should be rejected because the Constitution specifically empowers the Court to hear the action and all discretionary factors are met here.

ARGUMENT

I. It is Unconstitutional For The Federal Government to Tax The Interest On State and Local Bonds, And The Question Whether this Court should Exercise Original Jurisdiction Is Significantly Dependent Upon this Substantive Constitutional Issue

This action requires the Court to consider whether it should exercise original jurisdiction and whether the federal government may constitutionally impose a tax on interest from general obligation bonds issued by state and local governments. The jurisdictional question inextricably implicates the substantive constitutional issue. For in determining whether to exercise its original jurisdiction, the Court considers, among other things, "the seriousness and dignity of the claim," *Illinois* v. *City of Milwaukee*, 406 U.S. 91, 93 (1972), whether the exercise of jurisdiction will serve the policies underlying the grant of original jurisdiction, and whether the exercise of jurisdiction will serve the Court's "paramount responsibilities to the national system", *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493, 497, 499 (1971). These matters bearing on original jurisdiction necessitate prior understanding of the substantive constitutional issue. Therefore *amici's* discussion of the merits precedes a discussion of the factors bearing on the exercise of original jurisdiction.

A. Established Tenth Amendment Precepts Are Violated By The Federal Government's Claim that it can Tax The Interest On General Obligation Bonds Of State and Local Governments

This Court has repeatedly made clear that the Tenth Amendment prohibits federal regulation which "hamper[s] [a] state government's ability to fulfill its role in the Union" and thereby "undermine[s] the role of the States in our federal system." *United Transportation Union* v. *Long Island R.R.*, 455 U.S. 678, 688 (1982). The Court has thereby "recogniz[ed] the essential role of

the States in our federal system of government," *National League of Cities* v. *Usery*, 425 U.S. 833, 844 (1975). This role must be protected because "the Constitution, in all its provisions, looks to an indestructible Union, composed of indestructible States," *National League of Cities* at 844, quoting *Texas* v. *White*, 74 U.S. (7 Wall.) 700, 725 (1869).

Because of the need to protect the functioning of state and local governments, the constitutionality of federal laws having an adverse financial effect upon these entities "does not depend, . . . on 'particularized assessment of actual impact,' which may vary from State to State and time to time, but on a more generalized inquiry, essentially legal rather than factual, into the direct and obvious effect of the federal legislation on the ability of the states to allocate their resources." *EEOC* v. *Wyoming*, 103 S. Ct. 1054, 1063 (1983). Thus, in assessing constitutionality it is sufficient that "enough [effects of a federal law] can be satisfactorily anticipated for an outline discussion of their general import." *National League of Cities* at 850. A federal statute is therefore unconstitutional when it will have obvious adverse effects upon vital state and local activities such as schools, public health, sanitation, parks and recreation, fire prevention and police protection. *National League of Cities* at 851.

These established constitutional precepts are violated by the federal government's claim that it can tax the interest on general obligation bonds of state and local authorities. General obligation bonds, which have been issued since the nation began, are used to finance the most vital sovereign functions of state and local governments all across the country. They finance the construction of schools, roads, city halls, fire stations, police stations, prisons, hospitals, water works, sewer systems, and solid waste disposal facilities. If these bonds were not immune from federal taxation, the interest costs paid by state and local governments would rise dramatically and many of

these governments might thereby be foreclosed from raising the money necessary to build essential sovereign facilities. Also, because of the large increase in their interest costs, state and local governments would have less money remaining to pay for other sovereign functions. These other functions would suffer accordingly.

The harmful consequences that would result if state and local bonds, including general obligation bonds, were subjected to taxation have been set forth in affidavits of officials of leading financial houses, including Morgan Guaranty Trust Company and Goldman, Sachs & Co., which are major participants in the state and local bond markets.[3] The affidavits state that, in the absence of an exemption, many localities could be precluded from raising monies for projects, and they variously estimate that the interest rates on state and local bonds would rise between 25 and 75 percent.[4] Thus, if a state or local government pays 10 percent annual interest on a tax-exempt bond, it would have to pay between 12.5 percent and 17.5 percent if the exemption were unavailable. On a one hundred million dollar, 20-year issue the increased interest would run between 2.5 and 7.5 million dollars per year, or from 50 to 150 million dollars over the life of the bond.

---

[3] See the Affidavits of Richard L. Tauber, Vice President, Public Finance Department, Morgan Guaranty Trust Company, dated September 13, 1983; Terrence E. Comerford, Managing Director of Blyth Eastman Paine Webber Incorporated, dated September 7, 1983; Charles M. Harmon, Jr., General Partner, Goldman, Sachs & Co., New York, dated September 8, 1983; C. W. Houser, Senior Vice President, First City National Bank, Austin, Texas, dated September 2, 1983; James H. Kerley, Jr., Executive Vice President, First Southwest Company, Dallas, Texas, dated September 6, 1983; John E. Peterson, Director, Government Finance Research Center, Municipal Finance Officers Association, Washington, D.C., dated September 20, 1983; printed in the Appendix to this brief.

[4] One affidavit even estimates that in some circumstances the interest rate could rise between 200 and 300 percent. Affidavit of Charles M. Harmon, Jr., printed in Appendix to this brief.

Moreover, the collective amount of increased interest paid by all state and local governments would be staggering. Richard L. Tauber of Morgan Guaranty Trust Co. has stated that over 78 billion dollars of long term municipal bonds were issued in 1982 alone.[5] Thus, if one assumes a 10 percent interest rate on tax-exempt bonds,[6] and estimates that interest costs would increase from 25 to 75 percent in the absence of exemption, the increase in collective annual interest costs would run from 525 million dollars per year to 1.575 billion dollars per year. Extended over 10 years of annual interest payments, the increase in interest costs would range between 5.25 billion dollars and 15.75 billion dollars.

It is thus clear that a serious threat to the viability of state and local governments emanates from the federal government's claim that it can tax the interest on state and local general obligation bonds. As this Court has stated, constitutional analysis does not require precision in assessing the exact magnitude of the threat. Rather, it is enough that we can plainly anticipate obvious adverse effects upon sovereign functions. *National League of Cities* at 851. Here, such effects are the only anticipatable results of the federal claim of taxability. On its face, therefore, the federal claim violates the Tenth Amendment, which protects state and local authorities against federal impairment of their role in the Union.

B. The Sixteenth Amendment Preserved The Historically Tax Exempt Character of State and Local Bonds

The historically established constitutional exemption for interest on state and local bonds was preserved by the Sixteenth Amendment. This is demonstrated by exami-

---

[5] General obligation bonds constituted approximately 21 billion dollars of this total. Affidavit of John E. Peterson, printed in Appendix to this brief.

[6] The average yield of "A rated" municipal bonds issued in today's market is 9.75%. Affidavit of James H. Kerley, Jr., printed in Appendix to this brief.

nation of the legislative history surrounding adoption of the amendment and the views of this Court expressed in years following enactment of the amendment.

In the nineteenth century this Court established the doctrine of reciprocal immunity. *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat) 316 (1819); *Weston* v. *City of Charleston*, 27 U.S. (2 Pet.) 449 (1829); *The Collector* v. *Day*, 78 U.S. (11 Wall) 113 (1871); *Pollock* v. *Farmers Loan and Trust Co.*, 157 U.S. 419 (1895), opinion on rehearing, 158 U.S. 601 (1895). Under this doctrine, states could not tax the interest on federal bonds and the federal government could not tax the interest on state bonds. The doctrine recognized and protected the unique American system of dual sovereignties. As stated in *Collector* v. *Day*, at 124-127:

> The general government, and the states, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres.
>
> * * * *
>
> Such being the separate and independent condition of the states in our complex system . . . it would seem to follow, as a reasonable, if not a necessary consequence, that the means and instrumentalities employed for carrying on the operations of their governments for preserving their existence, and fulfilling the high and responsible duties assigned to them in the Constitution, should be left free and unimpaired; should not be liable to be crippled, much less defeated by the taxing power of another government . . . .

Despite the doctrine of reciprocal immunity, in 1894 the federal government enacted a statute which taxed the interest on state and local bonds. It also taxed income from real estate and personal property.[7] The constitu-

[7] A tax was levied as well on other forms of income, such as salaries and interest on corporate bonds.

tionality of this statute was at issue in this Court's two 1895 decisions in *Pollock, supra.*

In its first *Pollock* decision, the Court held that the tax on income from real estate was unconstitutional because it was a direct tax on real property but was not apportioned among the states according to the size of their populations. It thus violated Article I, Section 2, which specifically directed that "direct taxes shall be apportioned among the several states . . . according to their respective numbers." The Court also held the tax on interest from state and local bonds unconstitutional under the doctrine of reciprocal immunity because the tax was levied on the instrumentalities of state and local governments.[8]

On rehearing the Court adhered to its decision that the tax on income from real estate was void, and extended that holding to the tax on income from personal property, saying the levy was a direct tax on personal property but was not apportioned by population. The Court adhered to its holding that the tax on interest from state and municipal bonds was unconstitutional because it was a levy on the instrumentalities of state and local governments.

Subsequent to the *Pollock* case, Congress approved and the states ratified the Sixteenth Amendment. The amend-

---

[8] Justice Fuller, writing for the Court, said a tax on the interest on state bonds "would operate on the power to borrow before it is exercised, and would have an impermissible influence on the contract." He further said the levy would be a "tax on the power of the states and their instrumentalities to borrow money and consequently repugnant to the Constitution." 157 U.S. at 586. And in a separate opinion accompanying both majority opinions, Justice Field stated that "[t]hese bonds and securities are as important to the performance of the duties of the State as like bonds and securities of the United States are important to the performance of their duties, and are as exempt from the taxation of the United States as the former are exempt from the taxation of the states." 157 U.S. at 601.

ment was designed to facilitate the taxation of income from real and personal property by eliminating the *Pollock* requirement that a tax on income from such property must be apportioned by population. Elihu Root of New York, a leading Senatorial proponent of the amendment, specifically pointed out that its purpose was to permit taxation of income from real and personal property:

> The proposal followed the suggestion of the Supreme Court in the *Pollock case*. The evil to be remedied was avowedly and manifestly the incapacity of the National Government resulting from the decision that income practically could not be taxed when derived either from real estate or from personal property, although it could be taxed when derived from business or occupation.

45 Cong. Rec. 2539-40 (1910).

The amendment, however, was not intended to affect the long established doctrine of reciprocal immunity under which interest on state and local bonds was constitutionally exempt from taxation. Rather, the constitutional exemption for such interest was specifically preserved. This was made express in response to an objection raised by Governor Hughes of New York when submitting the amendment to his state legislature for ratification.

In his message to the state legislature, Governor Hughes pointed to the language of the amendment, which states that "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration." Governor Hughes called attention to the phrase "from whatever source derived," suggested that phrase might permit taxation of interest on state and local obligations, and objected to the amendment on this basis. Special Message from the Governor, New York Senate, No. 3 (1910).

Governor Hughes' suggestion, made on January 5, 1910, received national attention.[9] It was soon replied to and rejected by three leading Senators who championed the Amendment, Senator Borah of Idaho, Senator Root of New York, and Senator Brown of Nebraska, who had steered the amendment through Congress.

On February 10, 1910, Senator Borah indicated that Governor Hughes' suggestion was incorrect because the taxing power of the federal government was subject to implied limitations, 45 Cong. Reg. 1694-99. On February 17, 1910, Senator Root said that "much as I respect the opinion of the Governor of the State, I cannot agree with the view expressed in his special message on January 5." 45 Cong. Rec. 2539 (1910). Speaking as one who had "advocated in the Senate . . . the proposed amendment," Senator Root then gave "[his] view of its effect." That view, quoted *supra*, was that the amendment was simply intended to allow taxation of income from real and personal property.

On February 23, 1910, Senator Brown likewise repudiated Governor Hughes' suggestion. Senator Brown said:

> The amendment does not alter or modify the relation today existing between the States and the federal government. That relation will remain the same under the amendment as it is today without the amendment. It is conceded by all that the Government cannot, under the present constitution, tax state securities or state instrumentalities . . .

45 Cong. Rec. 2245-46 (1910).

The views of leading proponents of the Amendment thus demonstrate that it did not alter but instead pre-

---

[9] See Editorial, Wall Street Journal, January 6, 1910, p. 2; Chicago Daily Tribune, January 7, 1910, p. 8; Dover Republican, January 12, 1910, p. 6; World-Herald (Omaha), January 10, 1910, p. 4 (Editorial); New York Times, March 2, 1910, p. 8.

served the historical immunity from taxation of interest on state and local bonds. This construction is confirmed by numerous decisions of this Court issued within 25 years of the enactment of the Amendment.

This Court repeatedly held that the Sixteenth Amendment "did not extend the taxing power to new subjects, but merely removed the necessity which might otherwise exist for an apportionment among the States of taxes laid on income". *Eisner* v. *Macomber*, 252 U.S. 189, 206 (1920).[10] The Court further stated that "a tax on the interest payable on state and municipal bonds has been held invalid as a tax bearing directly upon the exercise of the borrowing power of the Government". *Helvering* v. *Mountain Producers Corporation*, 303 U.S. 376, 386 (1938). In the latter regard, Chief Justice Stone pointed out for the Court that a federal tax on the interest would "threaten impairment of the borrowing power of the state." *Helvering* v. *Gerhardt*, 304 U.S. 405, 466 (1938).[11]

---

[10] See also, *Brushaber* v. *Union Pacific R.R. Co.*, 240 U.S. 1, 17-19 (1916); *Stanton* v. *Baltic Mining Co.*, 240 U.S. 103, 112 (1916); *Tyee Realty Co.* v. *Anderson*, 240 U.S. 115, 117-118 (1916). *William E. Peck & Co.* v. *Lowe*, 247 U.S. 165, 172-3 (1918); *Evans* v. *Gore*, 253 U.S. 245, 255 (1920); *Metcalf* v. *Mitchell*, 269 U.S. 514, 521-522 (1926); *National Life Ins. Co.* v. *United States*, 277 U.S. 508, 521 (1928); *Willcuts* v. *Bunn*, 282 U.S. 216, 225-226 (1931); *Indian Motorcycle Co.* v. *United States*, 283 U.S. 570, 577 (1931); *Trinity Farm Construction Co.* v. *Grosjean*, 291 U.S. 466, 471 (1934); *Ashton* v. *Cameron County Water W.I., District No. One*, 298 U.S. 513, 530 (1936); *James* v. *Dravo Contracting Co.*, 302 U.S. 134, 156 (1937); *Hale* v. *Iowa State Board*, 302 U.S. 95, 107 (1937).

[11] It is noteworthy that Chief Justice Hughes, who as Governor of New York expressed concerns that the Sixteenth Amendment could be read to authorize federal taxation of the interest on state and local bonds, authored several opinions pointing out that interest on these bonds was immune from taxation and that the Sixteenth Amendment did not extend the federal taxing power to new subjects. *Willcuts, id.*; *Mountain Producers, id.*; *Dravo Contracting Co., id.*

C. The Federal Government Has Presented Faulty Analogies To Support Its Claim That It Can Tax Interest On General Obligation Bonds

Foregoing sections of this brief demonstrate that the tax exempt character of state and local general obligation bonds is constitutionally protected by the Tenth Amendment and that the historical tax immunity of the bonds was reaffirmed by enactment of the Sixteenth Amendment. However, the Secretary appears to briefly argue, by way of analogy, that the taxation of bond interest is constitutional because the federal government is presently taxing the incomes and benefits of state employees, capital gains on the sale of municipal bonds or transfers of such bonds occurring because of gift or death, and industrial development or arbitrage bonds.[12] These analogies are misplaced and will not support a tax on general obligation bond interest.

Several of the allegedly analogous taxes do not pose the same threat to the viability of state and local governments as does a tax on bond interest. This is true, for example, of capital gains taxes, gift and estate taxes, and taxes on the incomes of state employees. Because these taxes do not threaten to impair or undermine the ability of state and local governments to perform their role in the Union,[13] they do not raise the same Tenth Amendment problems as a tax on interest from general obligation bonds.

As well, unlike a tax on interest on bonds, the allegedly analogous taxes such as those on capital gains, industrial revenue bonds, and arbitrage bonds were not the subject of pinpoint Sixteenth Amendment legislative history showing that the taxes are unconstitutional.

---

[12] Brief for the Defendant In Opposition at 7, 7 n.8, 10-11.

[13] When holding that a tax could be imposed on the salaries of state employees, this Court specifically distinguished a tax on interest because it "threaten[s] impairment of the borrowing power of the state." *Helvering* v. *Gerhardt, supra,* at 466.

Finally, this Court has not determined the constitutionality of some of the claimed analogous taxes such as the tax on industrial revenue and arbitrage bonds. A tax on these types of bonds raises a number of considerations not presented by a tax on general obligation bonds. Since the constitutionality of the supposedly analogous taxes is undecided, and raises different considerations, it is an impermissible bootstrap to argue that these taxes support a tax on the interest on general obligation bonds.

II. This Court Should Exercise Its Original Jurisdiction

The complaint states a genuine case or controversy between South Carolina and a citizen of another state. Therefore, this Court has jurisdiction pursuant to Article II, Section 2, Clause 2 of the Constitution.[14]

Of course, this Court has not always exercised its original jurisdiction, even though it has observed that the founding fathers may have initially contemplated it would always do so. *Ohio* v. *Wyandotte Chemicals Corp.*, 401 U.S. 493 (1971). In determining whether to exercise its jurisdiction the Court considers the policies underlying the Article III jurisdictional grant, and its other judicial responsibilities, *Wyandotte Chemicals* at 499. The Court thus assesses: (1) "the seriousness and dignity of the claim," *Illinois* v. *City of Milwaukee*, at 93; (2) the availability of "another adequate forum in which [the plaintiff can] settle his claim," *United States* v. *Nevada*, 412 U.S. 534, 538 (1972); and (3) that "the Court's paramount responsibilities to the national system lie almost without exception in the domain of federal law," *Wyandotte Chemicals* at 497.

The application of these guideposts for determining jurisdiction counsel in favor of its exercise here. A sovereign state is raising a serious and well founded claim

[14] The Secretary appears to concede the existence of jurisdiction in this Court. Brief for the Defendant in Opposition at 11; Supplemental Memorandum of Defendant at 1 and 1, n.1.

that the federal government has adopted an unconstitutional statute, and that the federal government's actions threaten to impair the ability of state and local governments to perform their constitutional roles. The State's claim is supported by the Tenth Amendment, by the legislative history surrounding ratification of the Sixteenth Amendment, and by decisions of this Court. The claim raises vital issues of federal law, not questions of local law. Such important issues of federal law are preeminently within this Court's paramount responsibilities to the national system, and resolution of them by the Court paradigmatically serves the policies underlying the jurisdictional grant.

Further, an alternative forum does not seem to be available here. For the parties agree, with apparent merit, that the Anti-Injunction Act and its counterpart in the Declaratory Judgment Act bar suit in the lower courts.[15] Thus, this Court is the only tribunal in which South Carolina may bring suit to enforce its constitutional rights.

In his two briefs, the Secretary seeks to elide the appropriateness of the exercise of original jurisdiction. In the initial brief it was argued that the Anti-Injunction Act, and its counterpart in the Declaratory Judgment Act, are an absolute bar to suit in this Court by South Carolina. Thus, it was argued in effect that the statutory provisions constitute a withdrawal of the constitutional jurisdiction of this Court.

Subsequently, in his second brief, the Secretary argued that the statutory provisions constitute a procedural rule which is "not a withdrawal of subject matter jurisdiction" but "merely a limitation of remedies and a restriction on timing." And in both briefs the Secretary has

---

[15] Brief for the Defendant in Opposition at 4-11; Motion of South Carolina for Leave to File Complaint at 38-39; Reply Brief of Plaintiff at 3.

argued that, even if jurisdiction is not prohibited as a matter of binding statutory law, this Court nevertheless should decline to exercise it as a matter of discretion.[16]

No matter what form the Secretary's argument has taken at various times, however, its overriding defect is the same. It would bar the exercise of original jurisdiction by this Court even though such jurisdiction is specifically granted by the Constitution and the discretionary factors traditionally considered by the Court are met. The Secretary's argument thus contravenes Article III of the Constitution and the jurisprudence of this Court, and should therefore be rejected.[17]

---

[16] In his first brief the Secretary also suggested the Court should decline to exercise jurisdiction because the case allegedly does not present matters of "urgent concern" and requires "evidence of the actual burden" upon South Carolina. Brief For The Defendant In Opposition at 12. However, as shown earlier in this brief, the case presents serious constitutional questions relating to the ability of states and local governments to function in the federal union, and resolution of these questions does not require "a particularized assessment of actual impact," but only a generalized assessment of the effects of the statute. *National League of Cities* at 851. The affidavits filed in this case fully demonstrate the adverse impact of the Secretary's position.

[17] The overriding flaw in the Secretary's argument is not cured by his assertions that nothing "prevents a State, as taxpayer" from invoking the jurisdiction of the Court, or that the State could "support" a third party taxpayer in a test case. South Carolina is not asserting rights as a taxpayer, but sovereign rights protected by the Constitution. Moreover it need not await or rely on a suit by a third party taxpayer in order to vindicate its own sovereign rights.

CONCLUSION

For the foregoing reasons, this Court should grant the Motion for Leave to File an Original Complaint.[17]

Respectfully submitted,

LAWRENCE R. VELVEL
Chief Counsel
STATE AND LOCAL LEGAL CENTER
444 North Capitol Street, N.W.
Suite 349
Washington, D.C. 20001
(202) 638-1445

JAMES M. JOHNSTONE
DENNIS A. DUTTERER
WILEY, JOHNSON & REIN
1776 K Street, N.W.
Washington, D.C. 20006
(202) 429-7000
Counsel for the Amici Curiae

[17] Of course, after granting leave to file, the Court may also determine the merits without further delay, and rule that a tax on general obligation bonds is unconstitutional. This disposition would be appropriate because the Constitution clearly prohibits such a tax, and no public purpose would be served by the expense and delay of further adjudication.