

ORIGINAL

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 81-1613

TITLE MEMPHIS BANK & TRUST COMPANY
v. Appellant
RILEY C. GARNER, SHELBY COUNTY TRUSTEE ET AL.
PLACE Washington, D. C.

DATE November 29, 1982

PAGES 1 thru 38



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1 IN THE SUPREME COURT OF THE UNITED STATES

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3 MEMPHIS BANK & TRUST COMPANY :

4 Appellant :

5 v. : No. 81-1613

6 RILEY C. GARNER, SHELBY COUNTY :

7 TRUSTEE ET AL. :

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9 Washington, D.C.

10 Monday, November 29, 1982

11 The above-entitled matter came on for oral argument
12 before the Supreme Court of the United States at 10:55
13 a.m.

14 APPEARANCES:

15 K. MARTIN WORTHY, ESQ., Washington, D.C.; on behalf of
16 the Appellant.

17 JIMMY C. CREECY, ESQ., Deputy Attorney General of
18 Tennessee, Nashville, Tennessee; on behalf of
19 appellee, William M. Leech, Jr.

20 J. MINOR TAIT, JR. ESQ., Assistant City Attorney,
21 Memphis, Tennessee; on behalf of appellees Garner and
22 Foster.

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1 to be taxed at 3 percent on net income of the previous
2 year.

3 Earnings are required for this purpose to be
4 computed by including interest on obligations of the
5 federal government and its instrumentalities, and also
6 including interest on obligations of other states, but
7 by excluding interest on obligations of the state of
8 Tennessee itself. The tax in no event is to be less
9 than an ad valorem tax of 60 percent on the value of the
10 property of the bank.

11 The tax is an obligation of the bank itself,
12 and is not collectible by either the state or the bank
13 itself from its stockholders.

14 QUESTION: Mr. Worthy, do you pay another
15 separate franchise tax in Tennessee?

16 MR. WORTHY: Yes, sir. There is a -- all
17 banks and all other corporations are subject
18 specifically to a Tennessee franchise tax which is
19 imposed specifically on the -- to quote from that
20 statute -- on the privilege of engaging in business in
21 corporate form in the state. And every corporation is
22 also required to pay an excise tax which is imposed
23 specifically, to quote that statute, as compensation for
24 the benefits it receives from doing business in
25 Tennessee. There is no such language in the statute

1 imposing the bank tax.

2 Appellant, the Memphis Bank & Trust Company, a
3 state bank, paid the tax as so imposed under protest for
4 1977 and '78, and brought suit in the chancery court for
5 refund of the tax, contending that collection of the tax
6 violated federal law to the extent that the tax applied
7 to interest earned on obligations of the federal
8 government and federal farm credit agencies, and thereby
9 violated the prohibitions of state taxation contained in
10 Section 742 of Title 31 of the United States Code, and
11 Sections 2055, 2079 and 2134 of Title XII of the Code,
12 relating to farm credit agencies. It was thereafter
13 stipulated that if such interests were excluded,
14 appellant would have no liability for tax for the years
15 in issue.

16 Codifying a long line of decisions of this
17 Court, going back to M'Culloch versus Maryland, more
18 than 160 years ago, Section 742 of Title 31 of the Code
19 specifically prohibits every form of state taxation
20 directly or indirectly on interest from federal
21 obligations, except non-discriminatory franchise or
22 other non-property taxes in lieu thereof.

23 The Tennessee tax clearly violates the general
24 prohibition of the statute. The state claims, however,
25 that the tax fits within the exception for

1 non-discriminatory franchise or other non-property taxes
2 imposed in lieu thereof. Appellant submits that it does
3 not.

4 First of all, it's not a franchise tax or
5 other non-property tax imposed in lieu thereof.

6 QUESTION: Mr. Worthy, is that question to be
7 determined as a matter of federal law, do you think,
8 whether it's a franchise tax within the meaning of
9 Section 742?

10 MR. WORTHY: Yes, Justice O'Connor, I think it
11 is to be determined as a matter of federal law. I have,
12 obviously, -- I think this Court has held that it should
13 look at the effect of the law to determine whether it's
14 a franchise or a property tax. Obviously, the intent of
15 the legislature and the authority under which the
16 legislature acted are prime considerations in
17 determining the nature of the tax. But it is a question
18 to be resolved by this Court.

19 Even if the tax is a franchise tax, we believe
20 that it's clearly discriminatory. It is quite clear
21 that in enacting the bank tax, the Tennessee legislature
22 intended to impose a property tax and not a franchise or
23 similar non-property tax.

24 The preamble to the act imposing the tax
25 states specifically that the legislature is acting under

1 authority to tax intangible personal property of banks,
2 and to divide intangible personal property into
3 subclassifications. There is no mention of any
4 authority or any statement of intent to impose a
5 franchise or privilege tax.

6 QUESTION: So what your argument now is that
7 even if Tennessee obligations were included in the basis
8 of the tax, the tax is not one permitted by the federal
9 statute.

10 MR. WORTHY: That's correct, Justice White.
11 As I've indicated, the act creates a subclassification
12 of intangible personal property designated as shares of
13 banks to be taxed on the basis of 3 percent of net
14 earnings, with the net tax in no event to be less than
15 an ad valorem tax of 60 percent of the value of the
16 property of the bank, with a credit for tax paid on its
17 real and personal property.

18 The tax is codified in the same chapter of the
19 Tennessee Code as other property taxes, unlike those on
20 franchises and excises. Payment and collection are at
21 the local level, in contrast with the provisions for
22 payment and collection at the state level of Tennessee
23 franchise and privilege taxes. Furthermore, the tax is
24 allocated to the municipalities and counties on the
25 basis of their respective property tax rates.

1 As I previously indicated, the bank is subject
2 to both the regular general Tennessee franchise tax
3 imposed by a different chapter of the Code and to the
4 Tennessee excise tax imposed by a different chapter of
5 the Code.

6 The state nevertheless says that because the
7 bank tax is measured by income, it should be treated as
8 a franchise tax. This certainly does not follow. The
9 nature of a tax is not determined by its method of
10 calculation.

11 This Court has many times held that a tax
12 imposed as a franchise tax will be treated as a
13 franchise tax even though it is measured by the value of
14 the property. By the same token, a tax imposed as a
15 property tax should be treated as a property tax even
16 though the measure of the value of the property is
17 income.

18 It's long been settled in cases going back to
19 1829 by this Court that federal obligations may not be
20 included in the measure of a state property tax, and
21 this principle is now codified in Section 742 in
22 prohibiting a state property tax in any form which
23 directly or indirectly taxes federal obligations or the
24 interest thereon.

25 For this reason alone, the Tennessee statute

1 should be declared invalid insofar as it requires
2 interest from federal obligations to be included in the
3 tax base.

4 But even if the Tennessee tax were regarded as
5 a franchise tax, it clearly violates federal law because
6 it discriminates against federal obligations by
7 requiring that interest therefrom be taxed while
8 specifically exempting interest from obligations of
9 the state of Tennessee itself.

10 There have been numerous cases in which this
11 Court has stated that the proper test of whether there
12 is discrimination is simply whether the tax is higher as
13 a result of an investment being made in federal
14 obligations than it would be if a similar investment
15 were made in some other assets.

16 This principle is specifically demonstrated in
17 the Schuylkill case, the first Schuylkill case in 1935,
18 in which Pennsylvania imposed a tax on trust companies
19 on the value of shares represented by investments in
20 government obligations, but exempted from tax such value
21 represented by investments in Tennessee -- excuse me, in
22 Pennsylvania corporations and such other assets as
23 Pennsylvania chose to exempt.

24 This Court said it is impossible to avoid the
25 conclusion that the law discriminates in favor of

1 companies owning stocks already taxed or relieved from
2 taxation by the state, and against those companies
3 amongst whose assets there are United States bonds taxed
4 by reason of ownership of such federal securities.

5 Now, appellees in their brief vigorously
6 criticize Schuylkill contending that it stands alone as
7 authority in support of the bank's position in this
8 case. Not so. The principle is well established in
9 other cases.

10 In National Life versus United States in 1928,
11 this Court applied precisely the same principle to a
12 federal attempt to impose a tax on state obligations,
13 invalidating the tax, because it required petitioner to
14 pay more upon its taxable income than could have been
15 imposed had its income from state obligations been
16 derived instead from other securities.

17 And the test has been restated many times by
18 the Court as a basis for finding lack of discrimination.
19 For example, in the Home Insurance case in 1890 in
20 upholding a New York tax, this Court emphasized that the
21 tax sustained, and I quote, "would not be affected if
22 the nature of the property in which the whole capital
23 stock is invested were changed and put into real
24 property or bonds of New York or of other states."

25 That is, of course, the reverse of the

1 situation here in that the tax here would be reduced if
2 the investment were shifted from federal to state
3 bonds. And although dicta, the Court in the Bank of
4 Commerce case cited the statute in Weston versus City of
5 Charleston in which federal obligations and most other
6 personal assets, but not state obligations, were taxed
7 as a prime example of discrimination.

8 The Supreme Court of Pennsylvania more
9 recently, in the Curtis Publishing case in 1949 in which
10 this Court denied certiorari, invalidated a tax
11 strikingly similar to that of the Tennessee tax involved
12 here. Pennsylvania, like Tennessee, had adopted the
13 federal test of net income including interest on federal
14 obligations but excluding interest on Pennsylvania
15 obligations. It was held by the Supreme Court of
16 Pennsylvania that the inclusion of federal interest
17 while excluding state interest constituted unlawful
18 discrimination against federal obligations, in violation
19 of the Federal Constitution.

20 And just a few months ago, the Supreme Court
21 of Alaska, in the National Bank of Alaska case, held
22 that it would be an unlawful discrimination for state
23 privilege tax to include in its measure income from
24 federal obligations while excluding income from Alaska
25 state obligations.

1 In a slightly different context but involving
2 the same principle this Court, in fact, in 1960 in the
3 Phillips Chemical case, invalidated a state tax imposed
4 on a lessee of federal lands where an equivalent tax
5 burden was applied to lessees of all lands in the state
6 except state lands. The Court said, the state and the
7 school district concede that Phillips would not be taxed
8 at all if its lessor were the state or one of its
9 political subdivisions instead of the federal
10 government. It does not seem too much to require that
11 the state treat those who deal with the government as
12 well as it treats those with whom it deals itself.

13 This language was repeated by the Court in
14 invalidating a Washington state tax in the Moses Lake
15 Homes case in 1961, and certainly applies here.

16 As very simply put in Curtis, the state has no
17 right to tax federal securities while leaving its own
18 untaxed.

19 QUESTION: Mr. Worthy, do you think that
20 Section 548 of Title 12 U.S. Code has any impact here?

21 MR. WORTHY: Does it have any -- I'm sorry,
22 Justice O'Connor?

23 QUESTION: Any effect here on the result of
24 the case?

25 MR. WORTHY: No, I do not think so. Section

1 548 as now in effect and has been for several years and
2 as in effect during the years in issue here, simply
3 provides that the states may tax national banks to the
4 same extent as they tax state banks, and that section
5 obviously does not give the states any right to tax
6 either state or national banks to any greater extent
7 than they can tax any other corporation.

8 Section 548 as it existed prior to its
9 amendment provided, among other things, that a state
10 could not impose a tax on a national bank measured by
11 income to any greater extent than it imposed on
12 manufacturing and mercantile corporations.

13 Obviously, under the long line of cases of
14 this Court and as codified now in Section 742 of Title
15 31, states cannot impose a tax on mercantile or
16 manufacturing corporations which discriminate against
17 federal obligations or the interest thereon. I don't
18 think Section 548 really has any relevance whatever to
19 the issue before the Court today.

20 QUESTION: Did you cite a Pennsylvania Supreme
21 Court case?

22 MR. WORTHY: Yes, sir, I did. It's reported --

23 QUESTION: That's not listed in your -- at
24 least I don't find it readily.

25 MR. WORTHY: Yes, sir. It's 69 Atlantic 2d

1 410, and I believe it is referred to -- it's the Curtis
2 Publishing case, and it is --

3 QUESTION: I've got it.

4 MR. WORTHY: Yes, sir. I probably didn't
5 refer to the plaintiff but to the defendant.

6 Now, the state suggests in its brief that
7 there's no discrimination if inclusion of interest on
8 federal obligations is casual or incidental, and that
9 the federal obligations must be singled out for tax for
10 the rule of discrimination to apply. But I call to your
11 attention that that was not the case in the Phillips,
12 just cited, where this Court was careful to point out
13 that the tax burden on private lands was exactly the
14 same as on federal lands. Yet, exemption of state lands
15 was sufficient for the matter to be treated as one of
16 discrimination, invalidating the state tax.

17 And in Miller versus Milwaukee, a case relied
18 on very heavily by the State of Tennessee in its briefs,
19 the record discloses that the tax there involved did not
20 apply solely to income derived from federal obligations,
21 but also applied to income from a variety of other
22 sources such as wages, salaries, business profits,
23 dividends from activities carried on in other states.
24 And this Court held that the tax was invalid because of
25 its discrimination in exempting income from other

1 investments while including the income from federal
2 obligations.

3 The suggestion of appellees that the appellant
4 has the burden of establishing that state obligations
5 are in direct competition with the federal bonds, or the
6 burden of establishing that the Tennessee tax inhibits
7 the purchase of federal bonds simply has no support
8 whatever.

9 In valuing a debt obligation, a free market
10 takes into account a great many factors. The risk, the
11 term, the interest rate, the rate of return after all
12 taxes, and obviously, after everything has been taken
13 into account, the burden of the bank tax reduces the
14 value of federal obligations below what they would be if
15 no such tax was imposed. And the absence of such a tax
16 on Tennessee obligations increases the value of those
17 obligations above what they would be if such a tax was
18 imposed.

19 As the Curtis case said, when Pennsylvania
20 exempts from taxation its own securities but taxes
21 directly or indirectly the securities of the United
22 States, the latter securities are handicapped in their
23 competition with the securities of Pennsylvania among
24 buyers in the marketplace.

25 As far back as M'Culloch versus Maryland and

1 Weston versus City of Charleston in the 1800s, this
2 Court said that it would invalidate a discriminatory tax
3 however inconsiderable the burden on the government.
4 And in both Smith versus Davis in 1944 and the New
5 Jersey Realty Title Insurance Company case in 1946, this
6 Court reiterated the principle by ruling that the
7 exemption statute is intended, and I quote, "to prevent
8 taxes which diminish in the slightest degree the market
9 value or investment attractiveness of obligations issued
10 by the United States.

11 It can hardly be said that the burden here is
12 even slight or inconsiderable, in light of the Solicitor
13 General's calculation in the Amicus brief, which the
14 Solicitor General has filed in behalf of the federal
15 government in this case, that imposition of a tax by
16 every state similar to that of the bank tax imposed by
17 Tennessee would impose an additional burden on the
18 borrowing power of the United States of over a quarter
19 of a billion dollars a year.

20 For all of these reasons, we submit that the
21 Court should reverse the Tennessee Supreme Court and
22 hold that the Tennessee bank tax violates federal law to
23 the extent that it requires that there be included in
24 the tax base obligations of the federal government and
25 its instrumentalities and all the interest thereon,

1 while excluding the interest from that of the state of
2 Tennessee itself.

3 CHIEF JUSTICE BURGER: Mr. Creecy?

4 ORAL ARGUMENT OF JIMMY C. CREECY, ESQ.

5 ON BEHALF OF APPELLEE, WILLIAM M. LEECH, JR.

6 MR. CREECY: Mr. Chief Justice, and Justices,
7 may it please the Court:

8 Because of the impact of this case upon state
9 and local government, a motion was filed to divide the
10 argument in this case and it was granted. In examining
11 the Tennessee bank tax statute here, Section 742 sets up
12 two standards. One, the nature of the tax imposed; and
13 two, whether or not there is discrimination against
14 federal securities within the meaning of Section 742.
15 For the purposes of oral argument, I will address the
16 nature of the tax involved, and Mr. Minor Tait,
17 representing Shelby County in Memphis, Tennessee, will
18 address the discrimination issue.

19 Section 742 of Title 31 is a codification of
20 many opinions of this Court dealing with the parameters
21 within which a state may tax federal securities and the
22 interest thereon, in accordance with the Supremacy
23 Clause and the Borrowing Clause of the Federal
24 Constitution. As early as 1819 in the similar case of
25 M'Culloch v. Maryland the principle was established that

1 the states cannot directly tax federal obligations or
2 their interest. In 1829, the Court further noted in the
3 case of Weston v. City Council of Charleston that a
4 direct tax on U.S. obligations was prohibited and void.

5 Section 742, which originated and was first
6 codified in the 1860s, sets forth this basic exemption
7 that a state cannot tax stocks, bonds, Treasury notes or
8 other obligations of the United States government. It's
9 expressly prohibited by the Supremacy Clause of the
10 Federal Constitution and the Borrowing Clause.

11 However, this Court has noticed and recognized
12 that a tax upon the corporate franchise or corporate
13 privilege is permissible within the parameters of the
14 Constitution, even though these federal bonds and
15 interest may be included within the tax base. This
16 principle was first enunciated by this Court in 1867 in
17 the case of Society for Savings v. Coite and was
18 subsequently reaffirmed in a number of cases including
19 Flint v. Stone Tracy Company in 1911, Educational Films
20 Corporation of America v. Ward in 1931, and as recently
21 as 1956 in Werner Machine Company v. Director of
22 Taxation.

23 Now, the first question the Court will face
24 here in applying our bank tax to Section 742 is the type
25 of tax that we have. If the Court should determine that

1 this is a direct property tax, then the question of
2 discrimination becomes moot and would be void. But it's
3 our position that this is a franchise tax within the
4 meaning of the second sentence of Section 742, which
5 permits a non-discriminatory franchise tax.

6 QUESTION: Then you have two franchise taxes
7 on banks in Tennessee.

8 MR. CREECY: That's correct, Mr. Justice.
9 This bank tax is imposed only against banks. We have a
10 general corporate excise tax and a general corporate
11 franchise tax. Now, the statute which imposes the bank
12 tax specifically provides that this tax is in addition
13 to any other excise tax or any other taxes that may be
14 imposed against the bank.

15 QUESTION: Of course, I suppose the labels
16 don't mean anything.

17 MR. CREECY: Well, I think it's the effect of
18 the tax primarily that's important. Whether we call
19 this a property tax or a franchise tax, a gross receipt
20 tax or whatever is, to some extent, immaterial. But I
21 think the actual effect and operation of the tax is
22 important.

23 QUESTION: Is there any way for us to rule
24 with you without declaring that this is a "franchise"
25 tax? Is there any other way we can rule with you?

1 MR. CREECY: Well, Mr. Justice, I think the
2 term "franchise tax" as used in 742 is a generic term.
3 It doesn't include just, for instance, a tax on
4 corporate capital. As this Court has noted in several
5 opinions, a franchise tax may include a tax on net
6 income. I think the Court can quite easily rule that
7 this is a franchise tax within the meaning of Section
8 742.

9 Now, there is some language there that says
10 "or a non-property tax in lieu thereof" on
11 corporations. Now, the Court, I suppose, could take
12 that approach and say that it is a non-corporate -- I
13 mean, a non-property tax in lieu thereof imposed on
14 corporations. But it's our position that this is a
15 franchise tax that we're imposing.

16 Of course, the nature of the tax, rather than
17 the label attached to it, must be determined by its
18 operation and effect. And, of course, this Court is not
19 bound by the characterization of the tax which is placed
20 on it by the state code. But this Court has noted in a
21 number of cases that such interpretation is to be given
22 weight by this Court in determining the nature of the
23 tax.

24 The Tennessee Supreme Court in this case below
25 affirmatively held that this was an excise tax, and it

1 has done so in other independent decisions before the
2 court. The fact that the tax may be included within our
3 Code section that deals with direct property taxes, or
4 that it may be denominated a tax in lieu of property tax
5 does not make it a property tax, as is suggested by the
6 appellants in the case.

7 This Court has noted in the case of
8 Tradesmen's National Bank of Oklahoma v. Oklahoma Tax
9 Commissioner in 1940 that in defining a franchise tax,
10 that a franchise tax is a tax upon a corporation for the
11 exercise of its corporate privilege and franchise within
12 the state, and further, that this tax may be measured
13 either by net income or by net assets. And that the two
14 terms are used interchangeably. So when we attach the
15 label "excise tax" it's the same as the franchise tax as
16 used within 742.

17 As I stated, the tax is not a property tax but
18 in Tennessee it's a bank tax upon banks for the exercise
19 of the banking privilege in the state of Tennessee.

20 And for several reasons. Article II, Section
21 28 of our state constitution which was amended in 1973
22 permits our legislature to impose a tax upon banks and
23 other financial institutions in lieu of the intangible
24 personal property tax.

25 Now, the Tennessee General Assembly has done

1 this in 1977 by this bank tax within the meaning of the
2 statute; it specifically identifies the tax as an excise
3 tax, it makes the tax imposed in addition to any other
4 excise taxes or any other type of tax that the bank may
5 be required to pay the state of Tennessee.

6 QUESTION: Does the state of Tennessee levy
7 any kind of a tax on the Tennessee Valley Authority?

8 MR. CREECY: No, Your Honor, we do not. Under
9 the provisions of our law they make, in lieu of tax,
10 payments to the state of Tennessee based upon values as
11 a fairly complicated formula. They do not pay property
12 tax per se to the state.

13 QUESTION: Then I'll put it another way.
14 Could the state of Tennessee levy a tax absent that
15 arrangement, on the Tennessee Valley Authority.

16 MR. CREECY: Because the Tennessee Valley
17 Authority is an instrumentality of the federal
18 government, it's very doubtful that we could, Mr.
19 Justice.

20 QUESTION: Counsel, a minor point, if I may,
21 while you're interrupted. The parties stipulated that
22 no tax is due if the federal obligations can't be
23 included in net earnings. Now, does that stipulation
24 mean that no minimum tax would be owing, regardless of
25 what we held under the Tennessee tax provisions?

1 MR. CREECY: Under the facts and the situation
2 of this case, Madame Justice, the minimum tax does not
3 come into play because under the minimum tax computation
4 it is based upon the book value -- 60 percent of the
5 book value of the bank less the appraised value of real
6 or intangible personal property. In this case,
7 apparently the real or intangible personal property more
8 than wiped out any minimum tax that would have been
9 owed. So that's not a question.

10 QUESTION: But in effect, you've stipulated
11 that there would be none owing on the minimum tax.

12 MR. CREECY: That's correct.

13 QUESTION: Thank you.

14 MR. CREECY: The tax is imposed at the rate of
15 3 percent of net earnings. The amount of property held
16 by the bank is totally irrelevant. The value of this
17 property is irrelevant. What better way to measure the
18 exercise of a corporate franchise than the benefits that
19 inures to the corporation from this franchise; that is,
20 the net earnings.

21 Although below, as the appellants have
22 contended, there was a stipulation in the trial court
23 with regard to the amount of the tax and the source of
24 the interest that the tax was characterized as an
25 intangible personal property tax, unfortunately, but the

1 Supreme Court of Tennessee quite correctly held that
2 this was an excise tax. And that point was raised below
3 and argued before the Tennessee Supreme Court.

4 I believe that's all I have, Mr. Chief
5 Justice, unless there's some questions. Thank you.

6 CHIEF JUSTICE BURGER: Very well, Mr. Creecy.
7 Mr. Tait?

8 ORAL ARGUMENT OF J. MINOR TAIT, JR., ESQ.

9 ON BEHALF OF APPELLEES, GARNER and FOSTER

10 MR. TAIT: Mr. Chief Justice, and may it
11 please the Court:

12 As Mr. Creecy stated, we have more or less
13 divided our arguments, since the Court did grant us
14 permission to make divided argument. I'm primarily
15 going to address the question of discrimination.

16 I think that this case turns on two simple
17 points. Number one, what type of tax is involved; and
18 number two, is the tax discriminatory. Now, it's clear
19 that no state can tax an obligation of the United States
20 unless Congress has given its permission. I don't think
21 this point is even in issue.

22 At the time that we tried this case at the
23 trial level, Congress had given the states permission to
24 tax federal obligations in two areas. Number one was
25 12-548 which was the right to tax national banks and

1 national banks' shares. 31-742 gave the states the
2 right to tax any obligation as long as it was a
3 non-discriminatory franchise tax.

4 Now, at the trial level we raised both 548 and
5 742, but the Tennessee Supreme Court ruled that this was
6 a 742 tax, which was a non-discriminatory franchise
7 tax. So I only briefly addressed that in my brief.

8 Now, to be a franchise tax, as Mr. Creecy has
9 pointed out, it determines on whether or not the tax is
10 on the business of a corporation -- and I think it's
11 important to realize that when you talk about
12 non-discriminatory, you've got to determine are we
13 talking about a franchise tax, are we talking about a
14 property tax, are we talking about an income tax.

15 Now, I submit that the appellants in their
16 brief have lumped together all type of taxes that this
17 court has heretofore ruled on. They have lumped
18 together property taxes, they have lumped together
19 income taxes, they have lumped together franchise
20 taxes. Now, what we're talking about in this case is a
21 non-discriminatory franchise tax, and that's all. We're
22 not talking about a property tax or an income tax.

23 Now, it's been held by this Court on many
24 occasions that a state has wide discretion in enacting
25 franchise taxes. That if a corporation comes into a

1 state and gets the privileges to operate as a
2 corporation, they must pay a tax to do that. And it's
3 our position that a state has much wider discretion and
4 authority in the area of a franchise tax than it does in
5 the area of property taxes or income taxes.

6 Now, when we look at whether or not this is a
7 discriminatory act -- and I'm not going to address
8 whether or not it's a franchise tax or property tax
9 because Mr. Creecy has done that. But when we look in
10 the area of whether or not this is a discriminatory tax,
11 then we have to look to the decisions of this honorable
12 Court, and we have to look to the intention of Congress.

13 Now, it is our position that discriminatory
14 does not mean what the appellants would have this Court
15 believe it means. If you adopt the appellant's
16 definition of discrimination, as I understand their
17 argument they are saying that if a state exempts
18 anything from a tax base, then they have to exempt
19 federal obligations or else it's discriminatory.

20 Now, I take that to mean that if a state
21 exempted charities or hospitals or religious
22 institutions, then by the same token, they would have to
23 exempt government securities or government obligations.

24 QUESTION: I thought the cases Mr. Worthy was
25 quoting from indicated only that you can't treat state

1 bonds better than you can treat federal bonds.

2 MR. TAIT: That was what he was arguing to the
3 Court, but it's our position that these cases do not
4 hold that; that there's a common thread throughout the
5 holdings of this Court that when you talk about
6 discrimination in the context of a franchise tax, what
7 you're talking about is a direct effort by the state to
8 single out the federal obligations for taxation.

9 QUESTION: Why should intent make any
10 difference in this area? What if the Tennessee
11 legislature simply passes a tax and decides that A, B,
12 and C should be exempt and C, D and E should be used as
13 the base of the tax, and it turns out that they come out
14 with a product which, in effect, discriminates against
15 the federal government in Mr. Worthy's context because
16 it taxes the revenue from federal securities but doesn't
17 tax the revenue from state securities? Why would it
18 make any difference whether the state of Tennessee
19 intended to single out the federal government?

20 MR. TAIT: Well, the main reason, Justice
21 Rehnquist, is because that is what the decisions, in my
22 judgment, of this Court have held for over 100 years.
23 Now, that is the definition that the appellants are
24 urging on the Court; that a tax is discriminatory if the
25 taxpayer has to pay a higher tax because of the fact

1 that he owns federal obligations than if he did not own
2 federal obligations. That's the entire thrust of their
3 argument.

4 They're saying that that's the test that you
5 look at. That if he has to pay a higher tax because of
6 federal obligations, then that's a discriminatory tax.

7 QUESTION: Well, isn't this explicitly
8 discriminatory, though? It's an explicit discriminatory
9 classification. It says that it includes income from
10 federal bonds.

11 MR. TAIT: Justice White, we say that it is
12 not. We say that based upon the prior holdings of this
13 Court, --

14 QUESTION: Or, it explicitly excludes the --
15 which does it? Does it explicitly exclude the income
16 from state bonds?

17 MR. TAIT: The bank tax simply uses taxable
18 federal income as the base for the tax. And the bank
19 tax of Tennessee does not define or allow any
20 adjustments; it simply says you must go to the excise
21 tax of Tennessee and use that formula to determine the
22 final basis of the federal taxable income and the tax
23 base; that when you go to the excise statute of
24 Tennessee, the excise statute says you take the federal
25 base of taxable income and you make certain adjustments

1 and deductions.

2 Now, the problem is that the federal
3 government allows taxation on federal obligations, the
4 income from federal obligations, so when you get the
5 federal taxable income base, you've already got built
6 into that all federal obligations. Now, it does not
7 allow the taxation of Tennessee obligations. So here
8 again, when you --

9 QUESTION: So there is an explicit
10 classification there.

11 MR. TAIT: Well, that's not done by the state
12 of Tennessee, though, it's done by the federal
13 government in their federal tax structure.

14 QUESTION: I know, but the state of Tennessee
15 picks it up.

16 MR. TAIT: They do.

17 QUESTION: Picks it up, and it says we'll take
18 this base that includes the income from federal bonds
19 but which excludes the state bond income.

20 MR. TAIT: The state bonds are excluded under
21 the federal taxable income.

22 QUESTION: One could almost say it was
23 accidental. The alleged discrimination.

24 MR. TAIT: It's not done by the state of
25 Tennessee legislature. We're simply adopting what the

1 federal government uses on its taxable income basis.

2 But it's my point --

3 QUESTION: My remark was merely directed to
4 these comments about intent. Maybe there was no intent,
5 but it came out with Tennessee bonds being excluded.

6 MR. TAIT: I think it's clear from this record
7 that the Tennessee legislature itself did nothing to tax
8 federal obligations. And I think that's a key and
9 important point because throughout the cases on this
10 subject there's a thread that says that it has to be a
11 direct intentional act to single out the federal
12 obligations for taxation.

13 QUESTION: Mr. Tait, am I mistaken or do I
14 recall correctly that your tax law does impose a tax on
15 the income from other state bonds; not Tennessee but,
16 say, West Virginia?

17 MR. TAIT: On the basis from federal taxable
18 income, the state act adds in the obligations from other
19 states.

20 QUESTION: Now, that's not in the -- even
21 though the federal government doesn't tax those.

22 MR. TAIT: That's correct, Your Honor.

23 QUESTION: So what they did, in effect, is
24 they added into the federal base all state income except
25 from Tennessee bonds.

1 MR. TAIT: Except Tennessee. And under
2 Tennessee law, Tennessee obligations are excluded. So
3 Tennessee could not add in Tennessee obligations.

4 An interesting comment of this Court was in
5 Miller versus Milwaukee -- and this is a case, or one of
6 the cases that we're relying upon on our position that
7 it has to be more than just a discrimination or a
8 difference in the tax base. And I quote from Miller, "A
9 tax may very well be upheld as against any casual effect
10 it may have upon the bonds of the United States when
11 passed with a different intent and not aimed at them.
12 But it becomes a more serious attack on their immunity
13 when they are its obvious aim."

14 Now, it's our position that that shows that
15 what they're talking about in the context of a franchise
16 tax -- and I keep coming back to that because the
17 appellants are lumping in all type of taxes. They're
18 even talking about -- and Mr. Worthy mentioned -- cases
19 involved doing business with the United States
20 government, and they've cited in their brief property
21 taxes and income taxes.

22 But a franchise tax, based upon prior holdings
23 of this court, is a peculiar tax. And this Court has
24 ruled time and time again that the states have a wide
25 discretion in assessing a franchise tax. They can

1 include some property, exclude other property. They can
2 set one basis for one property, or set a different basis
3 for another property.

4 Now, this same theme --

5 QUESTION: May I ask this question? Supposing
6 it were not a franchise tax, for a moment, but were an
7 income tax, at say a 10 percent rate. So it would be
8 another non-property tax. Would you agree it would be
9 discriminatory for that kind of tax?

10 MR. TAIT: I think if it's not a 742
11 non-discriminatory franchise tax, or it's not a 548 tax
12 under the national bank shares, then the state of
13 Tennessee could not tax federal obligations. And I
14 still --

15 QUESTION: But could they include it in the --
16 oh, all right. But you would agree that would be
17 discriminatory in that case.

18 MR. TAIT: Not -- well, it depends on what
19 you're saying --

20 QUESTION: Well, you're saying you really
21 don't reach the discriminatory issue in that situation.

22 MR. TAIT: There's a difference in taxing the
23 property itself, and there's a difference in using the
24 property as the measure of the tax. Now, if they're
25 only using the income as the measure of the tax, then I

1 see nothing wrong with that. But the cases make a
2 distinction in that regard.

3 QUESTION: But would you say they could even
4 go up -- increase the rate to 10 or 15 percent and base
5 it on income and say we'll call this thing a franchise
6 tax, and it would be all right?

7 MR. TAIT: I don't think that it's what they
8 called it. I think that the act speaks for itself. And
9 if you are taxing property as compared to the privilege
10 or the franchise to do business, then it's not a
11 franchise tax, it's a property tax. And I don't think
12 they can do that in the context of a property tax.

13 But where you are taxing the right of a
14 corporation to do business -- and that's all the bank
15 tax is. In Tennessee, banks enjoy special privileges
16 and rights and immunities. Now, as a consideration of
17 that right to do business, then they pay a franchise
18 tax. And that's all that Tennessee is doing in this
19 case.

20 If they didn't operate as a bank, then they
21 would not --

22 QUESTION: How many franchise taxes could you
23 put on a bank?

24 MR. TAIT: As I understand the --

25 QUESTION: It's unlimited, isn't it? In your

1 theory.

2 MR. TAIT: I don't think there's any limit to
3 the amount of franchise or privilege taxes the state can
4 assess as long as they're not arbitrary and unreasonable.

5 Now, I'd like to point out that the banks do
6 pay the same excise franchise tax as other
7 corporations. Now, they are excluded from a business
8 tax in Tennessee, which is another privilege tax that
9 banks do not pay. But this bank tax only applies to
10 banks, to no one else.

11 QUESTION: Mr. Tait, would you agree that the
12 Tennessee bonds and securities are in substantial
13 competition with the federal securities here?

14 MR. TAIT: Justice O'Connor, we raised that in
15 our brief, and that is a question of fact. And I want
16 to point out that the appellants have been taking that
17 position throughout this lengthy litigation.

18 They're saying that these Tennessee bonds are
19 in substantial competition. I'd like to point out --
20 you asked a question of Mr. Worthy a moment ago, if 548
21 had any application. If you will look at 548, one of
22 the definitions of Congress is that the money capital
23 has to be in substantial competition with the federal
24 obligation. And that is specifically set out in 548,
25 which shows to me that the intent of Congress is that

1 these other obligations have to be in substantial
2 competition. There's no proof in this record; it's just
3 silent as a tomb, as they say, about whether or not
4 there's any direct competition.

5 And I think that's a very important point and
6 we raised that in our brief, that that was incumbent
7 upon the appellants to prove that, if that is their
8 position. Now, if they cite out -- and they take great
9 joy in citing the amicus brief of the Attorney General
10 that some \$250 million in obligations are involved.
11 That's assuming that all of these banks would abandon
12 U.S. obligations and buy Tennessee obligations, of which
13 there's no proof at all in this record.

14 QUESTION: Can I ask you one question before
15 you sit down. Am I correct in assuming there really is
16 no difference in the legal position of your client and
17 of the state's position?

18 MR. TAIT: The positions are identical.

19 QUESTION: I wonder why you filed separate
20 briefs and had separate arguments?

21 MR. TAIT: Well, the money goes to the county
22 and city; it does not go to the state -- the state has
23 an interest in the constitutionality of the statute in
24 question, and I might point out that this is of utmost
25 concern to the state of Tennessee because the formula

1 that we use in the bank tax is the same formula that we
2 use in our excise tax.

3 QUESTION: I'm not questioning your right,
4 either of you. I'm just curious to know as a matter --
5 because it's sometimes a less effective method of
6 presentation to divide arguments.

7 MR. TAIT: Well, I was going to argue and the
8 state wanted to be heard because of the
9 constitutionality, and that's basically what happened.
10 I felt like that we should split it because there's more
11 involved than just the interest of Memphis and Shelby
12 County, Tennessee in this lawsuit; it has statewide
13 application, and I just felt like it should be split and
14 agreed to. I thank you.

15 CHIEF JUSTICE BURGER: Mr. Worthy?

16 ORAL ARGUMENT OF K. MARTIN WORTHY, ESQ.

17 ON BEHALF OF THE APPELLANT -- REBUTTAL

18 MR. WORTHY: Mr. Chief Justice, may it please
19 the Court:

20 Mr. Creecy cited a number of cases in which
21 this Court has held that a franchise tax may properly be
22 imposed on the interest on federal obligations or on
23 federal obligations themselves. He failed to note,
24 however, that several of those cases, the Educational
25 Foundation case, the Werner Machine case, the

1 Tradesman's Bank case and many others, all note that the
2 states can impose such a tax, provided it is not
3 discriminatory.

4 For example, in the Werner Machine Company
5 case, it validated the tax, held it was lawful, since
6 the tax measures -- since the tax is the same whatever
7 the character of the assets may be.

8 Now, interestingly enough, when Mr. Tait talks
9 about discrimination, he hasn't really told us what
10 discrimination is except to say that all of the theories
11 of discrimination which this Court has announced in
12 numerous cases, are inapplicable. All he says is that
13 there is no discrimination if federal obligations are
14 not singled out.

15 As I pointed out in my original argument, in
16 both the Phillips Chemical case and the Miller versus
17 Milwaukee case, there was no singling out of federal
18 obligations, yet the tax was found to be invalid.

19 And insofar as the intent of the legislature
20 in imposing the tax is concerned, I do call to your
21 attention that the Tennessee legislature was
22 specifically aware, when it adopted the formula for the
23 measurement of income, as shown by the report of the
24 legislative committee which is referred to on page 10 of
25 our Reply Brief, that it knew that it was taxing

1 interest on federal obligations, knew that it was not
2 taxing interest on obligations of the state of
3 Tennessee, knew that it was taxing interest on
4 obligations of other states.

5 So it deliberately chose the course which it
6 followed.

7 Thank you.

8 CHIEF JUSTICE BURGER: Thank you, the case is
9 submitted.

10 (Whereupon, at 11:45 a.m., the case was
11 submitted.)

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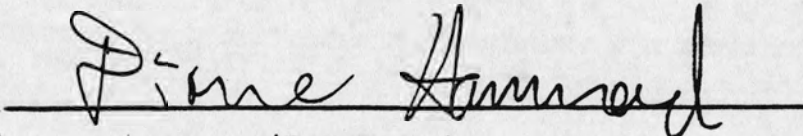
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MEMPHIS BANK & TRUST COMPANY, Appellant v. RILEY C. GARNER, SHELBY COUNTY TRUSTEE, ET AL. # 81-1613

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