ORIGINAL

OFFICIAL TRANSCRIPT PROCEEDINGS BEFORE

THE SUPREME COURT OF THE UNITED STATES

DKT/CASE NO. 83-1620

TITLE FIRST NATIONAL BANK OF ATLANTA, ETC., Appellant v. BARTOW COUNTY BOARD OF TAX ASSESSORS, ET AL.

PLACE Washington, D. C.

DATE October 30, 1984

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IN THE SUPREME COURT OF THE UNITED STATES

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FIRST NATIONAL BANK OF :

ATLANTA, ETC., :

Appellant :

v. : No. 83-1620

BARTOW COUNTY BOARD OF TAX :

ASSESSORS, ET AL. :

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Washington, D.C.

Tuesday, October 30, 1984

The above-entitled matter came on for oral argument before the Supreme Court of the United States at 12:58 o'clock p.m.

APPEARANCES:

CHARLES T. ZINK, ESQ., Atlanta, Georgia; on behalf of appellant.

ALAN I. HOROWITZ, ESQ., Asst. to the Sol. Gen., Dept. of Justice, Washington, D.C.; on behalf of U.S. as amicus curiae.

GRACE E. EVANS, ESQ., Asst. Atty. Gen. of Ga., Atlanta, Georgia; on behalf of Appellees.

C O N T E N T S

PROCEEDINGS

CHIEF JUSTICE BURGER: We will hear arguments next in First National Bank of Atlanta against Bartow County Board.

Mr. Zink, you may proceed whenever you're ready.

ORAL ARGUMENT OF CHARLES T. ZINK, ESQ.,

ON BEHALF OF APPELLANT

MR. ZINK: Mr. Chief Justice, and may it please the Court:

This case involves a conflict between the state taxing law and a federal statute limiting state taxation. Georgia had a bank share tax, which was measured by net worth. The federal law revised at statutes, Section 3701, limits the state taxation in federal obligations.

The question before the Court is whether the taxing formula adopted by the Georgia Supreme Court considers or takes into account federal obligations in violation of Section 3701.

This case is making its second appearance before the courts. In 1980, the bank deducted federal obligations from its net worth. The Georgia Supreme Court denied any deduction for the obligations. While that case was pending here, this Court decided the case of American Bank and Trust Company against Dallas County in 1983.

In American Bank, the Court decided that the amendment to Section 3701 that was enacted in 1959 required that there be a deduction of federal obligations. Consequently, the Court remanded this case to the Georgia Supreme Court for reconsideration in the light of American Bank.

On remand, the bank urged the Georgia Supreme Court that it be permitted to take a complete exclusion of the federal obligations. It urged that what the statute meant was that these be ignored and treated as nonexistent. Instead, the Georgia Supreme Court construed the Georgia bank share tax to require only a proportionate deduction.

It devised a formula, and that is set forth on page 5 of our brief, whereby the percentage of federal obligations to total assets was determined. And in the example given, that was 9.75 percent.

It then determined that only 9.75 percent of the bank's federal obligations were present in its net worth, and its formula would permit a deduction of only that amount, some $200,000. Thus, the formula adopted by the Georgia Supreme Court had the effect of reducing the deductions for federal obligations by a factor of almost 10 from approximately $2 million to $200,000.

Because the taxing formula did not exclude or ignore federal obligations, but instead considered them and took them into account in the computation of the tax, the bank appealed the decision to this Court. We feel the decision below should be reversed for at least three reasons.

The plain meaning of Section 3701 requires a complete and not a limited exclusion of federal obligations. It requires that they be treated as nonexistent. The legislative history of the statute shows that Congress intended for there to be a complete exclusion, and the rationale of the court below, if permitted to stand, would limit the protection for exempt obligations provided by the statute for all taxpayers and for all types of taxes in clear violation of the statute.

Now the language of Section 3701 reflects its purpose: to make federal obligations tax free as far as state taxes are concerned. The idea is that an individual, a corporation, or a bank can purchase federal obligations and know that the purchase will not be affected by state taxes in any way.

The Georgia formula, by contrast, if there's a contribution of federal obligations to capital, or if a bank purchases federal obligations from earnings, the tax increases. Now those consequences cannot be reconciled with the language of the statute.

In American Bank, the Court determined that the exemption contained in the statute as amended was sweeping. The Court went on in that case to hold that the statute did away with the inquiry to whether the tax was on an asset, and replaced it with the inquiry whether the obligations are considered in the computation of the tax.

The Court said in American Bank that "considered" for this purpose means "taken into account" or "included in the accounting."

Within that framework, I would like to examine what the majority of the Georgia Supreme Court did in its formula. It added in the value of the bank's federal obligations in computing total assets. It took them into account a second time as the numerator of the fraction used to determine the portion. And they were taken into account a third time as a component of net work to which the fraction was applied.

By the time the Georgia Supreme Court got to deducting the federal obligations from the tax base, 90 percent of the federal obligations had disappeared, and they permitted only a deduction for 10 percent.

We submit that the formula clearly takes into account, at least indirectly, the federal obligations that constitute a part of the bank's assets, a procedure which this court held in American Bank is impermissible. We respectfully submit that you avoid consideration of federal obligations only when you exclude them or threat them as nonexistent, and that the states must exclude them from total assets before determining net assets and taxing net worth.

Now the legislative history shows that this is exactly what Congress intended. The taxing authorities have suggested that our method of taking them off the top and ignoring the obligations is itself a consideration, but clearly that is not the case.

As shown in the Secretary of the Treasury's report in the House hearings and in the Senate Finance Committee's report, one impetus to the amendment to the statute in 1959 was the fact that Idaho had a tax, the 1933 Idaho Taxing Act, which included exempt income from federal obligations in gross income.

Now the secretary noted at page 70 of the hearings that Idaho did purport to take the exempt income out of the net income. Clearly there was no complete deduction, because if a full deduction were present from that formula, neither the secretary nor the

Congress would have been concerned.

QUESTION: Well there, Mr. Zink, there was an actual discrimination, wasn't there, in the Idaho situation against the federal obligations?

MR. ZINK: No, Your Honor, I do not believe so. It was a peculiar -- they included -- they defined gross income to include what is normally exempt income. They expressly included federal obligations, income from federal obligations in gross income.

Then there was another statute, or section in that taxing formula that said, well, to the extent that we can't include exempt income in your income, then you will lose a proportional part of your deductions against income based on the percentage of your exempt income to total income.

QUESTION: Well, now, do you think it was the secretary's feeling there that there was an element of unfair treatment, differential treatment between federal obligations and other obligations?

MR. ZINK: No, sir, I don't believe that was the problem, because I think they treated all exempt income the same way. The problem that the secretary had, as I read his report, is that here again we have got a statute, and the states are coming up with these arcane formulas that are indirect attempts to limit the effectiveness of the statute.

We have got to do something to beef up the statute to keep this from happening.

QUESTION: Do you think it is true about what the Supreme Court of Georgia has done here that the Georgia formula does not discrminate against federal obligations?

MR. ZINK: No, sir, I don't think it discriminates; I just think it violates the statute.

QUESTION: In your view, Mr. Zink, the state had to treat this as though the bank had no federal income producing assets at all? Is that right?

MR. ZINK: Yes, Your Honor, that's correct. In other words, you can come up with various formulas that indirectly tax federal obligations, and we feel that Congress in very plain language in 1959 said we're not going to let that happen any more. These -- neither the obligations nor the income will be considered in any form of tax that considers the obligations or the income in the computation of the tax.

It was to do away with these various formulas that were designed to try to limit the effectiveness of the --

QUESTION: Mr. Zink, does that mean that any time a bank had federal bonds of a value greater than the bank's net worth, there could be no net worth tax obligation?

MR. ZINK: That is correct, Your Honor.

We feel that when you look at the legislative history and what Idaho was trying to do to gross income, that it's clear that what the secretary and the Congress had in mind in the amendment of 1959 was to take the exempt income in that case off of gross, and that's what they wanted to do.

We think that they envisioned that the words of the amending statute would have that effect. Now if that same result followed here, the federal obligations would be excluded from gross assets before any computations of a net tax base.

Now this court has, on at least one occasion, determined that a proportionate deduction is insufficient to remove an asset from a tax base. In Schuylkill Trust Company against Pennsylvania, decided in 1935, the Court ruled without elaboration that a proportional deduction was insufficient to remove shares of a national bank from the net worth tax base.

QUESTION: Mr. Zink, if we follow your position here, do you think the states will be given the franchise taxes at greater cost to the banks?

MR. ZINK: They could, Your Honor. Of course franchise taxes are one of the exemptions provided in 3701 whereby the states can tax federal obligations. But of course if they don't tax federal obligations, as for example Georgia's is not in its new tax act, then they don't have to worry about franchise taxes. In other words, a regular income tax which, as you know now that the banking law was changed in 1969 to permit banks to be taxed in more typical ways, lots of states are going just to a typical corporate income tax and are not trying to tax federal obligations in that context.

Although the taxing authorities seek support for their position, in this Court's opinion in Atlas Life, United States against Atlas Life Insurance Company, the cases are wholly distinct. Atlas Life involved the destruction of the Life Insurance Company Tax Act of 1959.

In that Act, Congress imposed a tax on life insurance companies and allocated income from municipal securities on two accounts, the policyholder's account and the company's account. The Act stated that the policyholder's account was not taxed, and it permitted a deduction from the company's account.

The court held in Atlas Life that that allocation by Congress was not unconstitutional. Now the most obvious differences between Atlas Life and this case are, one, Atlas Life involved the validity of a congressional statute in light of the Constitution. And this case, by contrast, involves the validity of a state-adopted taxing formula in light of a very specific congressional statute.

The prohibition --

QUESTION: Well, at least proportionality was upheld in Atlas Life, wasn't it?

MR. ZINK: Yes, sir, but not in the net worth context. Of course Atlas was not a net worth case.

QUESTION: Well, the cases are different, but at least it indicates a proportionality approach.

MR. ZINK: I think that -- yes, sir, I think the -- yes, Your Honor. I think the Court said that this allocation does not violate the Constitution, and it was in a sense a proportionate allocation.

QUESTION: While I have you interrupted, do you think that the case that we had, American Bank and Trust Company against Dallas County, helps you or hurts you in your case?

MR. ZINK: It makes this case, Your Honor. I think the combination of Section 3701 as amended in 1959, and American Bank, I think I could have stood up and said those two things and sat down.

The prohibition in the statute, Section 3701, is very direct, explicit, and as this Court determined in American Bank, sweeping. The constitutional prohibition against the taxation is implied. Atlas Life involved the question of whether the tax was on the asset, and that's the very test which this Court held in Atlas Life -- I'm sorry, in American Bank, not to be appropriate in construing Section 3701.

Finally, the taxing scheme in Atlas Life was found by the Court not to wholly ignore federal exempt income. And that is what is required in connection with 3701.

Now the states cannot create formulas that limit the exemption. Section 3701 is not limited to banks, or to shares of banks; it protects federal obligations from taxation of any type and for all types of taxpayers. The consequences of the Georgia Supreme Court's error can go far beyond this bank and banks generally.

The rationale, for example, would permit a proportionate offset of expenses against exempt income. Now that would clearly violate the statute. The Court said in American Bank that Section 3701, as amended, is inconsistent with implied exceptions.

As shown in the examples in the bank's brief, some states have adopted formulas that provide less than the complete deduction of federal obligations from the tax base. We respectfully submit that this is simply a replay of the Idaho type problem which Congress faced in 1959 when it amended the statute.

We do not believe that Congress intended for this Court to have to evaluate each of these formulas on an individual basis. We feel that Congress intended in 1959 to stop the use of these formulas, and to deny the effectiveness of the exemption, and we feel that it did so in very plain and unmistakable words.

In short, we feel that any additional exceptions to Section 3701 should be adopted by Congress and not by the states, and that this case is controlled by the language of the statute.

I would like to reserve the remainder of my time for rebuttal. Thank you.

CHIEF JUSTICE BURGER: Mr. Horowitz.

ORAL ARGUMENT OF ALAN I. HOROWITZ, ESQ.,
ON BEHALF OF THE U.S. AS AMICUS CURIAE

MR. HOROWITZ: Thank you, Mr. Chief Justice, and may it please the Court:

This case involves the application of a federal statute, Revised Statute 3701 as amended in 1959, which exempts federal securities from state taxation. By its terms, it applies to every form of taxation that requires federal obligations to "be considered directly or indirectly in the computation of the tax." This Court, in American Bank, characterized the scope of that exemption as a sweeping one, and defined the words "considered" to mean included in the accounting.

It seems to me that there can be little doubt that the proportionate deduction method engrafted onto the Georgia bankshares tax by the State Supreme Court in this case violates the express terms of Revised Statute 3701. Indeed, I do not see where the state explains how the statute is to be interpreted in a way that makes their tax computation lawful.

Their argument seems to be that the word "considered" cannot mean what it seems to mean because federal obligations would be considered in any tax system. But that's really not true. The proposal of the government, which is the hand of the appellants here, that the amount of federal obligations be excluded at the outset of the tax computation, does not require any consideration of federal obligations at all. If given a list of assets and liabilities of the bank, the accountant can simply add up all the taxable assets of the bank, subtract the liabilities, and is then left with the net worth figure that serves as the tax base for the bankshares tax.

Now the consideration of the federal obligations that the state uses in this case is not a kind of technicality that brings it under the statute. It goes to the very heart of the purpose of the statute. Under the system of proof below, the amount of the tax increases as the level of federal obligations increases. And to some extent, this method undermines the tax exempt status of the securities, and therefore their marketability.

In fact, it seems fairly apparent that the Georgia legislature itself recognized that a full exclusion from that net worth is the appropriate way to preserve a tax exemption. And therefore, conversely, that the proportionate deduction method used by the court here in fact does tax the item in question to some degree. By that, I am referring to --

QUESTION: May I interrupt? I'm just trying to think. You say the tax goes up as the amount of federal obligations goes up?

MR. HOROWITZ: In some cases, if --

QUESTION: It wouldn't if they sold off non-federal and exchanged it for federal; then it would go down, wouldn't it?

MR. HOROWITZ: That's true.

QUESTION: I mean, they don't just get assets out of thin air. They've got to sell what they have in order to buy federal obligations.

MR. HOROWITZ: Well, they can get assets out of thin air. There can be a donation to capital, for example, of federal obligations.

QUESTION: Yes, but if you just started with a given balance sheet, and then buy or sell what you have got, the more federal obligations you buy, the lower your taxes. Isn't that right?

MR. HOROWITZ: That's true. If the converse were true, if exchanging non-federal obligations for federal obligations would increase the tax, that would really be discriminatory. That would be putting a higher tax on federal obligations than what is on other obligations. But the statute does not require that federal obligations be treated the same. It requires that they be tax exempt and that they not be considered at all in computing the tax.

What the state is really complaining about is this tax exemption. They don't like the idea that by buying federal obligations you're able to avoid the tax, but that's what a tax exemption is.

QUESTION: Mr. Horowitz, I'll ask you the same question I asked Mr. Zink. If your view prevails, aren't you driving the states into franchise taxation at greater cost, really, to the government?

MR. HOROWITZ: Oh, I don't know whether it would be a greater cost to the government or not. The states have a lot of other ways than possibly raising taxes, and Georgia, the statute that's involved here has already been repealed. I think they enacted a kind of an income tax. And whether or not that in fact results in a higher impact on federal obligations is not really the issue.

The statute has prohibited certain kinds of taxes and allowed certain kinds of taxes. I suppose that if Congress felt that a change in the franchise taxation was really having a substantial effect, they could amend 3701 to take out the exclusion from franchise taxation. But it seems to me that is not really the issue here.

The Georgia statute has a special --

QUESTION: Well, it may not be the issue, but I think it is a practical effect. Maybe you will be in here fighting franchise taxes.

MR. HOROWITZ: Well, we won't be in here fighting franchise taxes if the statute isn't amended. The statute has an exclusion for franchise taxes. If it's taken away, I don't know that we'll have to be here because I think it will be pretty clear.

QUESTION: You will cheerfully acquiesce?

MR. HOROWITZ: I don't know about that.

The Georgia statute has an exemption for real estate. The reason for that -- and real estate is entitled to a full exclusion, the same exclusion we argue as required here for federal taxes. Now the reason for that exclusion of course is that real estate is taxed separately under other provisions of Georgia law. But it seems to me that if Georgia really believed, the Georgia legislature really believed that their proportionate deduction method that they have here does not impose any tax on the federal obligations, then they ought to have the same proportionate deduction method for real estate.

In fact, they don't. They allow full exclusion for real estate. If their position in this case were correct, they're really giving a kind of an extra windfall to banks that hold real estate. They're allowing them to shelter other income with the real estate. That's what they argue is true with federal obligations, but it seems like they don't really believe that, because in fact there is this full exclusion for real estate.

I just point out that the state hasn't said anything about this in their brief. I'm not sure what their answer to that is.

I would also like to emphasize that this case is not really restricted to the bankshare context. The state has made several arguments about, because of the nature of the banking business, they're going to buy federal obligations anyway, and this case doesn't really amount to very much.

I mean, there is a broad principle that's involved here, which is whether this proportionate deduction method in fact complies with the statute or not. And if the state prevails in this case, there is a lot of opportunity for many other kinds of taxes, the treatment of those taxes to be changed by states which could, first of all, create a whole new host of problems in interpreting 3701 as to whether various kinds of proportionate deductions are in fact valid or not and would have a very substantial effect on the marketability of the United States securities.

Probably the most familiar example is to look at income taxes, either corporate income taxes or personal income taxes. Many states have personal income taxes that are similar to the federal system, where there is a computation made of total income, and then deductions are allowed for certain expenses -- mortgage interest expenses, charitable contributions, child care expenses, things like that.

Now it has always been understood that the interest income on United States savings bonds or other federal securities are totally excluded from the computation of those state income taxes. But in fact, under the position taken by the state below, if that's correct, there seems to be no reason why the state could not enact the same sort of proportionate deduction treatment of interest on federal bonds for income taxes. The argument would go just as it does here that some portion of the interest that is received by the taxpayer from the federal bonds is really allocable to these other deductions -- interest deductions, child care deductions, et cetera.

So some of that has already been taken into account, and therefore they are only going to subtract a portion of the interest from federal bonds from the final taxable income figure. That is a principle, a very broad application and that would have a substantial impact on the marketability of the United States securities.

I would also like just briefly to touch on this question of Atlas Life. We think the very simple answer to that is that that case only involves an interpretation of the Constitution. This case involves an interpretation of the statute that concededly must go beyond the Constitution.

Now the state has tried to suggest, to quote one sentence from this Court that the statute is co-extensive with the Constitution, but that obviously can't be the case because, if that were so, Congress wasn't really doing anything when it amended the statute in 1959, and everyone agrees that in fact they substantially expanded the scope of the statute in 1959.

Finally, I would also like to echo something Mr. Zink said. Which is, that part of the purpose of Congress in amending the statute in '59 was to eliminate this kind of semantical argument about whether the tax is on federal obligations or whether it isn't. It leads to a lot of litigation. It leads to a lot of difficulty. They set down a very bright rule that is easily applied.

If consideration of federal obligations is essential to the computation of the tax, then the tax is invalid. Now it may be that in some cases that tends to invalidate taxes that do not seem necessarily unfair on their face, but that is a consequence of the tax exemption. That is something that is within the power of Congress to enact, and that is what they have done here.

CHIEF JUSTICE BURGER: Ms. Evans.

ORAL ARGUMENT OF GRACE E. EVANS, ESQ.,

ON BEHALF OF APPELLEES

MS. EVANS: Mr. Chief Justice Burger, and may it please the Court:

While we basically agree with the facts as presented, we would like to emphasize certain additional facts in this case.

The Georgia bank share tax is not measured by gross assets. Instead, those assets which were purchased with liability funds are completely removed from the measure of the tax. The tax is only measured by those assets which were purchased by net worth funds. It is simply incorrect to say that Georgia's method only removes a portion of federal obligations from the tax. Instead, Georgia's method fully removes all federal obligation values from the computation of the tax, and it does so in this manner:

Georgia's method reasonably attributes a portion of federal obligation values to liabilities, and it reasonably attributes a portion of federal obligation values to net worth. And then it removes from both accounts federal obligation values. For example --

QUESTION: It doesn't produce the same result, does it?

MS. EVANS: Yes, Your Honor, it does.

QUESTION: That would happen if you treated the bank as owning no federal obligations at all?

MS. EVANS: If the bank owned no federal obligations at all, they would be entitled to no deduction. But in this case, for example in the case of C&S Bank that was used in the Georgia Supreme Court's example, there was a deduction of $200,000 of federal obligations that were attributed to the net worth account, but there was also attributed to the liability account approximately $1,700,000 of federal obligation value. And the total of the federal obligation values that were attributed to the liability account, and the total that were attributed to the net worth account, equal all federal obligation values. And as a result, all federal obligation values were removed from the measure of the tax.

First Atlanta's method, on the other hand, would create a double deduction. What First Atlanta is asking this Court to do is to deduct all federal obligation values one time from gross assets, and then to deduct those federal obligation values which were purchased with funds from liabilities a second time. And in doing so, it creates a deduction which is greatly in excess of federal obligation values that are actually represented in the adjusted tax base.

We submit that the judgment of the court below should be affirmed for three reasons. It should be affirmed because Georgia's method fully complies with Section 3701 by removing federal obligation values in full from the computation of the tax, and it does so without sheltering otherwise taxable assets.

Georgia's method is in accordance with the decisions of this Court, and Georgia's method effectuates the intent of Congress. Georgia's method fully complies with Section 3701. Section 3701 requires that federal obligation values be excluded from the computation of the tax. As I previously pointed out, Georgia's method presumes that a portion of federal obligation values are represented in net worth, and a portion are represented in liabilities. I remind the Court that before reaching the measure -- before reaching the tax base, that already 90 percent of assets have been removed, and Georgia is attributing a portion of those federal obligation values to those assets.

So, for example, Georgia says that if 9.75 percent of federal obligations are represented in total assets, then 9.75 are represented in net worth and in the liability account. And Georgia's method is one which is reasonable, and it's legitimate.

It is one that is recognized by both bankers and bank regulators. For example, the Bank Administration Institute recognizes that banks have on this side of the balance sheet liabilities and net worth, and they have a pool of funds which they can use to invest in assets. And these pool of funds are co-mingled.

What they do is, since they don't know which fund was used to purchase which asset, they presume that a portion of each and every fund is invested in each and every asset. This is the formula that they use in their cost analysis. The Federal Reserve Board does the same thing in their cost analysis.

Georgia has simply adopted that concept, and has attempted to accord federal obligations full tax-exempt status in a reasonable manner. They do so, and the formula is not inflexible. This formula is to be used only when a bank cannot demonstrate where their federal obligation values were purchased from.

If appellant, or any bank, can come in and demonstrate that greater federal obligation values are present in net worth, the Georgia court has said, we will make an appropriate adjustment. It is the intent of Georgia to fully accord tax-exempt status to these federal obligations.

And we would submit that the pro-rata method is equitable to a fault; that it really allocates to net worth a greater portion of federal obligation values than area actually present in net worth.

Prudent banking practices would dictate that liability funds, those funds which include deposits, would be used -- and these are very volatile sources, and have to be available for potential withdrawal demand -- that those funds would more than likely be used to invest in federal obligations, because they can be quickly sold and turned over.

On the other hand, net worth is not volatile. It's the most stable of all the bank's assets. And as a result, those funds can be invested in longer yielding assets which don't require a quick turnaround for withdrawal demands, because there are none, and are generally invested in bank premises in higher yielding assets.

First Atlanta's method, on the other hand, is irrational, yet is not required by Section 3701, and it distorts the intent of the Congress. It is irrational because what First Atlanta is saying to this Court and asking this Court to accept is this:

It is asking the Court to create an

irrebuttable presumption that all federal obligation values are present in net worth, a presumption which simply has no basis in reality. First Atlanta doesn't attempt to show that it has a basis in reality. They just say, if we're going to remove federal obligations from the tax base and we don't know if they were purchased from liabilities and we don't know if they were purchased from net worth, in effect they're saying let's just pretend that they are present in net worth because we know if we remove it there that they'll be completely gone.

Well, we could as easily pretend that they were all present in liabilities; because we recognize that those federal obligations which were purchased with liabilities are already excluded, and are never excluded in Georgia's tax base. So it could be accomplished in that way. But instead, Georgia has tried to fairly allocate that portion of federal obligations which would be represented in the liability account, and that portion which would be represented in the net worth account.

In effect, what First Atlanta is saying is that, as Justice Stone noted in Missouri v. Gehner, that tax exempt also means debt exempt. First Atlanta is saying that federal obligations would not be subject to any liabilities, and that simply is not the case in banking practices.

First Atlanta's method is not required by Section 3701. It creates a double deduction, and it affords a tax shelter. It creates a double deduction because it removes from total assets all federal obligation values. And then when those liability funds which were used to purchase those federal obligation values are removed, then those federal obligation values are removed a second time. And as a result, First Atlanta's method deducts federal obligation values which far exceed the amount of federal obligation values which are present in net worth, and it does so at the expense of the taxing power of the state to tax those assets which are proper subjects of state and local taxation.

First Atlanta's method also distorts the intent of Congress. As this Court pointed out in American Bank and Trust Company, the purpose of the amendment in 1959 to Section 3701 was to extend the reach of the immunity to taxes which previously had not been included. That is, indirect taxes such as bankshare taxes.

It is not correct, as appellant argues, that Iowa -- that the legislative history would indicate that federal obligations must be removed from gross assets.

Instead, the problem in Idaho -- I believe it was Idaho, was that they were attempting to tax federal obligation values indirectly by saying, we are not really imposing a tax on the federal obligation values; instead, we are imposing it on income. And they made no attempt whatsoever to remove federal obligation values from the computation of the tax.

First Atlanta's method distorts the intent of Congress because this double deduction has the effect of exaggerating the immunity from taxation into a total exemption from taxation. It would have the effect of wiping out bankshare taxes as a feasible revenue measure for the states. This is so because virtually all banks in the United States possess sufficient federal obligations to wipe out their bankshare tax liability.

We submit that such a radical change cannot be attributed to Congress to eliminate a revenue measure which at that time was being used by a majority of the states and, at that time, banks in those states owned enough federal obligations to wipe out their bankshare tax liability. That such a sharp change in existing state law cannot be attributed to Congress absent the clearest indication in the legislative history of that purpose, and there is no such indication in the legislative history.

Georgia's method is also in accordance with the decisions of this Court. In United States v. Atlas Life Insurance Company, this Court in 1965 recognized that a pro rata deduction similar to one that is being used by the Georgia court did not violate the constitutional prohibition against taxation of state and municipal bonds.

In Atlas Life, the Court was confronted with a similar problem that the Court is confronted with today. That is, how to remove tax exempt interest without, at the same time, sheltering taxable assets. They had, like Georgia has, a tax -- in that case there was a tax on investment income, but a portion of that investment income was excluded. And that portion that was attributed to the policyholder's share was excluded.

Well, in the same case, Georgia excludes that portion of assets that are attributed to liabilities. In Atlas Life, the portion that was attributed to the company was included in -- was taxed. In that case, the insurance company argued, the only way that we're going to be able to remove tax-exempt interest is to take it all from the company share, just like First Atlanta saying to the Court today that the only way to remove tax-exempt interest is to remove it from the net worth portion of those assets attributed to net worth.

But the Court rejected that. They said, there is no sound reason to believe that all tax exempt interest is attributed to the company's share. Instead, a portion of that tax exempt interest is also attributed to the policyholder's share. And they said that a pro rata method reasonably and fairly removed tax exempt interest without sheltering assets which were proper subjects of taxation.

And in reaching that conclusion, the Court looked at the extensive legislative history, and they noted that it was the conclusion of Congress that a pro rata method did not impose any tax at all on exempt values. The Department of the Treasury came and testified before Senate committee hearings and stated that the formula provided by the Senate bill did not place a tax on tax exempt interest.

Senator Byrd stated to the Senate committee: In providing the formula I have described to the Senate, it was the intention of the committee not to impose any tax on tax exempt interest.

Therefore, the Court concluded that a pro rata method which was similar to the method used by Georgia fully complied with the requirement that the tax exempt interest be removed.

In addition, Georgia's method effectuates the intent of Congress. As I previously indicated, in 1959 when Congress amended the statute, the purpose of that amendment was to extend the immunity to forms of taxation which had not previously been included. It is more reasonable to assume that Congress was familiar with and approved the pro rata method of recognizing exemptions upheld in Atlas Life.

This is because, at the time the income tax act was being considered in 1959, the amendment to Section 3701 was also being considered. There was a three month difference in their enactment. And as a result, Congress' findings and intent respecting pro rata allocation methods are particularly appropriate to understanding what Congress expected Section 3701 to accomplish.

First Atlanta would attribute to these same legislators a conclusion that states must be barred from employing pro rata methods, and we submit that such a stunning change in position cannot be attributed to Congress absent the clearest indication in the legislative history.

The Solicitor General has stated that Georgia's method would increase the cost of federal borrowing. We submit, as opposed to First Atlanta's method, that Georgia's method would have the opposite result. That, if anything, that it would tend to decrease the cost of federal borrowing.

The Solicitor General's prediction is unsupported in the record, and it is based on a false premise. The Solicitor General misunderstood and thought that Georgia was only excluding a portion of tax exempt values, and states that 90 percent, for example in the C&S example, that 90 percent of those federal obligations remained subject to the tax. That simply is not correct.

Under First Atlanta's method, the --

QUESTION: Well, what percent would you say remains subject under C&S's example?

MS. EVANS: Under C&S's example, all federal obligation values are removed from the tax. This is because $200,000 is removed from the net worth portion, and approximately $1,700,000 is removed when liabilities are deducted from total assets.

There are two deductions that go on here. One is when liabilities are removed from total assets. And then once you do that, you have net worth. Then Georgia removes from net worth an additional portion. But it removes that portion which can be reasonably attributed to net worth. And it also attributes the same portion to liabilities.

QUESTION: Ms. Evans, which is the larger of the two banks, C&S, or First Atlanta?

MS. EVANS: C&S in its brief stated that it was the largest bank in Georgia.

QUESTION: Can you spell out for me -- maybe you already have, but would you do it again if you have -- why C&S is on one side of this case as an amicus on the other side of this of this case from First Atlanta?

MS. EVANS: Your Honor, I hesitate to speak for C&S, but I would imagine -- and as they pointed out in their brief -- that C&S views the pro rata method as a fair method of fully excluding tax exempt values from the tax base.

QUESTION: Well, it is rather unusual, isn't it, where perhaps the two largest banks in Georgia, I don't know whether that is so, but anyway, two substantial banks are taking opposite positions on this rather vital banking case?

MS. EVANS: Well, we would also point out, Your Honor, that the Pennsylvania Bankers Association also endorses Georgia's method and recognizes that this method is a fair method of removing in full federal obligation values without sheltering taxable assets.

The real problem with First Atlanta's position is that it does accord a double deduction, and it has the effect of reducing, or deducting federal obligations far in excess of those values that are present in net worth.

QUESTION: May I ask a question about your computations?

MS. EVANS: Yes.

QUESTION: As I understand it, what you do is you figure out this ratio and take the percentage out of net worth. Then you say you are really taking all the federal obligations off the assets side of the balance sheet, because you subtract the net worth figure from the value of the federal obligations, and you get $1.7 million, or whatever it is, which is your liability portion, and you take that off. Am I describing it right? In other words, you take that sum off of both sides of the balance sheet?

MS. EVANS: Well --

QUESTION: But if I am right on what you said, I don't know how that squares with the language of the statute that says you don't consider the amount of federal obligations. It seems to me you've got to use them in order to get the liability figure you take out.

MS. EVANS: Well, now, the statute says that federal obligations cannot be considered in the computation of the tax.

QUESTION: Right.

MS. EVANS: And this Court defined "considered" to mean "included in the accounting." Georgia's method excludes --

QUESTION: I see.

MS. EVANS: -- from the computation of the tax--

QUESTION: So you're saying that's not considering it within the meaning of the statute?

MS. EVANS: That's correct, because they are not included in the accounting, in the computation of the tax. They are excluded from the computation of the tax.

QUESTION: Thank you.

MS. EVANS: We submit that Georgia's method would, if anything, decrease the cost of federal borrowing. That is because of this reason. As I indicated, virtually all banks in the United States possess sufficient amounts of federal obligations to wipe out their bankshare tax liability. As a result, there's no incentive for them to purchase more federal obligation values.

To the extent that their decision to buy federal obligations is influenced by a bank tax deduction, that incentive is removed. It is no longer there any more.

However, Georgia's method continues to have incentive, because for every marginal -- for every additional purchase of federal obligation values, there's also a marginal tax benefit as well.

To summarize, we submit that the principle governing this case was understood by Justices Stone, Brandeis, and Holmes in 1939 in their dissent in Missouri v. Gehner. It was understood by the entire Court in 1965 in United States v. Atlas Life Insurance Company.

First Atlanta today is asking this Court to unlearn the proper analysis, or to fail to apply the proper analysis. We submit that because Georgia's method fully complies with Section 3701 by removing in full federal obligation values from the computation of the tax without sheltering taxable assets, and that because Georgia's method is in accordance with the decisions of this Court and with the intent of Congress, we respectfully request that this Court affirm the judgment of the court below.

Thank you.

CHIEF JUSTICE BURGER: You're very welcome.

Did you have anything further?

ORAL ARGUMENT OF CHARLES T. ZINK, ESQ.

ON BEHALF OF APPELLANT -- REBUTTAL

MR. ZINK: If it please the Court, briefly:

The first point, the state taxing authorites have said that a partial -- and they've said this in the context of the attractiveness of purchasing federal obligations -- but they've said that a partial deduction of federal obligations on infinte purchases is a better deal than a flat deduction on the front.

Now while they make that argument for the attractiveness purpose, they have effectively conceded that the Georgia formula is not only on the obligation, but considers it. Because if it didn't, it would not be any different in economic impact. In short, I think if you example that argument they've made, you'll see that Georgia's formula is not tax neutral, and it is supposed to be.

Separately, the state taxing authorities have said that federal obligations are allocated to a nontaxable liability account. That's an attempt -- and I don't blame them -- to wrap their case in Atlas Life, Congress and Atlas Life said this account is nontaxable, and that one is not. Liabilities are not -- there's no allocation to a liability account.

What they're doing is using liabilities to offset and reduce the amount of federal obligations by liabilities that, in some cases, have absolutely nothing to do with the obligation. For example, one of the liabilities is an obligation in accrual for state tax liability. Now I ask you, how can that be a proper offset to federal obligations?

The state taxing authorities have said, and been concerned about a double deduction. This is not a double deduction case. We don't care about a double deduction. We just don't want to be taxed in contravention of the congressional statute. In my example that I gave of a contribution of federal obligations to capital, there is no sheltering effect at all.

Justice Stevens talked about the conversion of a taxable asset to a nontaxable asset, and that would be true if you've already had the asset on tax day. But if you earned a dollar during the year and before tax day used that dollar to buy a federal obligation under the Georgia formula, your tax goes up. We don't think that can be read to reconcile with the statute.

Finally, the taxing authorities have said that if we can trace the source of funds by which we purchase federal obligations, that they might give us a deduction. First, in the operations of a bank there is money coming in and out every day. It's a physical impossibility.

Second, there is nothing in the statute that conditions the exemption given by Congress on that type of burden, where you would actually have to say, yes, if you use that dollar to purchase a federal obligation, we will give you the exemption.

Thank you.

CHIEF JUSTICE BURGER: Thank you, counsel, the case is submitted. We will hear arguments next in Lawrence County against Lead-Deadwood School District.

(Whereupon, at 1:50 o'clock p.m., the case in the above-entitled matter was submitted.)

* * *

CERTIFICATION

Alderson Reporting Company, Inc., hereby certifies that the attached pages represents an accurate transcription of electronic sound recording of the oral argument before the Supreme Court of The United States in the Matter of:

#83-1620 - FIRST NATIONAL BANK OF ATLANTA, ETC., Appellant v.

BARTOW COUNTY BOARD OF TAX ACCESSORS, ET AL.

and that these attached pages constitutes the original transcript of the proceedings for the records of the court.

BY Paul A. Richardson

(REPORTER)

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