No. 94, Original

IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

STATE OF SOUTH CAROLINA,
Plaintiff,

NATIONAL GOVERNOR'S ASSOCIATION,
Plaintiff in Intervention,

v.

JAMES A. BAKER, III
Secretary of the Treasury of the United States of America,
Defendant.

BEFORE THE SPECIAL MASTER

BRIEF AMICUS CURIAE OF THE NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS IN SUPPORT OF PLAINTIFF STATE OF SOUTH CAROLINA

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INTEREST OF THE AMICUS CURIAE

This brief Amicus Curiae is filed pursuant to Rule 36 of the rules of this Court on behalf of the more than 1,800 local governments that are members of the National Institute of Municipal Law Officers, (NIMLO), in support of the State of South Carolina. The members of NIMLO are state political subdivisions. NIMLO is operated by the chief legal officers of its members variously called city attorney, county attorney, city or county solicitor, corpor-

tion counsel, director of law, or any one of some twenty other titles.

NIMLO's members, as political subdivisions, have a vital interest in the resolution of the question presented in this case; namely whether the United States may constitutionally impose a registration cost on the issuance of municipal bonds and thus effectively regulate the borrowing power of its fellow sovereigns. All political subdivisions have an interest in the answer to the question herein presented for the following reasons: 1) the imposition of a registration cost upon their unregistered bonds would effectively limit them in issuing such bonds and thereby deprive them of the option to do so even if they determine that it is more advantageous in the exercise of their governmental functions; and 2) the taxation of the interest on their bonds under the guise of a registration cost will impose on them a heavy burden of cost and of potential regulation by the United States of their exercise of their governmental activities.

NIMLO has previously filed a brief on the merits in this most important case asking the U.S. Supreme Court to take jurisdiction in this case. NIMLO presents in this brief an analysis of the Sixteenth Amendment to the United States Constitution illuminating the intention of its drafters and supporters which clearly denies to the National Government the extraordinary power to impose costly and burdensome regulations on the issuance of state and local government bonds. For this reason, and for the reasons discussed in NIMLO's previous brief on the jurisdiction of the U.S. Supreme Court to pass upon the issues herein, Amicus respectfully asks the Special Master appointed by the Court to hear the case to reaffirm the constitutional doctrine of state and local governmental immunity from

Federal interference with their vital governmental financial functions and hold that Pub. L. 97-48, Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), §310(b)(1) codified as Internal Revenue Code of 1954 §103(j) in imposing a registration requirement on state and municipal issuance of financial obligations exceeds the scope of the constitutional authority of Congress.

STATEMENT OF THE CASE

Amicus adopts the statement of the case and the facts as presented by Plaintiff State of South Carolina in its brief on the merits before the Special Master.

SUMMARY OF THE ARGUMENT

The history of the Sixteenth Amendment reflects the intent of its sponsors to prohibit the Federal government from imposing costs which are in effect a tax on the interest of state and local government bonds. Ratification of the Amendment was achieved only after its supporters, both in Congress and in other forums, publicly assured the States that taxing their issuance of bonds was not authorized by that Amendment. It would now certainly be a breach of faith with the States, which relied on such assurances to ratify the Amendment, for Congress to in legislation assert or this Court to find authority anywhere in the Constitution for the adoption of such legislation.

ARGUMENT

THE HISTORY OF THE SIXTEENTH AMENDMENT SHOWS AN INTENTION TO DENY THE NATIONAL GOVERNMENT POWER TO TAX OR OTHERWISE BURDEN STATE AND LOCAL GOVERNMENT BOND INTEREST.

In a challenge to the 1894 Income Tax Act the first decision in *Pollock v. Farmer's Loan & Trust Company,* 157 U.S. 419 (1895), distinguished four kinds of income covered by the Act: (1) salaries, professional income and business profits; (2) real estate rentals and profits; (3) income and profits from private personal property, including stock dividends and bond and note interest; and (4) interest from state and municipal bonds. The Court held unanimously that an income tax on income from the source of salaries, professional income and business profits was an indirect tax and within Congress' power without apportionment. 157 U.S. at 578. As to real estate, the Court held 7-2 that a tax on income from that source was a direct tax and that the 1894 act was unconstitutional with regard to it for lack of apportionment. As to the tax on income from the source of personal property, the Court was evenly divided as to whether it was direct so as to require apportionment. As to municipal bond interest, all of the Justices agreed that there was a total lack of power, not curable by apportionment, 157 U.S. at 585, 601, 652, 653.

The even division on the personal property question required a rehearing and the second *Pollock* decision. 158 U.S. 601 (1895). The result was 5-4 against the constitutionality of an unapportioned income tax on income from the source of personal property as well as real estate (158 U.S. at 637), but a unanimous reaffirmation that income from state and municipal bond interest was totally immune, whether or not the tax was apportioned. See *Hale v.*

State Board, 302 U.S. 95, 107 (1937). Finally, the entire Act was struck down by the U.S. Supreme Court.

On April 27, 1909, Senator Brown introduced a resolution to amend the Constitution to provide "The Congress shall have the power to lay and collect taxes on income and inheritances." (44 Cong. Rec. 1548). This formulation was criticized because Congress already had that power. Senator Raynor said: "unless you change the clause of the Constitution which provides for apportionment, the joint resolution will not repeal that clause." (44 Cong. Rec. 1568-1569).

On June 16, 1909, President Taft recommended that the Congress "shall propose an amendment to the Constitution conferring the power to levy an income tax upon the national government without apportionment among the states in proportion to population." (44 Cong. Rec. 3344).

Senator Brown responded the next day with the introduction of another joint resolution (44 Cong. Rec. 3377).

> "The Congress shall have power to lay and collect direct taxes on income without apportionment among the several states according to population."

On June 28, 1909, the Senate Finance Committee brought in a joint resolution in the language of the present Sixteenth Amendment. The word "direct" was removed from the Brown formulation and the words, "from whatever source derived," were substituted, with no explanation of the change. (44 Cong. Rec. 3900). It was, however, a more precise formulation because the *Pollock* apportionment requirement, which was to be overcome, related to a distinction between the various sources of income.

No suggestion was ever made in Congress that the pro-

posed Amendment had anything to do with taxation of state and local government bond interest.

The proposed Amendment then went to the States for ratification and was proceeding at a reasonable pace until Governor Charles E. Hughes' famous message to New York State's Legislature on January 5, 1910.* He raised the possibility that "The comprehensive words, 'from whatever source derived', if taken in their natural sense, would include not only incomes from ordinary, real or personal property, but also incomes derived from State and municipal securities," a result which he opposed.

The sponsors of the Amendment reacted sharply. As Senator Borah, a leading supporter of the Amendment, said on February 10, 1910, the Hughes message could derail the ratification process. He therefore made a lengthy legal argument contesting the Hughes position. (45 Cong. Rec. 1694 *et seq.*).

On February 23, 1910, Senator Brown, the original introducer of the Amendment Resolution, spoke to the Senate to the same effect. (45 Cong. Rec. 2245, 2247).

Senator Root of New York wrote to a member of the New York Legislature to counter the deterrent effect of his Governor's message. He said of the Hughes objection:

> "I do not find in the Amendment any such meaning or effect."

The Root letter was widely publicized. The *New York World* said in an editorial on March 1, 1910 (p. 10):

> "Mr. Root proves that the Amendment does not open a way for the taxation of State securities. He shows that the words from whatever source derived are soley designed to meet the situation

*Public papers of Governor Hughes, pp. 71, 73.

> raised in the decision of 1895 which distinguished between incomes from personal property and income derived from business or occupation."

The U.S. Supreme Court held in 1916, when its members were contemporaries familiar with the debates on the subject and included former Governor Hughes himself, that the Amendment added no new subject to the taxing power of Congress, but merely eliminated the apportionment requirement. *Brushaber v. Union Pacific R. Co.*, 240 U.S. 1, 11 (1916); *Stanton v. Baltic Mining Co.*, 240 U.S. 103, 112 (1916).

In *Peck & Co. v. Lowe,* 247 U.S. 165, 172 (1918) the Court reviewed the history of the Hughes message and the Senators' responses and reached the same result.

In *Willcutts v. Bunn,* 282 U.S. 216, 266 (1931), Chief Justice Hughes discarded his earlier concern saying for a unanimous Court:

> "In the case of the obligations of a state or of its political subdivisions, the subject held to be exempt from Federal taxation is the principal and interest of the obligations. *Pollock v. Farmers' Loan & Trust Co.,* 157 U.S. 429, 584-586 * * *."

Of all the arguments against the immunity of state bond interest, none is more specious than that it was ended by the Sixteenth Amendment. Rather we submit the contrary: reconsideration of the bond interest immunity rule was foreclosed by the ratification of the Amendment in reliance on assurances by its sponsors that the immunity would survive its adoption.

If Congress has the power to tax the interest on unregistered bonds under IRC Section 103(j) it cannot be because it has the power to tax the interest on all bonds of the States under the Constitution. It is open to the Defen-

dant only to argue that unregistered bonds are within some exception to the basic rule of bond immunity under the Constitution — an exception for which we find no basis.

CONCLUSION

For the foregoing reasons, as well as for those reasons stated in Amicus' earlier brief on the jurisdiction of the United States Supreme Court to pass upon the issues in this case, Amicus respectfully urges that the relief sought by Plaintiff be granted.

Respectfully submitted,

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