Presentation Outline

Bond Financing

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Real Estate Finance Class Guest Lecture

Introduction of Topic

Use of tax law to encourage behavior

Encouraged behavior a reflection of political determination of what the country needs

Statutory/Case Law Basis

Federal Internal Revenue Code (handout): 26 USC Section 103 etc.
Set forth specific types of projects permitted to be constructed with tax-exempt bonds that reflect Federal policy and behavior/projects the Federal Government wants to encourage:

1. General Obligation Bonds (State, School Districts, et al);
2. Revenue Bonds (New York State Thruway Authority, et al.);
3. Section 501c3 Bonds;
4. Industrial revenue/Private Activity Bonds
    - Manufacturing
    - Water Facilities
    - Electric Utility
    - Hazardous Waste Projects

NYS General Municipal Law (handout): Article 18-A

Set forth specific types of projects permitted to be constructed with tax-exempt bonds that reflect NYS policy and behavior/projects the State wants to encourage:

- Manufacturing;
- Industrial;
- Recreational;
- Industrial Pollution Control

Pollack v. Farmers' Loan & Trust (handout):

Held that interest paid on bonds issued by States is exempt from taxation by the Federal government.

South Carolina v. Baker (handout):

Held that the Federal government may tax interest on State-issued bonds unless the bonds are registered so as to prevent avoidance of tax by holders of unregistered bearer bonds who are not known to taxing authorities, who can clip the coupons and present them for payment and avoid tax on the interest if not voluntarily reported.

Benefits to Borrower (PCIDA memo in handout)

1. Transfer Tax Exemption

$4 per $1000 of value of transferred real property

2. Mortgage Recording Tax Exemption

   1.30% in Westchester; 1.80% in Yonkers; 2.80% for commercial property in NYC. IDA can't exempt MTA portion (0.30%) after July 1, 2017.

3. Sales Tax Exemption

   8.375% in White Plains; generally applies to 40-60% of project costs so it is a significant benefit/incentive

4. Reduced Energy Costs

   Up to 17.5% reduction to peak demand use charge; Con Edison tariff

5. Reduced real property taxes through a PILOT Agreement

   Often one of the most important economic benefit/incentive to be realized because of the aggregate amount and the term over which the benefit/incentive will be realized (10-20 years)

6. Longer Term Financing

   Generally 20-40 years; most usual is 30 years; sometimes see 20 and 25 years; almost never see 40 years

7. Lower Interest Rate (all below assume credit enhancement)

   Tax-exempt variable rates are keyed off SIFMA (Securities Industry & Financial Markets Association) index (keyed to tax-exempt bonds) or 30 day LIBOR (often equal to or perhaps 10-15 bps over 30 day LIBOR); EXPLAIN LIBOR: rate banks charge each other for overnight funding

Tax-exempt fixed rates are often equal to MMD (Municipal Market Data) with pricing varying by maturity and credit rating (Longer = higher rate; lower credit quality = higher rate)

Taxable variable rates are keyed off 30 day LIBOR (often equal to or perhaps 20-30 bps over LIBOR)

Taxable fixed rates are priced off MMD information with pricing varying depending on maturity and credit rating.

The lower interest rate is THE most important benefit/incentive to be realized because of the aggregate amount of interest saved over the length of the term, usually 30 years. E.g.: a 2% interest rate savings on $10MM over 30 years amounts to $6,000,000 which falls right to the bottom line which means more profit for an operating company or more money to devote to programs for a not for profit entity.

Without credit enhancement, rates can climb to near conventional bank rates (6.5%-10% assuming you can get a bank to even quote for 20-30 year loans)

Straight-Lease Transaction (PCIDA memo in handout)

All of the same benefits may be realized except for no bond proceeds.

Often combined with conventional borrowing or use of equity

Costs (PCIDA memo in handout)

Generally 3-6% of the aggregate amount of the principal amount of the bonds; certain irreducible costs; some costs of issuance are based on a percentage of the bond issue (like Issuer and Bank fees), others are hourly fees for attorneys and accountants and others are set by

regulators such as title costs; same amount of time and effort go into a $3MM issue as a $30MM issue and sometimes more time and effort is required in the smaller issue because of the Borrower's professionals (attorneys and accountants) aren't as sophisticated and there is "work transfer" to other professionals

Participants and Roles (PCIDA memo in handout):

Issuer:

Created by State Legislature and thereby invested with the authority to issue tax-exempt and taxable bonds as can the State Legislature that created the Issuer. Issuers are created for specific municipal/governmental entities at all governmental levels (e.g.: Westchester County, City of Yonkers, Town of Mt. Pleasant, Village of Port Chester)

Almost all issuers in NYS have the power to condemn land. Very unusual and not used (to my knowledge) although proposed to be used by Yonkers for the Struever/ Fidelco/Cappelli baseball stadium project along with associated retail, commercial and housing.

All Issuers also have local policies to be followed. Such policies essentially represent social engineering or economic behavior goals the members of the Issuer board (or the elected official or body that appointed such persons) wish to encourage. Examples include requiring **"green"** elements in projects; "encouraging" **Project Labor Agreements**; encouraging use of **union labor** either for the initial construction or, in some cases, for the life of the project (that can have substantial impacts on operating costs and would thereby make uneconomic most NFP projects; provide example of **"prevailing wage"** cost differential; Ulster IDA required it and dropped it after a year or two because they saw projects from NFPs completely disappear); **non-discrimination** policies; **list job openings** with local county departments of social services and labor to help move unemployed and

welfare recipients to productive employment; encourage use of **local contractors and suppliers**, etc.

Because of legislative politics in Albany, IDA authority to benefit NFP borrowers was allowed to "sunset" February 1, 2008. As a result, IDAs could no longer provide benefits to NFPs. That led to governmental entities from Counties, Cities, Towns and Villages to create Local Development Corporations (like WCLDC, YLDC, Town of Hempstead LDC; Village of Dobbs Ferry LDC, Port Chester LDC, etc) solely to provide the same benefits to NFPs that IDA can provide to For Profit entities. These were created under the NYS Not for Profit Law.

Until the LDC workaround was devised and "tested", some NFPs used out of state Issuers that were called Multi-State Issuers because they were formed with the authority to close transactions and provide benefits in geographic jurisdictions that extended beyond the geographical borders of the entity provided there was sufficient "nexus". Examples are the Wisconsin Public Finance Authority and the Florida Capital Trust Agency.

Multi-state issuers are also being used by For Profit entities who want to finance projects in multiple state jurisdictions concurrently. Downside: multi-state issuers can't grant benefits local issuers can provide under state authority like Mortgage Recording Tax Exemption and Sales Tax Exemption. Use of a multi-state depends on the economic analysis.

Important Restrictions:
"Anti-raiding" provisions in State law prevent an IDA from involvement in a project if it would result in the removal of a facility to one part of the State to another unless the Borrower would leave the State or if to preserve the Borrower's competitive position in its industry.

Retail prohibition: Issuers prohibited from involvement in projects where more than 1/3 of the facility is devoted to retail use and used by customers who visit the facility (e.g.: shopping mall) to purchase goods

and services. Exceptions to the retail prohibition: if the goods and services are not readily available to residents in the general area OR the project is located in an economically highly distressed area (where unemployment exceeds the State average by 120% and is in a census tract where poverty rates are 20% or greater). Example: Fortunoff Retail Center.

1. **Borrower:**

   Privately owned or publicly owned operating companies (e.g.: IBM; Magnetic Analysis Corporation)

   Privately owned or publicly owned real estate developers (e.g.: Fortwest II LLC; SL Green REIT)

   Not For Profit organizations (e.g.: educational institutions like Pace University, Mercy College and Purchase College; cultural institutions like the Jacob Burns Film Center, the Music Conservatory of Westchester and the Council for the Arts in Westchester; social service organizations like the Westchester Jewish Community Services and New York Foundling Hospital; private schools like the Masters School, Rye Country Day School and the Tiger Woods Learning Center in Anaheim, CA; recreational and health/wellness organizations like the Boys & Girls Club of Northern Westchester and the Rye YMCA; hospitals like the House Ear Institute in LA

- **Users**

  Borrower and/or tenants and sub-tenants

- **Participating Lender**

  Bank or insurance company that provides credit enhancement for the bonds; substitutes its credit for that of the Borrower in the

marketplace or may purchase bonds directly, which is more common today because of Fed policy on "monetary easing".

Security required by Participating Lender:
-Mortgage on project real estate (or spread over multiple parcels owned)
-Pledge of all project revenues ("rents, issues and profits")
-Pledge of all or substantially all of Borrower's assets or maybe limited to project assets or other personal property
-Guarantee

Note that bonds of the type we are discussing do NOT have the backing of the governmental entity for whom the issuer was formed. E.g.: bonds issued by the WCIDA do not have the backing of the County of Westchester nor the pledge of the full faith and guarantee of the County nor its taxing power behind the issue.

Upon a default under the bond issue, the Bondholders look to the credit enhancer (bank) to pay them and make them whole, in which case the bank goes after the Borrower under the procedures provided for in the bond financing documents. If no credit enhancement, the Bondholders foreclose against the project assets (foreclose the mortgage; execute on the lien pledge; look to the Borrower guarantee; look to a third party Guarantor, if available).

- **Bond Trustee**

A commercial bank that specializes in providing such services. It acts as a conduit between the Borrower and Bondholders; collects the periodic interest or P&I payment from Borrower and then disburses those moneys to the Bondholders entitled to payment

- **Underwriter/Placement Agent**

  An investment banking firm

- **Bondholders**

  Financial institutions, funds, trusts, wealthy individuals (usually must be an "accredited investor" having required net worth and income levels and thus able to absorb the loss if the bonds are defaulted)

- **Bond Counsel**

  A law firm that is in the "Red Book" of nationally recognized bond counsels. Their opinion as to the taxability of the interest earned on the bonds is acceptable to Bondholders and others. Their tax analysis and experience is the basis for issuing an opinion that the interest on the bonds is tax exempt under Federal, State and other taxing jurisdictions' laws.

  Note: " tax exempt" means the interest is triple tax-free of income taxation by the Federal government, the State government and any lower taxing jurisdiction like NYC. "Taxable" still means double tax-exempt but the interest on the bonds does not enjoy income tax exemption from the Federal government.

- **Counsels for each principal participant**

  Various law firms experienced in bond financing matters. Problems arise when inexperienced lawyers and firms are hired to work on bond financing transactions. Example: Professional Children's School.

Process: (PCIDA memo in handout; WCIDA and WCLDC Applications in handout)

1. Sometimes informal discussion with Issuer staff pre-App filing;
2. filing Application; public meeting of Issuer (with participation of Borrower/Counsel) to induce the project;
3. Borrower assembles the financing team depending on structure of financing (Borrower, Underwriter, Trustee, Bank that may provide credit enhancement through LOC or may directly purchase bonds at a negotiated rate, counsels for each participant),
4. TEFRA (Tax Equity & Fiscal Responsibility Act) Hearing;
5. approval by highest elected official under TEFRA,
6. additional public meeting of Issuer to adopt SEQRA Determination and Final Bond Resolution;
7. pre-closing;
8. closing and funding

Timing (PCIDA memo in handout)

Generally 2-4 months. Personal record: 1 month. Some projects take several years; give reasons

Examples of Typical Projects

Tiger Woods Learning Center
Fortunoff
Rye Country Day School
Greenwich and Rye YMCAs
City Center Parking Garage
Yonkers South West Executive Park
Magnetic Analysis Corporation

Step through economic example in PCIDA memorandum to show how bond financing/straight lease transaction saves money

BOND FINANCING

INDEX

EXHIBIT 1

26 USC § 103 - Interest on State and local bonds

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Exclusion

Except as provided in subsection (b), gross income does not include interest on any State or local bond.

(b) Exceptions

Subsection (a) shall not apply to—

(1) Private activity bond which is not a qualified bond

Any private activity bond which is not a qualified bond (within the meaning of section 141).

(2) Arbitrage bond

Any arbitrage bond (within the meaning of section 148).

(3) Bond not in registered form, etc.

Any bond unless such bond meets the applicable requirements of section 149.

(c) Definitions

For purposes of this section and part IV—

(1) State or local bond

The term "State or local bond" means an obligation of a State or political subdivision thereof.

(2) State

The term "State" includes the District of Columbia and any possession of the United States.

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26 USC § 140 - Cross references to other Acts

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) For exemption of—

(1) Allowances and expenditures to meet losses sustained by persons serving the United States abroad, due to appreciation of foreign currencies, see section 5943 of title 5, United States Code.

(2) Amounts credited to the Maritime Administration under section 9(b)(6) of the Merchant Ship Sales Act of 1946, see section 9(c)(1) of that Act (50 App. U.S.C. 1742). [1]

(3) Benefits under laws administered by the Veterans' Administration, see section 5301 of title 38, United States Code.

(4) Earnings of ship contractors deposited in special reserve funds, see section 53507 of title 46, United States Code.

(5) Income derived from Federal Reserve banks, including capital stock and surplus, see section 7 of the Federal Reserve Act (12 U.S.C. 531).

(6) Special pensions of persons on Army and Navy medal of honor roll, see 38 U.S.C. 1562 (a)-(c).

(b) For extension of military income tax-exemption benefits to commissioned officers of Public Health Service in certain circumstances, see section 212 of the Public Health Service Act (42 U.S.C. 213).

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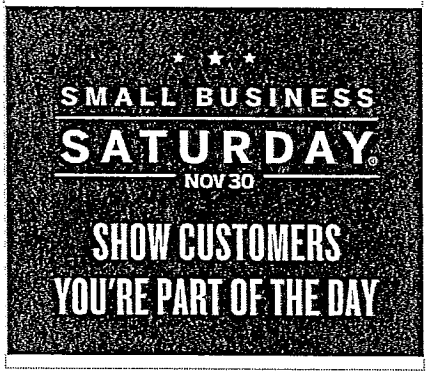
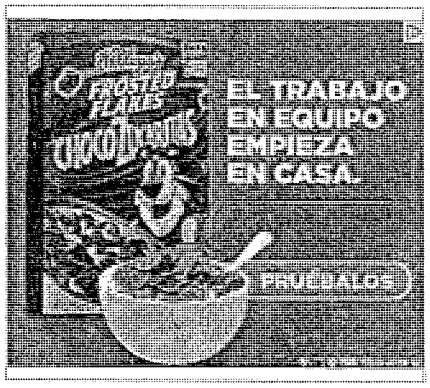
[1] See References in Text note below.





26 USC § 141 - Private activity bond; qualified bond

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Private activity bond

For purposes of this title, the term "private activity bond" means any bond issued as part of an issue—

(1) which meets—

(A) the private business use test of paragraph (1) of subsection (b), and

(B) the private security or payment test of paragraph (2) of subsection (b), or

(2) which meets the private loan financing test of subsection (c).

(b) Private business tests

(1) Private business use test

Except as otherwise provided in this subsection, an issue meets the test of this paragraph if more than 10 percent of the proceeds of the issue are to be used for any private business use.

(2) Private security or payment test

Except as otherwise provided in this subsection, an issue meets the test of this paragraph if the payment of the principal of, or the interest on, more than 10 percent of the proceeds of such issue is (under the terms of such issue or any underlying arrangement) directly or indirectly—

(A) secured by any interest in—

(i) property used or to be used for a private business use, or

(ii) payments in respect of such property, or

(B) to be derived from payments (whether or not to the issuer) in respect of property, or borrowed money, used or to be used for a private business use.

(3) 5 percent test for private business use not related or disproportionate to government use financed by the issue

(A) In general

An issue shall be treated as meeting the tests of paragraphs (1) and (2) if such tests would be met if such paragraphs were applied—

(i) by substituting "5 percent" for "10 percent" each place it appears, and

(ii) by taking into account only—

(I) the proceeds of the issue which are to be used for any private business use which is not related to any government use of such proceeds,

(II) the disproportionate related business use proceeds of the issue, and

(III) payments, property, and borrowed money with respect to any use of proceeds described in subclause (I) or (II).

(B) Disproportionate related business use proceeds

For purposes of subparagraph (A), the disproportionate related business use proceeds of an issue is an amount equal to the aggregate of the excesses (determined under the following sentence) for each private business use of the proceeds of an issue which is related to a government use of such proceeds. The excess determined under this sentence is the excess of—

(i) the proceeds of the issue which are to be used for the private business use, over

(ii) the proceeds of the issue which are to be used for the government use to which such private business use relates.

(4) Lower limitation for certain output facilities

An issue 5 percent or more of the proceeds of which are to be used with respect to any output facility (other than a facility for the furnishing of water) shall be treated as meeting the tests of paragraphs (1) and (2) if the nonqualified amount with respect to such issue exceeds the excess of—

(A) $15,000,000, over

(B) the aggregate nonqualified amounts with respect to all prior tax-exempt issues 5 percent or more of the proceeds of which are or will be used with respect to such facility (or any other facility which is part of the same project).

There shall not be taken into account under subparagraph (B) any bond which is not outstanding at the time of the later issue or which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue.

(5) Coordination with volume cap where nonqualified amount exceeds $15,000,000

If the nonqualified amount with respect to an issue—

(A) exceeds $15,000,000, but

(B) does not exceed the amount which would cause a bond which is part of such issue to be treated as a private activity bond without regard to this paragraph,

such bond shall nonetheless be treated as a private activity bond unless the issuer allocates a portion of its volume cap under section 146 to such issue in an amount equal to the excess of such nonqualified amount over $15,000,000.

(6) Private business use defined

(A) In general

For purposes of this subsection, the term "private business use" means use (directly or indirectly) in a trade or business carried on by any person other than a governmental unit. For purposes of the preceding sentence, use as a member of the general public shall not be taken into account.

(B) Clarification of trade or business

For purposes of the 1st sentence of subparagraph (A), any activity carried on by a person other than a natural person shall be treated as a trade or business.

(7) Government use

The term "government use" means any use other than a private business use.

(8) Nonqualified amount

For purposes of this subsection, the term "nonqualified amount" means, with respect to an issue, the lesser of—

(A) the proceeds of such issue which are to be used for any private business use, or

(B) the proceeds of such issue with respect to which there are payments (or property or borrowed money) described in paragraph (2).

(9) Exception for qualified 501(c)(3) bonds

There shall not be taken into account under this subsection or subsection (c) the portion of the proceeds of an issue which (if issued as a separate issue) would be

treated as a qualified 501(c)(3) bond if the issuer elects to treat such portion as a qualified 501(c)(3) bond.

(c) Private loan financing test

(1) In general

An issue meets the test of this subsection if the amount of the proceeds of the issue which are to be used (directly or indirectly) to make or finance loans (other than loans described in paragraph (2)) to persons other than governmental units exceeds the lesser of—

(A) 5 percent of such proceeds, or

(B) $5,000,000.

(2) Exception for tax assessment, etc., loans

For purposes of paragraph (1), a loan is described in this paragraph if such loan—

(A) enables the borrower to finance any governmental tax or assessment of general application for a specific essential governmental function,

(B) is a nonpurpose investment (within the meaning of section 148 (f)(6)(A)), or

(C) is a qualified natural gas supply contract (as defined in section 148 (b)(4)).

(d) Certain issues used to acquire nongovernmental output property treated as private activity bonds

(1) In general

For purposes of this title, the term "private activity bond" includes any bond issued as part of an issue if the amount of the proceeds of the issue which are to be used (directly or indirectly) for the acquisition by a governmental unit of nongovernmental output property exceeds the lesser of—

(A) 5 percent of such proceeds, or

(B) $5,000,000.

(2) Nongovernmental output property

Except as otherwise provided in this subsection, for purposes of paragraph (1), the term "nongovernmental output property" means any property (or interest therein) which before such acquisition was used (or held for use) by a person other than a governmental unit in connection with an output facility (within the meaning of subsection (b)(4)) (other than a facility for the furnishing of water). For purposes of the preceding sentence, use (or the holding for use) before October 14, 1987, shall not be taken into account.

(3) Exception for property acquired to provide output to certain areas

For purposes of paragraph (1)—

(A) In general

The term "nongovernmental output property" shall not include any property which is to be used in connection with an output facility 95 percent or more of the output of which will be consumed in—

(i) a qualified service area of the governmental unit acquiring the property, or

(ii) a qualified annexed area of such unit.

(B) Definitions

For purposes of subparagraph (A)—

(i) Qualified service area The term "qualified service area" means, with respect to the governmental unit acquiring the property, any area throughout which such unit provided (at all times during the 10-year period ending on the date such property is acquired by such unit) output of the same type as the output to be provided by such property. For purposes of the preceding sentence, the period before October 14, 1987, shall not be taken into account.

(ii) Qualified annexed area The term "qualified annexed area" means, with respect to the governmental unit acquiring the property, any area if—

(I) such area is contiguous to, and annexed for general governmental purposes into, a qualified service area of such unit,

(II) output from such property is made available to all members of the general public in the annexed area, and

(III) the annexed area is not greater than 10 percent of such qualified service area.

(C) Limitation on size of annexed area not to apply where output capacity does not increase by more than 10 percent

Subclause (III) of subparagraph (B)(ii) shall not apply to an annexation of an area by a governmental unit if the output capacity of the property acquired in connection with the annexation, when added to the output capacity of all other property which is not treated as nongovernmental output property by reason of subparagraph (A)(ii) with respect to such annexed area, does not exceed 10 percent of the output capacity of the property providing output of the same type to the qualified service area into which it is annexed.

(D) Rules for determining relative size, etc.

For purposes of subparagraphs (B)(ii) and (C)—

(i) The size of any qualified service area and the output capacity of property serving such area shall be determined as the close of the calendar year preceding the calendar year in which the acquisition of nongovernmental output property or the annexation occurs.

(ii) A qualified annexed area shall be treated as part of the qualified service area into which it is annexed for purposes of determining whether any other area annexed in a later year is a qualified annexed area.

(4) Exception for property converted to nonoutput use

For purposes of paragraph (1)—

(A) In general

The term "nongovernmental output property" shall not include any property which is to be converted to a use not in connection with an output facility.

(B) Exception

Subparagraph (A) shall not apply to any property which is part of the output function of a nuclear power facility.

(5) Special rules

In the case of a bond which is a private activity bond solely by reason of this subsection—

(A) subsections (c) and (d) ofsection 147 (relating to limitations on acquisition of land and existing property) shall not apply, and

(B) paragraph (8) of section 142 (a) shall be applied as if it did not contain "local".

(6) Treatment of joint action agencies

With respect to nongovernmental output property acquired by a joint action agency the members of which are governmental units, this subsection shall be applied at the member level by treating each member as acquiring its proportionate share of such property.

(7) Exception for qualified electric and natural gas supply contracts

The term "nongovernmental output property" shall not include any contract for the prepayment of electricity or natural gas which is not investment property under section 148 (b)(2).

(e) Qualified bond

For purposes of this part, the term "qualified bond" means any private activity bond if—

(1) In general

Such bond is—

(A) an exempt facility bond,

(B) a qualified mortgage bond,

(C) a qualified veterans' mortgage bond,

(D) a qualified small issue bond,

(E) a qualified student loan bond,

(F) a qualified redevelopment bond, or

(G) a qualified 501(c)(3) bond.

(2) Volume cap

Such bond is issued as part of an issue which meets the applicable requirements of section 146, and [1]

(3) Other requirements

Such bond meets the applicable requirements of each subsection of section 147.

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[1] So in original. Probably should end with a period after "146".

26 USC § 142 - Exempt facility bond

There are 2 Updates Pending. Select the tab below to view.

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) General rule

For purposes of this part, the term "exempt facility bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide—

(1) airports,

(2) docks and wharves,

(3) mass commuting facilities,

(4) facilities for the furnishing of water,

(5) sewage facilities,

(6) solid waste disposal facilities,

(7) qualified residential rental projects,

(8) facilities for the local furnishing of electric energy or gas,

(9) local district heating or cooling facilities,

(10) qualified hazardous waste facilities,

(11) high-speed intercity rail facilities,

(12) environmental enhancements of hydroelectric generating facilities,

(13) qualified public educational facilities,

(14) qualified green building and sustainable design projects, or

(15) qualified highway or surface freight transfer facilities.

(b) Special exempt facility bond rules

For purposes of subsection (a)—

(1) Certain facilities must be governmentally owned

(A) In general

A facility shall be treated as described in paragraph (1), (2), (3), or (12) of subsection (a) only if all of the property to be financed by the net proceeds of the issue is to be owned by a governmental unit.

(B) Safe harbor for leases and management contracts

For purposes of subparagraph (A), property leased by a governmental unit shall be treated as owned by such governmental unit if—

(i) the lessee makes an irrevocable election (binding on the lessee and all successors in interest under the lease) not to claim depreciation or an investment credit with respect to such property,

(ii) the lease term (as defined in section 168 (i)(3)) is not more than 80 percent of the reasonably expected economic life of the property (as determined under section 147 (b)), and

(iii) the lessee has no option to purchase the property other than at fair market value (as of the time such option is exercised).

Rules similar to the rules of the preceding sentence shall apply to management contracts and similar types of operating agreements.

(2) Limitation on office space

An office shall not be treated as described in a paragraph of subsection (a) unless—

(A) the office is located on the premises of a facility described in such a paragraph, and

(B) not more than a de minimis amount of the functions to be performed at such office is not directly related to the day-to-day operations at such facility.

(c) Airports, docks and wharves, mass commuting facilities and high-speed intercity rail facilities

For purposes of subsection (a)—

(1) Storage and training facilities

Storage or training facilities directly related to a facility described in paragraph (1), (2), (3) or (11) of subsection (a) shall be treated as described in the paragraph in which such facility is described.

(2) Exception for certain private facilities

Property shall not be treated as described in paragraph (1), (2), (3) or (11) of subsection (a) if such property is described in any of the following subparagraphs and is to be used for any private business use (as defined in section 141 (b)(6)).

(A) Any lodging facility.

(B) Any retail facility (including food and beverage facilities) in excess of a size necessary to serve passengers and employees at the exempt facility.

(C) Any retail facility (other than parking) for passengers or the general public located outside the exempt facility terminal.

(D) Any office building for individuals who are not employees of a governmental unit or of the operating authority for the exempt facility.

(E) Any industrial park or manufacturing facility.

(d) Qualified residential rental project

For purposes of this section—

(1) In general

The term "qualified residential rental project" means any project for residential rental property if, at all times during the qualified project period, such project meets the requirements of subparagraph (A) or (B), whichever is elected by the issuer at the time of the issuance of the issue with respect to such project:

(A) 20-50 test

The project meets the requirements of this subparagraph if 20 percent or more of the residential units in such project are occupied by individuals whose income is 50 percent or less of area median gross income.

(B) 40-60 test

The project meets the requirements of this subparagraph if 40 percent or more of the residential units in such project are occupied by individuals whose income is 60 percent or less of area median gross income.

For purposes of this paragraph, any property shall not be treated as failing to be residential rental property merely because part of the building in which such property is located is used for purposes other than residential rental purposes.

• Dodd-Frank: Title IX - Investor Protections and Improvements to the Regulation of Securities

(2) Definitions and special rules

For purposes of this subsection—

(A) Qualified project period

The term "qualified project period" means the period beginning on the 1st day on which 10 percent of the residential units in the project are occupied and ending on the latest of—

(i) the date which is 15 years after the date on which 50 percent of the residential units in the project are occupied,

(ii) the 1st day on which no tax-exempt private activity bond issued with respect to the project is outstanding, or

(iii) the date on which any assistance provided with respect to the project under section 8 of the United States Housing Act of 1937 terminates.

(B) Income of individuals; area median gross income

(i) In general The income of individuals and area median gross income shall be determined by the Secretary in a manner consistent with determinations of lower income families and area median gross income under section 8 of the United States Housing Act of 1937 (or, if such program is terminated, under such program as in effect immediately before such termination). Determinations under the preceding sentence shall include adjustments for family size. Subsections (g) and (h) ofsection 7872 shall not apply in determining the income of individuals under this subparagraph.

(ii) Special rule relating to basic housing allowances For purposes of determining income under this subparagraph, payments under section 403 of title 37, United States Code, as a basic pay allowance for housing shall be disregarded with respect to any qualified building.

(iii) Qualified building For purposes of clause (ii), the term "qualified building" means any building located—

(I) in any county in which is located a qualified military installation to which the number of members of the Armed Forces of the United States assigned to units based out of such qualified military installation, as of June 1, 2008, has increased by not less than 20 percent, as compared to such number on December 31, 2005, or

(II) in any county adjacent to a county described in subclause (I).

(iv) Qualified military installation For purposes of clause (iii), the term "qualified military installation" means any military installation or facility the number of members of the Armed Forces of the United States assigned to which, as of June 1, 2008, is not less than 1,000.

(C) Students

Rules similar to the rules of 42(i)(3)(D) [1] shall apply for purposes of this subsection.

(D) Single-room occupancy units

A unit shall not fail to be treated as a residential unit merely because such unit is a single-room occupancy unit (within the meaning of section 42).

(E) Hold harmless for reductions in area median gross income

(i) In general Any determination of area median gross income under subparagraph (B) with respect to any project for any calendar year after 2008 shall not be less than the area median gross income determined under such subparagraph with respect to such project for the calendar year preceding the calendar year for which such determination is made.

(ii) Special rule for certain census changes In the case of a HUD hold harmless impacted project, the area median gross income with respect to such project for any calendar year after 2008 (hereafter in this clause referred to as the current calendar year) shall be the greater of the amount determined without regard to this clause or the sum of—

(I) the area median gross income determined under the HUD hold harmless policy with respect to such project for calendar year 2008, plus

(II) any increase in the area median gross income determined under subparagraph (B) (determined without regard to the HUD hold harmless policy and this subparagraph) with respect to such project for the current calendar year over the area median gross income (as so determined) with respect to such project for calendar year 2008.

(iii) HUD hold harmless policy The term "HUD hold harmless policy" means the regulations under which a policy similar to the rules of clause (i) applied to prevent a change in the method of determining area median gross income from resulting in a reduction in the area median gross income determined with respect to certain projects in calendar years 2007 and 2008.

(iv) HUD hold harmless impacted project The term "HUD hold harmless impacted project" means any project with respect to which area median gross income was determined under subparagraph (B) for calendar year 2007 or 2008 if such determination would have been less but for the HUD hold harmless policy.

(3) Current income determinations

For purposes of this subsection—

(A) In general

The determination of whether the income of a resident of a unit in a project exceeds the applicable income limit shall be made at least annually on the basis of the current income of the resident. The preceding sentence shall not apply with respect to any project for any year if during such year no residential unit in the project is occupied by a new resident whose income exceeds the applicable income limit.

(B) Continuing resident's income may increase above the applicable limit

If the income of a resident of a unit in a project did not exceed the applicable income limit upon commencement of such resident's occupancy of such unit (or as of any prior determination under subparagraph (A)), the income of such resident shall be treated as continuing to not exceed the applicable income limit. The preceding sentence shall cease to apply to any resident whose income as of the most recent determination under subparagraph (A) exceeds 140 percent of the applicable income limit if after such determination, but before the next determination, any residential unit of comparable or smaller size in the same project is occupied by a new resident whose income exceeds the applicable income limit.

(C) Exception for projects with respect to which affordable housing credit is allowed

In the case of a project with respect to which credit is allowed under section 42, the second sentence of subparagraph (B) shall be applied by substituting "building (within the meaning of section 42)" for "project".

(4) Special rule in case of deep rent skewing

(A) In general

In the case of any project described in subparagraph (B), the 2d sentence of subparagraph (B) of paragraph (3) shall be applied by substituting—

(i) "170 percent" for "140 percent", and

(ii) "any low-income unit in the same project is occupied by a new resident whose income exceeds 40 percent of area median gross income" for "any residential unit of comparable or smaller size in the same project is occupied by a new resident whose income exceeds the applicable income limit".

(B) Deep rent skewed project

A project is described in this subparagraph if the owner of the project elects to have this paragraph apply and, at all times during the qualified project period, such project meets the requirements of clauses (i), (ii), and (iii):

(i) The project meets the requirements of this clause if 15 percent or more of the low-income units in the project are occupied by individuals whose income is 40 percent or less of area median gross income.

(ii) The project meets the requirements of this clause if the gross rent with respect to each low-income unit in the project does not exceed 30 percent of the applicable income limit which applies to individuals occupying the unit.

(iii) The project meets the requirements of this clause if the gross rent with respect to each low-income unit in the project does not exceed 1/2 of the average gross rent with respect to units of comparable size which are not occupied by individuals who meet the applicable income limit.

(C) Definitions applicable to subparagraph (B)

For purposes of subparagraph (B)—

(i) Low-income unit The term "low-income unit" means any unit which is required to be occupied by individuals who meet the applicable income limit.

(ii) Gross rent The term "gross rent" includes—

(I) any payment under section 8 of the United States Housing Act of 1937, and

(II) any utility allowance determined by the Secretary after taking into account such determinations under such section 8.

(5) Applicable income limit

For purposes of paragraphs (3) and (4), the term "applicable income limit" means—

(A) the limitation under subparagraph (A) or (B) of paragraph (1) which applies to the project, or

(B) in the case of a unit to which paragraph (4)(B)(i) applies, the limitation which applies to such unit.

(6) Special rule for certain high cost housing area

In the case of a project located in a city having 5 boroughs and a population in excess of 5,000,000, subparagraph (B) of paragraph (1) shall be applied by substituting "25 percent" for "40 percent".

(7) Certification to Secretary

The operator of any project with respect to which an election was made under this subsection shall submit to the Secretary (at such time and in such manner as the Secretary shall prescribe) an annual certification as to whether such project continues to meet the requirements of this subsection. Any failure to comply with the provisions of the preceding sentence shall not affect the tax-exempt status of any bond but shall subject the operator to penalty, as provided in section 6652 (j).

(e) Facilities for the furnishing of water

For purposes of subsection (a)(4), the term "facilities for the furnishing of water" means any facility for the furnishing of water if—

(1) the water is or will be made available to members of the general public (including electric utility, industrial, agricultural, or commercial users), and

(2) either the facility is operated by a governmental unit or the rates for the furnishing or sale of the water have been established or approved by a State or political subdivision thereof, by an agency or instrumentality of the United States, or by a public service or public utility commission or other similar body of any State or political subdivision thereof.

(f) Local furnishing of electric energy or gas

For purposes of subsection (a)(8)—

(1) In general

The local furnishing of electric energy or gas from a facility shall only include furnishing solely within the area consisting of—

(A) a city and 1 contiguous county, or

(B) 2 contiguous counties.

(2) Treatment of certain electric energy transmitted outside local area

(A) In general

A facility shall not be treated as failing to meet the local furnishing requirement of subsection (a)(8) by reason of electricity transmitted pursuant to an order of the Federal Energy Regulatory Commission under section 211 or 213 of the Federal Power Act (as in effect on the date of the enactment of this paragraph) if the portion of the cost of the facility financed with tax-exempt bonds is not greater than the portion of the cost of the facility which is allocable to the local furnishing of electric energy (determined without regard to this paragraph).

(B) Special rule for existing facilities

In the case of a facility financed with bonds issued before the date of an order referred to in subparagraph (A) which would (but for this subparagraph) cease to be tax-exempt by reason of subparagraph (A), such bonds shall not cease to be tax-exempt bonds (and section 150 (b)(4) shall not apply) if, to the extent necessary to comply with subparagraph (A)—

(i) an escrow to pay principal of, premium (if any), and interest on the bonds is established within a reasonable period after the date such order becomes final, and

(ii) bonds are redeemed not later than the earliest date on which such bonds may be redeemed.

(3) Termination of future financing

For purposes of this section, no bond may be issued as part of an issue described in subsection (a)(8) with respect to a facility for the local furnishing of electric energy or gas on or after the date of the enactment of this paragraph unless—

(A) the facility will—

(i) be used by a person who is engaged in the local furnishing of that energy source on January 1, 1997, and

(ii) be used to provide service within the area served by such person on January 1, 1997 (or within a county or city any portion of which is within such area), or

(B) the facility will be used by a successor in interest to such person for the same use and within the same service area as described in subparagraph (A).

(4) Election to terminate tax-exempt bond financing by certain furnishers

(A) In general

In the case of a facility financed with bonds issued before the date of the enactment of this paragraph which would cease to be tax-exempt by reason of the failure to meet the local furnishing requirement of subsection (a)(8) as a result of a service area expansion, such bonds shall not cease to be tax-exempt bonds (and section 150 (b)(4) shall not apply) if the person engaged in such local furnishing by such facility makes an election described in subparagraph (B).

(B) Election

An election is described in this subparagraph if it is an election made in such manner as the Secretary prescribes, and such person (or its predecessor in interest) agrees that—

(i) such election is made with respect to all facilities for the local furnishing of electric energy or gas, or both, by such person,

(ii) no bond exempt from tax under section 103 and described in subsection (a)(8) may be issued on or after the date of the enactment of this paragraph with respect to all such facilities of such person,

(iii) any expansion of the service area—

(I) is not financed with the proceeds of any exempt facility bond described in subsection (a)(8), and

(II) is not treated as a nonqualifying use under the rules of paragraph (2), and

(iv) all outstanding bonds used to finance the facilities for such person are redeemed not later than 6 months after the later of—

(I) the earliest date on which such bonds may be redeemed, or

(II) the date of the election.

(C) Related persons

For purposes of this paragraph, the term "person" includes a group of related persons (within the meaning of section 144 (a)(3)) which includes such person.

(g) Local district heating or cooling facility

(1) In general

For purposes of subsection (a)(9), the term "local district heating or cooling facility" means property used as an integral part of a local district heating or cooling system.

(2) Local district heating or cooling system

(A) In general

For purposes of paragraph (1), the term "local district heating or cooling system" means any local system consisting of a pipeline or network (which may be connected to a heating or cooling source) providing hot water, chilled water, or steam to 2 or more users for—

(i) residential, commercial, or industrial heating or cooling, or

(ii) process steam.

(B) Local system

For purposes of this paragraph, a local system includes facilities furnishing heating and cooling to an area consisting of a city and 1 contiguous county.

(h) Qualified hazardous waste facilities

For purposes of subsection (a)(10), the term "qualified hazardous waste facility" means any facility for the disposal of hazardous waste by incineration or entombment but only if—

(1) the facility is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on the date of the enactment of the Tax Reform Act of 1986), and

(2) the portion of such facility which is to be provided by the issue does not exceed the portion of the facility which is to be used by persons other than—

(A) the owner or operator of such facility, and

(B) any related person (within the meaning of section 144 (a)(3)) to such owner or operator.

(i) High-speed intercity rail facilities

(1) In general

For purposes of subsection (a)(11), the term "high-speed intercity rail facilities" means any facility (not including rolling stock) for the fixed guideway rail transportation of passengers and their baggage between metropolitan statistical areas (within the meaning of section 143 (k)(2)(B)) using vehicles that are reasonably expected to be capable of attaining a maximum speed in excess of 150 miles per hour between

scheduled stops, but only if such facility will be made available to members of the general public as passengers.

(2) Election by nongovernmental owners

A facility shall be treated as described in subsection (a)(11) only if any owner of such facility which is not a governmental unit irrevocably elects not to claim—

(A) any deduction under section 167 or 168, and

(B) any credit under this subtitle,

with respect to the property to be financed by the net proceeds of the issue.

(3) Use of proceeds

A bond issued as part of an issue described in subsection (a)(11) shall not be considered an exempt facility bond unless any proceeds not used within a 3-year period of the date of the issuance of such bond are used (not later than 6 months after the close of such period) to redeem bonds which are part of such issue.

(j) Environmental enhancements of hydroelectric generating facilities

(1) In general

For purposes of subsection (a)(12), the term "environmental enhancements of hydroelectric generating facilities" means property—

(A) the use of which is related to a federally licensed hydroelectric generating facility owned and operated by a governmental unit, and

(B) which—

(i) protects or promotes fisheries or other wildlife resources, including any fish by-pass facility, fish hatchery, or fisheries enhancement facility, or

(ii) is a recreational facility or other improvement required by the terms and conditions of any Federal licensing permit for the operation of such generating facility.

(2) Use of proceeds

A bond issued as part of an issue described in subsection (a)(12) shall not be considered an exempt facility bond unless at least 80 percent of the net proceeds of the issue of which it is a part are used to finance property described in paragraph (1)(B)(i).

(k) Qualified public educational facilities

(1) In general

For purposes of subsection (a)(13), the term "qualified public educational facility" means any school facility which is—

(A) part of a public elementary school or a public secondary school, and

(B) owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency described in paragraph (2).

(2) Public-private partnership agreement described

A public-private partnership agreement is described in this paragraph if it is an agreement—

(A) under which the corporation agrees—

(i) to do 1 or more of the following: construct, rehabilitate, refurbish, or equip a school facility, and

(ii) at the end of the term of the agreement, to transfer the school facility to such agency for no additional consideration, and

(B) the term of which does not exceed the term of the issue to be used to provide the school facility.

(3) School facility

For purposes of this subsection, the term "school facility" means—

(A) any school building,

(B) any functionally related and subordinate facility and land with respect to such building, including any stadium or other facility primarily used for school events, and

(C) any property, to which section 168 applies (or would apply but for section 179), for use in a facility described in subparagraph (A) or (B).

(4) Public schools

For purposes of this subsection, the terms "elementary school" and "secondary school" have the meanings given such terms by section 14101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 8801), as in effect on the date of the enactment of this subsection.

(5) Annual aggregate face amount of tax-exempt financing

(A) In general

An issue shall not be treated as an issue described in subsection (a)(13) if the aggregate face amount of bonds issued by the State pursuant thereto (when added to the aggregate face amount of bonds previously so issued during the calendar year) exceeds an amount equal to the greater of—

(i) $10 multiplied by the State population, or

(ii) $5,000,000.

(B) Allocation rules

(i) In general Except as otherwise provided in this subparagraph, the State may allocate the amount described in subparagraph (A) for any calendar year in such manner as the State determines appropriate.

(ii) Rules for carryforward of unused limitation A State may elect to carry forward an unused limitation for any calendar year for 3 calendar years following the calendar year in which the unused limitation arose under rules similar to the rules of section 146 (f), except that the only purpose for which the carryforward may be elected is the issuance of exempt facility bonds described in subsection (a)(13).

(l) Qualified green building and sustainable design projects

(1) In general

For purposes of subsection (a)(14), the term "qualified green building and sustainable design project" means any project which is designated by the Secretary, after consultation with the Administrator of the Environmental Protection Agency, as a qualified green building and sustainable design project and which meets the requirements of clauses (i), (ii), (iii), and (iv) of paragraph (4)(A).

(2) Designations

(A) In general

Within 60 days after the end of the application period described in paragraph (3)(A), the Secretary, after consultation with the Administrator of the Environmental Protection Agency, shall designate qualified green building and sustainable design projects. At least one of the projects designated shall be located in, or within a 10-mile radius of, an empowerment zone as designated pursuant to section 1391, and at least one of the projects designated shall be located in a rural State. No more than one project shall be designated in a State. A project shall not be designated if such project includes a stadium or arena for professional sports exhibitions or games.

(B) Minimum conservation and technology innovation objectives

The Secretary, after consultation with the Administrator of the Environmental Protection Agency, shall ensure that, in the aggregate, the projects designated shall—

(i) reduce electric consumption by more than 150 megawatts annually as compared to conventional generation,

(ii) reduce daily sulfur dioxide emissions by at least 10 tons compared to coal generation power,

(iii) expand by 75 percent the domestic solar photovoltaic market in the United States (measured in megawatts) as compared to the expansion of that market from 2001 to 2002, and

(iv) use at least 25 megawatts of fuel cell energy generation.

(3) Limited designations

A project may not be designated under this subsection unless—

(A) the project is nominated by a State or local government within 180 days of the enactment of this subsection, and

(B) such State or local government provides written assurances that the project will satisfy the eligibility criteria described in paragraph (4).

(4) Application

(A) In general

A project may not be designated under this subsection unless the application for such designation includes a project proposal which describes the energy efficiency, renewable energy, and sustainable design features of the project and demonstrates that the project satisfies the following eligibility criteria:

(i) Green building and sustainable design At least 75 percent of the square footage of commercial buildings which are part of the project is registered for United States Green Building Council's LEED certification and is reasonably expected (at the time of the designation) to receive such certification. For purposes of determining LEED certification as required under this clause, points shall be credited by using the following:

(I) For wood products, certification under the Sustainable Forestry Initiative Program and the American Tree Farm System.

(II) For renewable wood products, as credited for recycled content otherwise provided under LEED certification.

(III) For composite wood products, certification under standards established by the American National Standards Institute, or such other voluntary standards as published in the Federal Register by the Administrator of the Environmental Protection Agency.

(ii) Brownfield redevelopment The project includes a brownfield site as defined by section 101(39) of the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (42 U.S.C. 9601), including a site described in subparagraph (D)(ii)(II)(aa) thereof.

(iii) State and local support The project receives specific State or local government resources which will support the project in an amount equal to at least $5,000,000. For purposes of the preceding sentence, the term "resources" includes tax abatement benefits and contributions in kind.

(iv) Size The project includes at least one of the following:

(I) At least 1,000,000 square feet of building.

(II) At least 20 acres.

(v) Use of tax benefit The project proposal includes a description of the net benefit of the tax-exempt financing provided under this subsection which will be allocated for financing of one or more of the following:

(I) The purchase, construction, integration, or other use of energy efficiency, renewable energy, and sustainable design features of the project.

(II) Compliance with certification standards cited under clause (i).

(III) The purchase, remediation, and foundation construction and preparation of the brownfields site.

(vi) Prohibited facilities An issue shall not be treated as an issue described in subsection (a)(14) if any proceeds of such issue are used to provide any facility the principal business of which is the sale of food or alcoholic beverages for consumption on the premises.

(vii) Employment The project is projected to provide permanent employment of at least 1,500 full time equivalents (150 full time equivalents in rural States) when completed and construction employment of at least 1,000 full time equivalents (100 full time equivalents in rural States).

The application shall include an independent analysis which describes the project's economic impact, including the amount of projected employment.

(B) Project description

Each application described in subparagraph (A) shall contain for each project a description of—

(i) the amount of electric consumption reduced as compared to conventional construction,

(ii) the amount of sulfur dioxide daily emissions reduced compared to coal generation,

(iii) the amount of the gross installed capacity of the project's solar photovoltaic capacity measured in megawatts, and

(iv) the amount, in megawatts, of the project's fuel cell energy generation.

(5) Certification of use of tax benefit

No later than 30 days after the completion of the project, each project must certify to the Secretary that the net benefit of the tax-exempt financing was used for the purposes described in paragraph (4).

(6) Definitions

For purposes of this subsection—

(A) Rural State

The term "rural State" means any State which has—

(i) a population of less than 4,500,000 according to the 2000 census,

(ii) a population density of less than 150 people per square mile according to the 2000 census, and

(iii) increased in population by less than half the rate of the national increase between the 1990 and 2000 censuses.

(B) Local government

The term "local government" has the meaning given such term by section 1393 (a)(5).

(C) Net benefit of tax-exempt financing

The term "net benefit of tax-exempt financing" means the present value of the interest savings (determined by a calculation established by the Secretary) which result from the tax-exempt status of the bonds.

(7) Aggregate face amount of tax-exempt financing

(A) In general

An issue shall not be treated as an issue described in subsection (a)(14) if the aggregate face amount of bonds issued by the State or local government pursuant thereto for a project (when added to the aggregate face amount of bonds previously so issued for such project) exceeds an amount designated by the Secretary as part of the designation.

(B) Limitation on amount of bonds

The Secretary may not allocate authority to issue qualified green building and sustainable design project bonds in an aggregate face amount exceeding $2,000,000,000.

(8) Termination

Subsection (a)(14) shall not apply with respect to any bond issued after September 30, 2012.

(9) Treatment of current refunding bonds

Paragraphs (7)(B) and (8) shall not apply to any bond (or series of bonds) issued to refund a bond issued under subsection (a)(14) before October 1, 2012, if—

(A) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue,

(B) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

(C) the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond.

For purposes of subparagraph (A), average maturity shall be determined in accordance with section 147 (b)(2)(A).

(m) Qualified highway or surface freight transfer facilities

(1) In general

For purposes of subsection (a)(15), the term "qualified highway or surface freight transfer facilities" means—

(A) any surface transportation project which receives Federal assistance under title 23, United States Code (as in effect on the date of the enactment of this subsection),

(B) any project for an international bridge or tunnel for which an international entity authorized under Federal or State law is responsible and which receives Federal assistance under title 23, United States Code (as so in effect), or

(C) any facility for the transfer of freight from truck to rail or rail to truck (including any temporary storage facilities directly related to such transfers) which receives Federal assistance under either title 23 or title 49, United States Code (as so in effect).

(2) National limitation on amount of tax-exempt financing for facilities

(A) National limitation

The aggregate amount allocated by the Secretary of Transportation under subparagraph (C) shall not exceed $15,000,000,000.

(B) Enforcement of national limitation

An issue shall not be treated as an issue described in subsection (a)(15) if the aggregate face amount of bonds issued pursuant to such issue for any qualified highway or surface freight transfer facility (when added to the aggregate face amount of bonds previously so issued for such facility) exceeds the amount allocated to such facility under subparagraph (C).

(C) Allocation by Secretary of Transportation

The Secretary of Transportation shall allocate the amount described in subparagraph (A) among qualified highway or surface freight transfer facilities in such manner as the Secretary determines appropriate.

(3) Expenditure of proceeds

An issue shall not be treated as an issue described in subsection (a)(15) unless at least 95 percent of the net proceeds of the issue is expended for qualified highway or surface freight transfer facilities within the 5-year period beginning on the date of issuance. If at least 95 percent of such net proceeds is not expended within such 5-year period, an issue shall be treated as continuing to meet the requirements of this paragraph if the issuer uses all unspent proceeds of the issue to redeem bonds of the

issue within 90 days after the end of such 5-year period. The Secretary, at the request of the issuer, may extend such 5-year period if the issuer establishes that any failure to meet such period is due to circumstances beyond the control of the issuer.

(4) Exception for current refunding bonds

Paragraph (2) shall not apply to any bond (or series of bonds) issued to refund a bond issued under subsection (a)(15) if—

(A) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue,

(B) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

(C) the refunded bond is redeemed not later than 90 days after the date of the issuance of the refunding bond.

For purposes of subparagraph (A), average maturity shall be determined in accordance with section 147 (b)(2)(A).

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[1] So in original. Probably should be "section 42(i)(3)(D)".

26 USC § 143 - Mortgage revenue bonds: qualified mortgage bond and qualified veterans' mortgage bond

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Qualified mortgage bond

(1) Qualified mortgage bond defined

For purposes of this title, the term "qualified mortgage bond" means a bond which is issued as part of a qualified mortgage issue.

(2) Qualified mortgage issue defined

(A) Definition

For purposes of this title, the term "qualified mortgage issue" means an issue by a State or political subdivision thereof of 1 or more bonds, but only if—

(i) all proceeds of such issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences,

(ii) such issue meets the requirements of subsections (c), (d), (e), (f), (g), (h), (i), and (m)(7),

(iii) such issue does not meet the private business tests of paragraphs (1) and (2) of section 141 (b), and

(iv) except as provided in subparagraph (D)(ii), repayments of principal on financing provided by the issue are used not later than the close of the 1st semiannual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds which are part of such issue.

Clause (iv) shall not apply to amounts received within 10 years after the date of issuance of the issue (or, in the case of refunding bond, the date of issuance of the original bond).

(B) Good faith effort to comply with mortgage eligibility requirements

An issue which fails to meet 1 or more of the requirements of subsections (c), (d), (e), (f), and (i) shall be treated as meeting such requirements if—

(i) the issuer in good faith attempted to meet all such requirements before the mortgages were executed,

(ii) 95 percent or more of the proceeds devoted to owner-financing was devoted to residences with respect to which (at the time the mortgages were executed) all such requirements were met, and

(iii) any failure to meet the requirements of such subsections is corrected within a reasonable period after such failure is first discovered.

(C) Good faith effort to comply with other requirements

An issue which fails to meet 1 or more of the requirements of subsections (g), (h), and (m)(7) shall be treated as meeting such requirements if—

(i) the issuer in good faith attempted to meet all such requirements, and

(ii) any failure to meet such requirements is due to inadvertent error after taking reasonable steps to comply with such requirements.

(D) Proceeds must be used within 42 months of date of issuance

(i) In general Except as otherwise provided in this subparagraph, an issue shall not meet the requirement of subparagraph (A)(i) unless—

(I) all proceeds of the issue required to be used to finance owner-occupied residences are so used within the 42-month period beginning on the date of issuance of the issue (or, in the case of a refunding bond, within the 42-month period beginning on the date of issuance of the original bond) or, to the extent not so used within such period, are used within such period to redeem bonds which are part of such issue, and

(II) no portion of the proceeds of the issue are used to make or finance any loan (other than a loan which is a nonpurpose investment within the meaning of section 148 (f)(6)(A)) after the close of such period.

(ii) Exception Clause (I) (and clause (iv) of subparagraph (A)) shall not be construed to require amounts of less than $250,000 to be used to redeem bonds. The Secretary may by regulation treat related issues as 1 issue for purposes of the preceding sentence.

(b) Qualified veterans' mortgage bond defined

For purposes of this part, the term "qualified veterans' mortgage bond" means any bond—

(1) which is issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide residences for veterans,

(2) the payment of the principal and interest on which is secured by the general obligation of a State,

(3) which is part of an issue which meets the requirements of subsections (c), (g), (i)(1), and (l), and

(4) which is part of an issue which does not meet the private business tests of paragraphs (1) and (2) of section 141 (b).

Rules similar to the rules of subparagraphs (B) and (C) of subsection (a)(2) shall apply to the requirements specified in paragraph (3) of this subsection.

(c) Residence requirements

(1) For a residence

A residence meets the requirements of this subsection only if—

(A) it is a single-family residence which can reasonably be expected to become the principal residence of the mortgagor within a reasonable time after the financing is provided, and

(B) it is located within the jurisdiction of the authority issuing the bond.

(2) For an issue

An issue meets the requirements of this subsection only if all of the residences for which owner-financing is provided under the issue meet the requirements of paragraph (1).

(d) 3-year requirement

(1) In general

An issue meets the requirements of this subsection only if 95 percent or more of the net proceeds of such issue are used to finance the residences of mortgagors who had no present ownership interest in their principal residences at any time during the 3-year period ending on the date their mortgage is executed.

(2) Exceptions

For purposes of paragraph (1), the proceeds of an issue which are used to provide—

(A) financing with respect to targeted area residences,

(B) qualified home improvement loans and qualified rehabilitation loans,

(C) financing with respect to land described in subsection (i)(1)(C) and the construction of any residence thereon, and

(D) in the case of bonds issued after the date of the enactment of this subparagraph, financing of any residence for a veteran (as defined in section 101 of title 38, United States Code), if such veteran has not previously qualified for and received such financing by reason of this subparagraph,

shall be treated as used as described in paragraph (1).

(3) Mortgagor's interest in residence being financed

For purposes of paragraph (1), a mortgagor's interest in the residence with respect to which the financing is being provided shall not be taken into account.

(e) Purchase price requirement

(1) In general

An issue meets the requirements of this subsection only if the acquisition cost of each residence the owner-financing of which is provided under the issue does not exceed 90 percent of the average area purchase price applicable to such residence.

(2) Average area purchase price

For purposes of paragraph (1), the term "average area purchase price" means, with respect to any residence, the average purchase price of single family residences (in the statistical area in which the residence is located) which were purchased during the most recent 12-month period for which sufficient statistical information is available. The determination under the preceding sentence shall be made as of the date on which the commitment to provide the financing is made (or, if earlier, the date of the purchase of the residence).

(3) Separate application to new residences and old residences

For purposes of this subsection, the determination of average area purchase price shall be made separately with respect to—

(A) residences which have not been previously occupied, and

(B) residences which have been previously occupied.

(4) Special rule for 2 to 4 family residences

For purposes of this subsection, to the extent provided in regulations, the determination of average area purchase price shall be made separately with respect to 1 family, 2 family, 3 family, and 4 family residences.

(5) Special rule for targeted area residences

In the case of a targeted area residence, paragraph (1) shall be applied by substituting "110 percent" for "90 percent".

(6) Exception for qualified home improvement loans

Paragraph (1) shall not apply with respect to any qualified home improvement loan.

(f) Income requirements

(1) In general

An issue meets the requirements of this subsection only if all owner-financing provided under the issue is provided for mortgagors whose family income is 115 percent or less of the applicable median family income.

(2) Determination of family income

For purposes of this subsection, the family income of mortgagors, and area median gross income, shall be determined by the Secretary after taking into account the regulations prescribed under section 8 of the United States Housing Act of 1937 (or, if

such program is terminated, under such program as in effect immediately before such termination).

(3) Special rule for applying paragraph (1) in the case of targeted area residences

In the case of any financing provided under any issue for targeted area residences—

(A) 1/3 of the amount of such financing may be provided without regard to paragraph (1), and

(B) paragraph (1) shall be treated as satisfied with respect to the remainder of the owner financing if the family income of the mortgagor is 140 percent or less of the applicable median family income.

(4) Applicable median family income

For purposes of this subsection, the term "applicable median family income" means, with respect to a residence, whichever of the following is the greater:

(A) the area median gross income for the area in which such residence is located, or

(B) the statewide median gross income for the State in which such residence is located.

(5) Adjustment of income requirement based on relation of high housing costs to income

(A) In general

If the residence (for which financing is provided under the issue) is located in a high housing cost area and the limitation determined under this paragraph is greater than the limitation otherwise applicable under paragraph (1), there shall be substituted for the income limitation in paragraph (1), a limitation equal to the percentage determined under subparagraph (B) of the area median gross income for such area.

(B) Income requirements for residences in high housing cost area

The percentage determined under this subparagraph for a residence located in a high housing cost area is the percentage (not greater than 140 percent) equal to the product of—

(I) 115 percent, and

(II) the amount by which the housing cost/income ratio for such area exceeds 0.2.

(C) High housing cost areas

For purposes of this paragraph, the term "high housing cost area" means any statistical area for which the housing cost/income ratio is greater than 1.2.

(D) Housing cost/income ratio

For purposes of this paragraph—

(i) In general The term "housing cost/income ratio" means, with respect to any statistical area, the number determined by dividing—

(I) the applicable housing price ratio for such area, by

(II) the ratio which the area median gross income for such area bears to the median gross income for the United States.

(ii) Applicable housing price ratio For purposes of clause (i), the applicable housing price ratio for any area is the new housing price ratio or the existing housing price ratio, whichever results in the housing cost/income ratio being closer to 1.

(iii) New housing price ratio The new housing price ratio for any area is the ratio which—

(I) the average area purchase price (as defined in subsection (e)(2)) for residences described in subsection (e)(3)(A) which are located in such area bears to

(II) the average purchase price (determined in accordance with the principles of subsection (e)(2)) for residences so described which are located in the United States.

(iv) Existing housing price ratio The existing housing price ratio for any area is the ratio determined in accordance with clause (iii) but with respect to residences described in subsection (e)(3)(B).

(6) Adjustment to income requirements based on family size

In the case of a mortgagor having a family of fewer than 3 individuals, the preceding provisions of this subsection shall be applied by substituting—

(A) "100 percent" for "115 percent" each place it appears, and

(B) "120 percent" for "140 percent" each place it appears.

(g) Requirements related to arbitrage

(1) In general

An issue meets the requirements of this subsection only if such issue meets the requirements of paragraph (2) of this subsection and, in the case of an issue described in subsection (b)(1), such issue also meets the requirements of paragraph (3) of this subsection. Such requirements shall be in addition to the requirements of section 148.

(2) Effective rate of mortgage interest cannot exceed bond yield by more than 1.125 percentage points

(A) In general

An issue shall be treated as meeting the requirements of this paragraph only if the excess of—

(i) the effective rate of interest on the mortgages provided under the issue, over

(ii) the yield on the issue,

is not greater than 1.125 percentage points.

(B) Effective rate of mortgage interest

(i) In general In determining the effective rate of interest on any mortgage for purposes of this paragraph, there shall be taken into account all fees, charges, and other amounts borne by the mortgagor which are attributable to the mortgage or to the bond issue.

(ii) Specification of some of the amounts to be treated as borne by the mortgagor For purposes of clause (i), the following items (among others) shall be treated as borne by the mortgagor:

(I) all points or similar charges paid by the seller of the property, and

(II) the excess of the amounts received from any person other than the mortgagor by any person in connection with the acquisition of the mortgagor's interest in the property over the usual and reasonable acquisition costs of a person acquiring like property where owner-financing is not provided through the use of qualified mortgage bonds or qualified veterans' mortgage bonds.

(iii) Specification of some of the amounts to be treated as not borne by the mortgagor For purposes of clause (i), the following items shall not be taken into account:

(I) any expected rebate of arbitrage profits, and

(II) any application fee, survey fee, credit report fee, insurance charge, or similar amount to the extent such amount does not exceed amounts charged in such area in cases where owner-financing is not provided through the use of qualified mortgage bonds or qualified veterans' mortgage bonds. Subclause (II) shall not apply to origination fees, points, or similar amounts.

(iv) Prepayment assumptions In determining the effective rate of interest—

(I) it shall be assumed that the mortgage prepayment rate will be the rate set forth in the most recent applicable mortgage maturity experience table published by the Federal Housing Administration, and

(II) prepayments of principal shall be treated as received on the last day of the month in which the issuer reasonably expects to receive such prepayments. The Secretary may by regulation adjust the mortgage prepayment rate otherwise used in determining the effective rate of interest to the extent the Secretary determines that such an adjustment is appropriate by reason of the impact of subsection (m).

(C) Yield on the issue

For purposes of this subsection, the yield on an issue shall be determined on the basis of—

(i) the issue price (within the meaning of sections 1273 and 1274), and

(ii) an expected maturity for the bonds which is consistent with the assumptions required under subparagraph (B)(iv).

(3) Arbitrage and investment gains to be used to reduce costs of owner-financing

(A) In general

An issue shall be treated as meeting the requirements of this paragraph only if an amount equal to the sum of—

(i) the excess of—

(I) the amount earned on all nonpurpose investments (other than investments attributable to an excess described in this clause), over

(II) the amount which would have been earned if such investments were invested at a rate equal to the yield on the issue, plus

(ii) any income attributable to the excess described in clause (i),

is paid or credited to the mortgagors as rapidly as may be practicable.

(B) Investment gains and losses

For purposes of subparagraph (A), in determining the amount earned on all nonpurpose investments, any gain or loss on the disposition of such investments shall be taken into account.

(C) Reduction where issuer does not use full 1.125 percentage points under paragraph (2)

(i) In general The amount required to be paid or credited to mortgagors under subparagraph (A) (determined under this paragraph without regard to this subparagraph) shall be reduced by the unused paragraph (2) amount.

(ii) Unused paragraph (2) amount For purposes of clause (i), the unused paragraph (2) amount is the amount which (if it were treated as an interest payment made by mortgagors) would result in the excess referred to in paragraph (2)(A) being equal to 1.125 percentage points. Such amount shall be fixed and determined as of the yield determination date.

(D) Election to pay United States

Subparagraph (A) shall be satisfied with respect to any issue if the issuer elects before issuing the bonds to pay over to the United States—

(i) not less frequently than once each 5 years after the date of issue, an amount equal to 90 percent of the aggregate amount which would be required to be paid or credited to mortgagors under subparagraph (A) (and not theretofore paid to the United States), and

(ii) not later than 60 days after the redemption of the last bond, 100 percent of such aggregate amount not theretofore paid to the United States.

(E) Simplified accounting

The Secretary shall permit any simplified system of accounting for purposes of this paragraph which the issuer establishes to the satisfaction of the Secretary will assure that the purposes of this paragraph are carried out.

(F) Nonpurpose investment

For purposes of this paragraph, the term "nonpurpose investment" has the meaning given such term by section 148 (f)(6)(A).

(h) Portion of loans required to be placed in targeted areas

(1) In general

An issue meets the requirements of this subsection only if at least 20 percent of the proceeds of the issue which are devoted to providing owner-financing is made available (with reasonable diligence) for owner-financing of targeted area residences for at least 1 year after the date on which owner-financing is first made available with respect to targeted area residences.

(2) Limitation

Nothing in paragraph (1) shall be treated as requiring the making available of an amount which exceeds 40 percent of the average annual aggregate principal amount of mortgages executed during the immediately preceding 3 calendar years for single-family, owner-occupied residences located in targeted areas within the jurisdiction of the issuing authority.

(i) Other requirements

(1) Mortgages must be new mortgages

(A) In general

An issue meets the requirements of this subsection only if no part of the proceeds of such issue is used to acquire or replace existing mortgages.

(B) Exceptions

Under regulations prescribed by the Secretary, the replacement of—

(i) construction period loans,

(ii) bridge loans or similar temporary initial financing, and

(iii) in the case of a qualified rehabilitation, an existing mortgage,

shall not be treated as the acquisition or replacement of an existing mortgage for purposes of subparagraph (A).

(C) Exception for certain contract for deed agreements

(i) In general In the case of land possessed under a contract for deed by a mortgagor—

(I) whose principal residence (within the meaning of section 121) is located on such land, and

(II) whose family income (as defined in subsection (f)(2)) is not more than 50 percent of applicable median family income (as defined in subsection (f)(4)), the contract for deed shall not be treated as an existing mortgage for purposes of subparagraph (A).

(ii) Contract for deed defined For purposes of this subparagraph, the term "contract for deed" means a seller-financed contract for the conveyance of land under which—

(I) legal title does not pass to the purchaser until the consideration under the contract is fully paid to the seller, and

(II) the seller's remedy for nonpayment is forfeiture rather than judicial or nonjudicial foreclosure.

(2) Certain requirements must be met where mortgage is assumed

An issue meets the requirements of this subsection only if each mortgage with respect to which owner-financing has been provided under such issue may be assumed only if the requirements of subsections (c), (d), and (e), and the requirements of paragraph (1) or (3)(B) of subsection (f) (whichever applies), are met with respect to such assumption.

(j) Targeted area residences

(1) In general

For purposes of this section, the term "targeted area residence" means a residence in an area which is either—

(A) a qualified census tract, or

(B) an area of chronic economic distress.

(2) Qualified census tract

(A) In general

For purposes of paragraph (1), the term "qualified census tract" means a census tract in which 70 percent or more of the families have income which is 80 percent or less of the statewide median family income.

(B) Data used

The determination under subparagraph (A) shall be made on the basis of the most recent decennial census for which data are available.

(3) Area of chronic economic distress

(A) In general

For purposes of paragraph (1), the term "area of chronic economic distress" means an area of chronic economic distress—

(i) designated by the State as meeting the standards established by the State for purposes of this subsection, and

(ii) the designation of which has been approved by the Secretary and the Secretary of Housing and Urban Development.

(B) Criteria to be used in approving State designations

The criteria used by the Secretary and the Secretary of Housing and Urban Development in evaluating any proposed designation of an area for purposes of this subsection shall be—

(i) the condition of the housing stock, including the age of the housing and the number of abandoned and substandard residential units,

(ii) the need of area residents for owner-financing under this section, as indicated by low per capita income, a high percentage of families in poverty, a high number of welfare recipients, and high unemployment rates,

(iii) the potential for use of owner-financing under this section to improve housing conditions in the area, and

(iv) the existence of a housing assistance plan which provides a displacement program and a public improvements and services program.

(k) Other definitions and special rules

For purposes of this section—

(1) Mortgage

The term "mortgage" means any owner-financing.

(2) Statistical area

(A) In general

The term "statistical area" means—

(i) a metropolitan statistical area, and

(ii) any county (or the portion thereof) which is not within a metropolitan statistical area.

(B) Metropolitan statistical area

The term "metropolitan statistical area" includes the area defined as such by the Secretary of Commerce.

(C) Designation where adequate statistical information not available

For purposes of this paragraph, if there is insufficient recent statistical information with respect to a county (or portion thereof) described in subparagraph (A)(ii), the Secretary may substitute for such county (or portion thereof) another area for which there is sufficient recent statistical information.

(D) Designation where no county

In the case of any portion of a State which is not within a county, subparagraphs (A)(ii) and (C) shall be applied by substituting for "county" an area designated by the Secretary which is the equivalent of a county.

(3) Acquisition cost

(A) In general

The term "acquisition cost" means the cost of acquiring the residence as a completed residential unit.

(B) Exceptions

The term "acquisition cost" does not include—

(i) usual and reasonable settlement or financing costs,

(ii) the value of services performed by the mortgagor or members of his family in completing the residence, and

(iii) the cost of land (other than land described in subsection (i)(1)(C)(i)) which has been owned by the mortgagor for at least 2 years before the date on which construction of the residence begins.

(C) Special rule for qualified rehabilitation loans

In the case of a qualified rehabilitation loan, for purposes of subsection (e), the term "acquisition cost" includes the cost of the rehabilitation.

(4) Qualified home improvement loan

The term "qualified home improvement loan" means the financing (in an amount which does not exceed $15,000)—

(A) of alterations, repairs, and improvements on or in connection with an existing residence by the owner thereof, but

(B) only of such items as substantially protect or improve the basic livability or energy efficiency of the property.

(5) Qualified rehabilitation loan

(A) In general

The term "qualified rehabilitation loan" means any owner-financing provided in connection with—

(i) a qualified rehabilitation, or

(ii) the acquisition of a residence with respect to which there has been a qualified rehabilitation,

but only if the mortgagor to whom such financing is provided is the first resident of the residence after the completion of the rehabilitation.

(B) Qualified rehabilitation

For purposes of subparagraph (A), the term "qualified rehabilitation" means any rehabilitation of a building if—

(i) there is a period of at least 20 years between the date on which the building was first used and the date on which the physical work on such rehabilitation begins,

(ii) in the rehabilitation process—

(I) 50 percent or more of the existing external walls of such building are retained in place as external walls,

(II) 75 percent or more of the existing external walls of such building are retained in place as internal or external walls, and

(III) 75 percent or more of the existing internal structural framework of such building is retained in place, and

(iii) the expenditures for such rehabilitation are 25 percent or more of the mortgagor's adjusted basis in the residence.

For purposes of clause (iii), the mortgagor's adjusted basis shall be determined as of the completion of the rehabilitation or, if later, the date on which the mortgagor acquires the residence.

(6) Determinations on actuarial basis

All determinations of yield, effective interest rates, and amounts required to be paid or credited to mortgagors or paid to the United States under subsection (g) shall be made on an actuarial basis taking into account the present value of money.

(7) Single-family and owner-occupied residences include certain residences with 2 to 4 units

Except for purposes of subsection (h)(2), the terms "single-family" and "owner-occupied", when used with respect to residences, include 2, 3, or 4 family residences—

(A) one unit of which is occupied by the owner of the units, and

(B) which were first occupied at least 5 years before the mortgage is executed.

Subparagraph (B) shall not apply to any 2-family residence if the residence is a targeted area residence and the family income of the mortgagor meets the requirement of subsection (f)(3)(B).

(8) Cooperative housing corporations

(A) In general

In the case of any cooperative housing corporation—

(i) each dwelling unit shall be treated as if it were actually owned by the person entitled to occupy such dwelling unit by reason of his ownership of stock in the corporation, and

(ii) any indebtedness of the corporation allocable to the dwelling unit shall be treated as if it were indebtedness of the shareholder entitled to occupy the dwelling unit.

(B) Adjustment to targeted area requirement

In the case of any issue to provide financing to a cooperative housing corporation with respect to cooperative housing not located in a targeted area, to the extent provided in regulations, such issue may be combined with 1 or more other issues for purposes of determining whether the requirements of subsection (h) are met.

(C) Cooperative housing corporation

The term "cooperative housing corporation" has the meaning given to such term by section 216 (b)(1).

(9) Treatment of limited equity cooperative housing

(A) Treatment as residential rental property

Except as provided in subparagraph (B), for purposes of this part—

(i) any limited equity cooperative housing shall be treated as residential rental property and not as owner-occupied housing, and

(ii) bonds issued to provide such housing shall be subject to the same requirements and limitations as bonds the proceeds of which are to be used to provide qualified residential rental projects (as defined in section 142 (d)).

(B) Bonds subject to qualified mortgage bond termination date

Subparagraph (A) shall not apply to any bond issued after the date specified in subsection (a)(1)(B).

(C) Limited equity cooperative housing

For purposes of this paragraph, the term "limited equity cooperative housing" means any dwelling unit which a person is entitled to occupy by reason of his ownership of stock in a qualified cooperative housing corporation.

(D) Qualified cooperative housing corporation

For purposes of this paragraph, the term "qualified cooperative housing corporation" means any cooperative housing corporation (as defined in section 216 (b)(1)) if—

(i) the consideration paid for stock held by any stockholder entitled to occupy any house or apartment in a building owned or leased by the corporation may not exceed the sum of—

(I) the consideration paid for such stock by the first such stockholder, as adjusted by a cost-of-living adjustment determined by the Secretary,

(II) payments made by any stockholder for improvements to such house or apartment, and

(III) payments (other than amounts taken into account under subclause (I) or (II)) attributable to any stockholder to amortize the principal of the corporation's indebtedness arising from the acquisition or development of real property, including improvements thereof,

(ii) the value of the corporation's assets (reduced by any corporate liabilities), to the extent such value exceeds the combined transfer values of the outstanding corporate stock, shall be used only for public benefit or charitable purposes, or directly to benefit the corporation itself, and shall not be used directly to benefit any stockholder, and

(iii) at the time of issuance of the issue, such corporation makes an election under this paragraph.

(E) Effect of election

If a cooperative housing corporation makes an election under this paragraph, section 216 shall not apply with respect to such corporation (or any successor thereof) during the qualified project period (as defined in section 142 (d)(2)).

(F) Corporation must continue to be qualified cooperative

Subparagraph (A)(i) shall not apply to limited equity cooperative housing unless the cooperative housing corporation continues to be a qualified cooperative housing corporation at all times during the qualified project period (as defined in section 142 (d)(2)).

(G) Election irrevocable

Any election under this paragraph, once made, shall be irrevocable.

(10) Treatment of resale price control and subsidy lien programs

(A) In general

In the case of a residence which is located in a high housing cost area (as defined in section 143 (f)(5)), the interest of a governmental unit in such residence by reason of financing provided under any qualified program shall not be taken into account under this section (other than subsection (m)), and the acquisition cost of the residence which is taken into account under subsection (e) shall be such cost reduced by the amount of such financing.

(B) Qualified program

For purposes of subparagraph (A), the term "qualified program" means any governmental program providing mortgage loans (other than 1st mortgage loans) or grants—

(i) which restricts (throughout the 9-year period beginning on the date the financing is provided) the resale of the residence to a purchaser qualifying under this section

and to a price determined by an index that reflects less than the full amount of any appreciation in the residence's value, or

(ii) which provides for deferred or reduced interest payments on such financing and grants the governmental unit a share in the appreciation of the residence,

but only if such financing is not provided directly or indirectly through the use of any tax-exempt private activity bond.

(11) Special rules for residences located in disaster areas

In the case of a residence located in an area determined by the President to warrant assistance from the Federal Government under the Robert T. Stafford Disaster Relief and Emergency Assistance Act (as in effect on the date of the enactment of the Taxpayer Relief Act of 1997), this section shall be applied with the following modifications to financing provided with respect to such residence within 2 years after the date of the disaster declaration:

(A) Subsection (d) (relating to 3-year requirement) shall not apply.

(B) Subsections (e) and (f) (relating to purchase price requirement and income requirement) shall be applied as if such residence were a targeted area residence.

The preceding sentence shall apply only with respect to bonds issued after May 1, 2008, and before January 1, 2010.

(12) 1 Special rules for subprime refinancings

(A) In general

Notwithstanding the requirements of subsection (i)(1), the proceeds of a qualified mortgage issue may be used to refinance a mortgage on a residence which was originally financed by the mortgagor through a qualified subprime loan.

(B) Special rules

In applying subparagraph (A) to any refinancing—

(i) subsection (a)(2)(D)(i) shall be applied by substituting "12-month period" for "42-month period" each place it appears,

(ii) subsection (d) (relating to 3-year requirement) shall not apply, and

(iii) subsection (e) (relating to purchase price requirement) shall be applied by using the market value of the residence at the time of refinancing in lieu of the acquisition cost.

(C) Qualified subprime loan

The term "qualified subprime loan" means an adjustable rate single-family residential mortgage loan made after December 31, 2001, and before January 1, 2008, that the bond issuer determines would be reasonably likely to cause financial hardship to the borrower if not refinanced.

(D) Termination

This paragraph shall not apply to any bonds issued after December 31, 2010.

(12) 1 Special rules for residences destroyed in federally declared disasters

(A) Principal residence destroyed

At the election of the taxpayer, if the principal residence (within the meaning of section 121) of such taxpayer is—

(i) rendered unsafe for use as a residence by reason of a federally declared disaster occurring before January 1, 2010, or

(ii) demolished or relocated by reason of an order of the government of a State or political subdivision thereof on account of a federally declared disaster occurring before such date,

then, for the 2-year period beginning on the date of the disaster declaration, subsection (d)(1) shall not apply with respect to such taxpayer and subsection (e) shall be applied by substituting "110" for "90" in paragraph (1) thereof.

(B) Principal residence damaged

(i) In general At the election of the taxpayer, if the principal residence (within the meaning of section 121) of such taxpayer was damaged as the result of a federally declared disaster occurring before January 1, 2010, any owner-financing provided in connection with the repair or reconstruction of such residence shall be treated as a qualified rehabilitation loan.

(ii) Limitation The aggregate owner-financing to which clause (i) applies shall not exceed the lesser of—

(I) the cost of such repair or reconstruction, or

(II) $150,000.

(C) Federally declared disaster

For purposes of this paragraph, the term "federally declared disaster" has the meaning given such term by section 165 (h)(3)(C)(i).

(D) Election; denial of double benefit

(i) Election An election under this paragraph may not be revoked except with the consent of the Secretary.

(ii) Denial of double benefit If a taxpayer elects the application of this paragraph, paragraph (11) shall not apply with respect to the purchase or financing of any residence by such taxpayer.

(l) Additional requirements for qualified veterans' mortgage bonds

An issue meets the requirements of this subsection only if it meets the requirements of paragraphs (1), (2), and (3).

(1) Veterans to whom financing may be provided

An issue meets the requirements of this paragraph only if each mortgagor to whom financing is provided under the issue is a qualified veteran.

(2) Requirement that State program be in effect before June 22, 1984

An issue meets the requirements of this paragraph only if it is a general obligation of a State which issued qualified veterans' mortgage bonds before June 22, 1984.

(3) Volume limitation

(A) In general

An issue meets the requirements of this paragraph only if the aggregate amount of bonds issued pursuant thereto (when added to the aggregate amount of qualified veterans' mortgage bonds previously issued by the State during the calendar year) does not exceed the State veterans limit for such calendar year.

(B) State veterans limit

(i) In general In the case of any State to which clause (ii) does not apply, the State veterans limit for any calendar year is the amount equal to—

(I) the aggregate amount of qualified veterans bonds issued by such State during the period beginning on January 1, 1979, and ending on June 22, 1984 (not including the amount of any qualified veterans bond issued by such State during the calendar year (or portion thereof) in such period for which the amount of such bonds so issued was the lowest), divided by

(II) the number (not to exceed 5) of calendar years after 1979 and before 1985 during which the State issued qualified veterans bonds (determined by only taking into account bonds issued on or before June 22, 1984).

(ii) Alaska, Oregon, and Wisconsin In the case of the following States, the State veterans limit for any calendar year is the amount equal to—

(I) $100,000,000 for the State of Alaska,

(II) $100,000,000 for the State of Oregon, and

(III) $100,000,000 for the State of Wisconsin.

(iii) Phasein In the case of calendar years beginning before 2010, clause (ii) shall be applied by substituting for each of the dollar amounts therein an amount equal to the applicable percentage of such dollar amount. For purposes of the preceding sentence, the applicable percentage shall be determined in accordance with the following table:

For Calendar Year:	Applicable percentage is:
2006	20 percent
2007	40 percent
2008	60 percent
2009	80 percent.

(C) Treatment of refunding issues

(i) In general For purposes of subparagraph (A), the term "qualified veterans' mortgage bond" shall not include any bond issued to refund another bond but only if the maturity date of the refunding bond is not later than the later of—

(I) the maturity date of the bond to be refunded, or

(II) the date 32 years after the date on which the refunded bond was issued (or in the case of a series of refundings, the date on which the original bond was issued). The preceding sentence shall apply only to the extent that the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(ii) Exception for advance refunding Clause (i) shall not apply to any bond issued to advance refund another bond.

(4) Qualified veteran

For purposes of this subsection, the term "qualified veteran" means any veteran who—

(A) served on active duty, and

(B) applied for the financing before the date 25 years after the last date on which such veteran left active service.

(5) Special rule for certain short-term bonds

In the case of any bond—

(A) which has a term of 1 year or less,

(B) which is authorized to be issued under O.R.S. 407.435 (as in effect on the date of the enactment of this subsection), to provide financing for property taxes, and

(C) which is redeemed at the end of such term,

the amount taken into account under this subsection with respect to such bond shall be 1/15 of its principal amount.

(m) Recapture of portion of Federal subsidy from use of qualified mortgage bonds and mortgage credit certificates

(1) In general

If, during the taxable year, any taxpayer disposes of an interest in a residence with respect to which there is or was any federally-subsidized indebtedness for the payment of which the taxpayer was liable in whole or part, then the taxpayer's tax imposed by this chapter for such taxable year shall be increased by the lesser of—

(A) the recapture amount with respect to such indebtedness, or

(B) 50 percent of the gain (if any) on the disposition of such interest.

(2) Exceptions

Paragraph (1) shall not apply to—

(A) any disposition by reason of death, and

(B) any disposition which is more than 9 years after the testing date.

(3) Federally-subsidized indebtedness

For purposes of this subsection—

(A) In general

The term "federally-subsidized indebtedness" means any indebtedness if—

(i) financing for the indebtedness was provided in whole or part from the proceeds of any tax-exempt qualified mortgage bond, or

(ii) any credit was allowed under section 25 (relating to interest on certain home mortgages) to the taxpayer for interest paid or incurred on such indebtedness.

(B) Exception for home improvement loans

Such term shall not include any indebtedness to the extent such indebtedness is federally-subsidized indebtedness solely by reason of being a qualified home improvement loan (as defined in subsection (k)(4)).

(4) Recapture amount

For purposes of this subsection—

(A) In general

The recapture amount with respect to any indebtedness is the amount equal to the product of—

(i) the federally-subsidized amount with respect to the indebtedness,

(ii) the holding period percentage, and

(iii) the income percentage.

(B) Federally-subsidized amount

The federally-subsidized amount with respect to any indebtedness is the amount equal to 6.25 percent of the highest principal amount of the indebtedness for which the taxpayer was liable.

(C) Holding period percentage

(i) In general The term "holding period percentage" means the percentage determined in accordance with the following table: If the disposition occurs during a year after the The holding period testing date which is: percentage is: The 1st such year 20 The 2d such year 40 The 3d such year 60 The 4th such year 80 The 5th such year 100 The 6th such year 80 The 7th such year 60 The 8th such year 40 The 9th such year 20.

(ii) Retirements of indebtedness If the federally-subsidized indebtedness is completely repaid during any year of the 4-year period beginning on the testing date, the holding period percentage for succeeding years shall be determined by reducing ratably to zero over the succeeding 5 years the holding period percentage which would have been determined under this subparagraph had the taxpayer disposed of his interest in the residence on the date of the repayment.

(D) Testing date

The term "testing date" means the earliest date on which all of the following requirements are met:

(i) The indebtedness is federally-subsidized indebtedness.

(ii) The taxpayer is liable in whole or part for payment of the indebtedness.

(E) Income percentage

The term "income percentage" means the percentage (but not greater than 100 percent) which—

(i) the excess of—

(I) the modified adjusted gross income of the taxpayer for the taxable year in which the disposition occurs, over

(II) the adjusted qualifying income for such taxable year, bears to

(ii) $5,000.

The percentage determined under the preceding sentence shall be rounded to the nearest whole percentage point (or, if it includes a half of a percentage point, shall be increased to the nearest whole percentage point).

(5) Adjusted qualifying income; modified adjusted gross income

(A) Adjusted qualifying income

For purposes of paragraph (4), the term "adjusted qualifying income" means the product of—

(i) the highest family income which (as of the date the financing was provided) would have met the requirements of subsection (f) with respect to the residents, and

(ii) 1.05 to the nth power where "n" equals the number of full years during the period beginning on the date the financing was provided and ending on the date of the disposition.

For purposes of clause (i), highest family income shall be determined without regard to subsection (f)(3)(A) and on the basis of the number of members of the taxpayer's family as of the date of the disposition.

(B) Modified adjusted gross income

For purposes of paragraph (4), the term "modified adjusted gross income" means adjusted gross income—

(i) increased by the amount of interest received or accrued by the taxpayer during the taxable year which is excluded from gross income under section 103, and

(ii) decreased by the amount of gain (if any) included in gross income of the taxpayer by reason of the disposition to which this subsection applies.

(6) Special rules relating to limitation on recapture amount based on gain realized

(A) In general

For purposes of paragraph (1), gain shall be taken into account whether or not recognized, and the adjusted basis of the taxpayer's interest in the residence shall be determined without regard to sections 1033 (b) and 1034 (e) (as in effect on the day before the date of the enactment of the Taxpayer Relief Act of 1997) for purposes of determining gain.

(B) Dispositions other than sales, exchanges, and involuntary conversions

In the case of a disposition other than a sale, exchange, or involuntary conversion, gain shall be determined as if the interest had been sold for its fair market value.

(C) Involuntary conversions resulting from casualties

In the case of property which (as a result of its destruction in whole or in part by fire, storm, or other casualty) is compulsorily or involuntarily converted, paragraph (1) shall not apply to such conversion if the taxpayer purchases (during the period specified in section 1033 (a)(2)(B)) property for use as his principal residence on the site of the converted property. For purposes of subparagraph (A), the adjusted basis of the taxpayer in the residence shall not be adjusted for any gain or loss on a conversion to which this subparagraph applies.

(7) Issuer to inform mortgagor of federally-subsidized amount and family income limits

The issuer of the issue which provided the federally-subsidized indebtedness to the mortgagor shall—

(A) at the time of settlement, provide a written statement informing the mortgagor of the potential recapture under this subsection, and

(B) not later than 90 days after the date such indebtedness is provided, provide a written statement to the mortgagor specifying—

(i) the federally-subsidized amount with respect to such indebtedness, and

(ii) the adjusted qualifying income (as defined in paragraph (5)) for each category of family size for each year of the 9-year period beginning on the date the financing was provided.

(8) Special rules

(A) No basis adjustment

No adjustment shall be made to the basis of any property for the increase in tax under this subsection.

(B) Special rule where 2 or more persons hold interests in residence

Except as provided in subparagraph (C) and in regulations prescribed by the Secretary, if 2 or more persons hold interests in any residence and are jointly liable for the federally-subsidized indebtedness, the recapture amount shall be determined separately with respect to their respective interests in the residence.

(C) Transfers to spouses and former spouses

Paragraph (1) shall not apply to any transfer on which no gain or loss is recognized under section 1041. In any such case, the transferee shall be treated under this subsection in the same manner as the transferor would have been treated had such transfer not occurred.

(D) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out this subsection, including regulations dealing with dispositions of partial interests in a residence.

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[1] So in original. Two pars. (12) have been enacted.

26 USC § 144 - Qualified small issue bond; qualified student loan bond; qualified redevelopment bond

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Qualified small issue bond

(1) In general

For purposes of this part, the term "qualified small issue bond" means any bond issued as part of an issue the aggregate authorized face amount of which is $1,000,000 or less and 95 percent or more of the net proceeds of which are to be used—

(A) for the acquisition, construction, reconstruction, or improvement of land or property of a character subject to the allowance for depreciation, or

(B) to redeem part or all of a prior issue which was issued for purposes described in subparagraph (A) or this subparagraph.

(2) Certain prior issues taken into account

If—

(A) the proceeds of 2 or more issues of bonds (whether or not the issuer of each such issue is the same) are or will be used primarily with respect to facilities located in the same incorporated municipality or located in the same county (but not in any incorporated municipality),

(B) the principal user of such facilities is or will be the same person or 2 or more related persons, and

(C) but for this paragraph, paragraph (1) (or the corresponding provision of prior law) would apply to each such issue,

then, for purposes of paragraph (1), in determining the aggregate face amount of any later issue there shall be taken into account the aggregate face amount of tax-exempt bonds issued under all prior such issues and outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(3) Related persons

For purposes of this subsection, a person is a related person to another person if—

(A) the relationship between such persons would result in a disallowance of losses under section 267 or 707 (b), or

(B) such persons are members of the same controlled group of corporations (as defined in section 1563 (a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein).

(4) $10,000,000 limit in certain cases

(A) In general

At the election of the issuer with respect to any issue, this subsection shall be applied—

(i) by substituting "$10,000,000" for "$1,000,000" in paragraph (1), and

(ii) in determining the aggregate face amount of such issue, by taking into account not only the amount described in paragraph (2), but also the aggregate amount of capital expenditures with respect to facilities described in subparagraph (B) paid or incurred during the 6-year period beginning 3 years before the date of such issue and ending 3 years after such date (and financed otherwise than out of the proceeds of outstanding tax-exempt issues to which paragraph (1) (or the corresponding provision of prior law) applied), as if the aggregate amount of such capital expenditures constituted the face amount of a prior outstanding issue described in paragraph (2).

(B) Facilities taken into account

For purposes of subparagraph (A)(ii), the facilities described in this subparagraph are facilities—

(i) located in the same incorporated municipality or located in the same county (but not in any incorporated municipality), and

(ii) the principal user of which is or will be the same person or 2 or more related persons.

For purposes of clause (i), the determination of whether or not facilities are located in the same governmental unit shall be made as of the date of issue of the issue in question.

(C) Certain capital expenditures not taken into account

For purposes of subparagraph (A)(ii), any capital expenditure—

(i) to replace property destroyed or damaged by fire, storm, or other casualty, to the extent of the fair market value of the property replaced,

(ii) required by a change made after the date of issue of the issue in question in a Federal or State law or local ordinance of general application or required by a change made after such date in rules and regulations of general application issued under such a law or ordinance,

(iii) required by circumstances which could not be reasonably foreseen on such date of issue or arising out of a mistake of law or fact (but the aggregate amount of expenditures not taken into account under this clause with respect to any issue shall not exceed $1,000,000), or

(iv) described in clause (i) or (ii) of section 41 (b)(2)(A) for which a deduction was allowed under section 174 (a),

shall not be taken into account.

(D) Limitation on loss of tax exemption

In applying subparagraph (A)(ii) with respect to capital expenditures made after the date of any issue, no bond issued as a part of such issue shall cease to be treated as a qualified small issue bond by reason of any such expenditure for any period before the date on which such expenditure is paid or incurred.

(E) Certain refinancing issues

In the case of any issue described in paragraph (1)(B), an election may be made under subparagraph (A) of this paragraph only if all of the prior issues being redeemed are issues to which paragraph (1) (or the corresponding provision of prior law) applied. In applying subparagraph (A)(ii) with respect to such a refinancing issue, capital expenditures shall be taken into account only for purposes of determining whether the prior issues being redeemed qualified (and would have continued to qualify) under paragraph (1) (or the corresponding provision of prior law).

(F) Aggregate amount of capital expenditures where there is urban development action grant

In the case of any issue 95 percent or more of the net proceeds of which are to be used to provide facilities with respect to which an urban development action grant has been made under section 119 of the Housing and Community Development Act of 1974, capital expenditures of not to exceed $10,000,000 shall not be taken into

account for purposes of applying subparagraph (A)(ii). This subparagraph shall not apply to bonds issued after December 31, 2006.

[LII]

(G) Additional capital expenditures not taken into account

With respect to bonds issued after December 31, 2006, in addition to any capital expenditure described in subparagraph (C), capital expenditures of not to exceed $10,000,000 shall not be taken into account for purposes of applying subparagraph (A)(ii).

(5) Issues for residential purposes

This subsection shall not apply to any bond issued as part of an issue 5 percent or more of the net proceeds of which are to be used directly or indirectly to provide residential real property for family units.

(6) Limitations on treatment of bonds as part of the same issue

(A) In general

For purposes of this subsection, separate lots of bonds which (but for this subparagraph) would be treated as part of the same issue shall be treated as separate issues unless the proceeds of such lots are to be used with respect to 2 or more facilities—

(i) which are located in more than 1 State, or

(ii) which have, or will have, as the same principal user the same person or related persons.

(B) Franchises

For purposes of subparagraph (A), a person (other than a governmental unit) shall be considered a principal user of a facility if such person (or a group of related persons which includes such person)—

(i) guarantees, arranges, participates in, or assists with the issuance (or pays any portion of the cost of issuance) of any bond the proceeds of which are to be used to finance or refinance such facility, and

(ii) provides any property, or any franchise, trademark, or trade name (within the meaning of section 1253), which is to be used in connection with such facility.

(7) Subsection not to apply if bonds issued with certain other tax-exempt bonds

This subsection shall not apply to any bond issued as part of an issue (other than an issue to which paragraph (4) applies) if the interest on any other bond which is part of such issue is excluded from gross income under any provision of law other than this subsection.

(8) Restrictions on financing certain facilities

This subsection shall not apply to an issue if—

(A) more than 25 percent of the net proceeds of the issue are to be used to provide a facility the primary purpose of which is one of the following: retail food and beverage services, automobile sales or service, or the provision of recreation or entertainment; or

(B) any portion of the proceeds of the issue is to be used to provide the following: any private or commercial golf course, country club, massage parlor, tennis club, skating facility (including roller skating, skateboard, and ice skating), racquet sports facility (including any handball or racquetball court), hot tub facility, suntan facility, or racetrack.

(9) Aggregation of issues with respect to single project

For purposes of this subsection, 2 or more issues part or all of the net proceeds of which are to be used with respect to a single building, an enclosed shopping mall, or a strip of offices, stores, or warehouses using substantial common facilities shall be treated as 1 issue (and any person who is a principal user with respect to any of such issues shall be treated as a principal user with respect to the aggregated issue).

(10) Aggregate limit per taxpayer

(A) In general

This subsection shall not apply to any issue if the aggregate authorized face amount of such issue allocated to any test-period beneficiary (when increased by the outstanding tax-exempt facility-related bonds of such beneficiary) exceeds $40,000,000.

(B) Outstanding tax-exempt facility-related bonds

(i) In general For purposes of applying subparagraph (A) with respect to any issue, the outstanding tax-exempt facility-related bonds of any person who is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in clause (ii)—

(I) which are allocated to such beneficiary, and

(II) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(ii) Bonds taken into account For purposes of clause (i), the bonds referred to in this clause are—

(I) exempt facility bonds, qualified small issue bonds, and qualified redevelopment bonds, and

(II) industrial development bonds (as defined in section 103 (b)(2), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) to which section 141 (a) does not apply.

(C) Allocation of face amount of issue

(i) In general Except as otherwise provided in regulations, the portion of the face amount of an issue allocated to any test-period beneficiary of a facility financed by the proceeds of such issue (other than an owner of such facility) is an amount which bears the same relationship to the entire face amount of such issue as the portion of such facility used by such beneficiary bears to the entire facility.

(ii) Owners Except as otherwise provided in regulations, the portion of the face amount of an issue allocated to any test-period beneficiary who is an owner of a facility financed by the proceeds of such issue is an amount which bears the same relationship to the entire face amount of such issue as the portion of such facility owned by such beneficiary bears to the entire facility.

(D) Test-period beneficiary

For purposes of this paragraph, except as provided in regulations, the term "test-period beneficiary" means any person who is an owner or a principal user of facilities being financed by the issue at any time during the 3-year period beginning on the later of—

(i) the date such facilities were placed in service, or

(ii) the date of issue.

(E) Treatment of related persons

For purposes of this paragraph, all persons who are related (within the meaning of paragraph (3)) to each other shall be treated as 1 person.

(11) Limitation on acquisition of depreciable farm property

(A) In general

This subsection shall not apply to any issue if more than $250,000 of the net proceeds of such issue are to be used to provide depreciable farm property with respect to which the principal user is or will be the same person or 2 or more related persons.

(B) Depreciable farm property

For purposes of this paragraph, the term "depreciable farm property" means property of a character subject to the allowance for depreciation which is to be used in a trade or business of farming.

(C) Prior issues taken into account

In determining the amount of proceeds of an issue to be used as described in subparagraph (A), there shall be taken into account the aggregate amount of each prior issue to which paragraph (1) (or the corresponding provisions of prior law) applied which were or will be so used.

(12) Termination dates

(A) In general

This subsection shall not apply to—

(i) any bond (other than a bond described in clause (ii)) issued after December 31, 1986, or

(ii) any bond (or series of bonds) issued to refund a bond issued on or before such date unless—

(I) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue,

(II) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond, and

(III) the net proceeds of the refunding bond are used to redeem the refunded bond not later than 90 days after the date of the issuance of the refunding bond.

For purposes of clause (ii)(I), average maturity shall be determined in accordance with section 147 (b)(2)(A).

(B) Bonds issued to finance manufacturing facilities and farm property

Subparagraph (A) shall not apply to any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide—

(i) any manufacturing facility, or

(ii) any land or property in accordance with section 147 (c)(2).

(C) Manufacturing facility

For purposes of this paragraph—

(i) In general The term "manufacturing facility" means any facility which is used in the manufacturing or production of tangible personal property (including the processing resulting in a change in the condition of such property). A rule similar to the rule of section 142 (b)(2) shall apply for purposes of the preceding sentence.

(ii) Certain facilities included Such term includes facilities which are directly related and ancillary to a manufacturing facility (determined without regard to this clause) if—

(I) such facilities are located on the same site as the manufacturing facility, and

(II) not more than 25 percent of the net proceeds of the issue are used to provide such facilities.

(iii) Special rules for bonds issued in 2009 and 2010 In the case of any issue made after the date of enactment of this clause and before January 1, 2011, clause (ii) shall not apply and the net proceeds from a bond shall be considered to be used to provide a manufacturing facility if such proceeds are used to provide—

(I) a facility which is used in the creation or production of intangible property which is described in section 197 (d)(1)(C)(iii), or

(II) a facility which is functionally related and subordinate to a manufacturing facility (determined without regard to this subclause) if such facility is located on the same site as the manufacturing facility.

(b) Qualified student loan bond

For purposes of this part—

(1) In general

The term "qualified student loan bond" means any bond issued as part of an issue the applicable percentage or more of the net proceeds of which are to be used directly or indirectly to make or finance student loans under—

(A) a program of general application to which the Higher Education Act of 1965 applies if—

(i) limitations are imposed under the program on—

(I) the maximum amount of loans outstanding to any student, and

(II) the maximum rate of interest payable on any loan,

(ii) the loans are directly or indirectly guaranteed by the Federal Government,

(iii) the financing of loans under the program is not limited by Federal law to the proceeds of tax-exempt bonds, and

(iv) special allowance payments under section 438 of the Higher Education Act of 1965—

(I) are authorized to be paid with respect to loans made under the program, or

(II) would be authorized to be made with respect to loans under the program if such loans were not financed with the proceeds of tax-exempt bonds, or

(B) a program of general application approved by the State if no loan under such program exceeds the difference between the total cost of attendance and other forms of student assistance (not including loans pursuant to section 428B(a)(1) of the Higher Education Act of 1965 (relating to parent loans) or subpart I [1] of part C of title VII of the Public Health Service Act (relating to student assistance)) for which the student borrower may be eligible. A program shall not be treated as described in this subparagraph if such program is described in subparagraph (A).

A bond shall not be treated as a qualified student loan bond if the issue of which such bond is a part meets the private business tests of paragraphs (1) and (2) of section 141 (b) (determined by treating 501(c)(3) organizations as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513 (a)).

(2) Applicable percentage

For purposes of paragraph (1), the term "applicable percentage" means—

(A) 90 percent in the case of the program described in paragraph (1)(A), and

(B) 95 percent in the case of the program described in paragraph (1)(B).

(3) Student borrowers must be residents of issuing State, etc.

A student loan shall be treated as being made or financed under a program described in paragraph (1) with respect to an issue only if the student is—

(A) a resident of the State from which the volume cap under section 146 for such loan was derived, or

(B) enrolled at an educational institution located in such State.

(4) Discrimination on basis of school location not permitted

A program shall not be treated as described in paragraph (1)(A) if such program discriminates on the basis of the location (in the United States) of the educational institution in which the student is enrolled.

(c) Qualified redevelopment bond

For purposes of this part—

(1) In general

The term "qualified redevelopment bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used for 1 or more redevelopment purposes in any designated blighted area.

(2) Additional requirements

A bond shall not be treated as a qualified redevelopment bond unless—

(A) the issue described in paragraph (1) is issued pursuant to—

(i) a State law which authorizes the issuance of such bonds for redevelopment purposes in blighted areas, and

(ii) a redevelopment plan which is adopted before such issuance by the governing body described in paragraph (4)(A) with respect to the designated blighted area,

(B)

(i) the payment of the principal and interest on such issue is primarily secured by taxes of general applicability imposed by a general purpose governmental unit, or

(ii) any increase in real property tax revenues (attributable to increases in assessed value) by reason of the carrying out of such purposes in such area is reserved exclusively for debt service on such issue (and similar issues) to the extent such increase does not exceed such debt service,

(C) each interest in real property located in such area—

(i) which is acquired by a governmental unit with the proceeds of the issue, and

(ii) which is transferred to a person other than a governmental unit,

is transferred for fair market value,

(D) the financed area with respect to such issue meets the no additional charge requirements of paragraph (5), and

(E) the use of the proceeds of the issue meets the requirements of paragraph (6).

(3) Redevelopment purposes

For purposes of paragraph (1)—

(A) In general

The term "redevelopment purposes" means, with respect to any designated blighted area—

(i) the acquisition (by a governmental unit having the power to exercise eminent domain) of real property located in such area,

(ii) the clearing and preparation for redevelopment of land in such area which was acquired by such governmental unit,

(iii) the rehabilitation of real property located in such area which was acquired by such governmental unit, and

(iv) the relocation of occupants of such real property.

(B) New construction not permitted

The term "redevelopment purposes" does not include the construction (other than the rehabilitation) of any property or the enlargement of an existing building.

(4) Designated blighted area

For purposes of this subsection—

(A) In general

The term "designated blighted area" means any blighted area designated by the governing body of a local general purpose governmental unit in the jurisdiction of which such area is located.

(B) Blighted area

The term "blighted area" means any area which the governing body described in subparagraph (A) determines to be a blighted area on the basis of the substantial

presence of factors such as excessive vacant land on which structures were previously located, abandoned or vacant buildings, substandard structures, vacancies, and delinquencies in payment of real property taxes.

(C) Designated areas may not exceed 20 percent of total assessed value of real property in government's jurisdiction

(i) In general An area may be designated by a governmental unit as a blighted area only if the designation percentage with respect to such area, when added to the designation percentages of all other designated blighted areas within the jurisdiction of such governmental unit, does not exceed 20 percent.

(ii) Designation percentage For purposes of this subparagraph, the term "designation percentage" means, with respect to any area, the percentage (determined at the time such area is designated) which the assessed value of real property located in such area is of the total assessed value of all real property located within the jurisdiction of the governmental unit which designated such area.

(iii) Exception where bonds not outstanding The designation percentage of a previously designated blighted area shall not be taken into account under clause (i) if no qualified redevelopment bond (or similar bond) is or will be outstanding with respect to such area.

(D) Minimum designated area

(i) In general Except as provided in clause (ii), an area shall not be treated as a designated blighted area for purposes of this subsection unless such area is contiguous and compact and its area equals or exceeds 100 acres.

(ii) 10-acre minimum in certain cases Clause (i) shall be applied by substituting "10 acres" for "100 acres" if not more than 25 percent of the financed area is to be provided (pursuant to the issue and all other such issues) to 1 person. For purposes of the preceding sentence, all related persons (as defined in subsection (a)(3)) shall be treated as 1 person. For purposes of this clause, an area provided to a developer on a short-term interim basis shall not be treated as provided to such developer.

(5) No additional charge requirements

The financed area with respect to any issue meets the requirements of this paragraph if, while any bond which is part of such issue is outstanding—

(A) no owner or user of property located in the financed area is subject to a charge or fee which similarly situated owners or users of comparable property located outside such area are not subject, and

(B) the assessment method or rate of real property taxes with respect to property located in the financed area does not differ from the assessment method or rate of real property taxes with respect to comparable property located outside such area.

For purposes of the preceding sentence, the term "comparable property" means property which is of the same type as the property to which it is being compared and which is located within the jurisdiction of the designating governmental unit.

(6) Use of proceeds requirements

The use of the proceeds of an issue meets the requirements of this paragraph if—

(A) not more than 25 percent of the net proceeds of such issue are to be used to provide (including the provision of land for) facilities described in subsection (a)(8) orsection 147 (e), and

(B) no portion of the proceeds of such issue is to be used to provide (including the provision of land for) any private or commercial golf course, country club, massage parlor, hot tub facility, suntan facility, racetrack or other facility used for gambling, or any store the principal business of which is the sale of alcoholic beverages for consumption off premises.

(7) Financed area

For purposes of this subsection, the term "financed area" means, with respect to any issue, the portion of the designated blighted area with respect to which the proceeds of such issue are to be used.

(8) Restriction on acquisition of land not to apply

Section 147 (c) (other than paragraphs (1)(B) and (2) thereof) shall not apply to any qualified redevelopment bond.

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[1] See References in Text note below.

26 USC § 145 - Qualified 501(c)(3) bond

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) In general

For purposes of this part, except as otherwise provided in this section, the term "qualified 501(c)(3) bond" means any private activity bond issued as part of an issue if—

(1) all property which is to be provided by the net proceeds of the issue is to be owned by a 501(c)(3) organization or a governmental unit, and

(2) such bond would not be a private activity bond if—

(A) 501(c)(3) organizations were treated as governmental units with respect to their activities which do not constitute unrelated trades or businesses, determined by applying section 513 (a), and

(B) paragraphs (1) and (2) of section 141 (b) were applied by substituting "5 percent" for "10 percent" each place it appears and by substituting "net proceeds" for "proceeds" each place it appears.

(b) $150,000,000 limitation on bonds other than hospital bonds

(1) In general

A bond (other than a qualified hospital bond) shall not be treated as a qualified 501(c)(3) bond if the aggregate authorized face amount of the issue (of which such bond is a part) allocated to any 501(c)(3) organization which is a test-period beneficiary (when increased by the outstanding tax-exempt nonhospital bonds of such organization) exceeds $150,000,000.

(2) Outstanding tax-exempt nonhospital bonds

(A) In general

For purposes of applying paragraph (1) with respect to any issue, the outstanding tax-exempt nonhospital bonds of any organization which is a test-period beneficiary with respect to such issue is the aggregate amount of tax-exempt bonds referred to in subparagraph (B)—

(i) which are allocated to such organization, and

(ii) which are outstanding at the time of such later issue (not including as outstanding any bond which is to be redeemed (other than in an advance refunding) from the net proceeds of the later issue).

(B) Bonds taken into account

For purposes of subparagraph (A), the bonds referred to in this subparagraph are—

(i) any qualified 501(c)(3) bond other than a qualified hospital bond, and

(ii) any bond to which section 141 (a) does not apply if—

(I) such bond would have been an industrial development bond (as defined in section 103 (b)(2), as in effect on the day before the date of the enactment of the Tax Reform Act of 1986) if 501(c)(3) organizations were not exempt persons, and

(II) such bond was not described in paragraph (4), (5), or (6) of such section 103 (b) (as in effect on the date such bond was issued).

(C) Only nonhospital portion of bonds taken into account

(i) In general A bond shall be taken into account under subparagraph (B) only to the extent that the proceeds of the issue of which such bond is a part are not used with respect to a hospital.

(ii) Special rule If 90 percent or more of the net proceeds of an issue are used with respect to a hospital, no bond which is part of such issue shall be taken into account under subparagraph (B)(ii).

(3) Aggregation rule

For purposes of this subsection, 2 or more organizations under common management or control shall be treated as 1 organization.

(4) Allocation of face amount of issue; test-period beneficiary

Rules similar to the rules of subparagraphs (C), (D), and (E) of section 144 (a)(10) shall apply for purposes of this subsection.

(5) Termination of limitation

This subsection shall not apply with respect to bonds issued after the date of the enactment of this paragraph as part of an issue 95 percent or more of the net proceeds of which are to be used to finance capital expenditures incurred after such date.

(c) Qualified hospital bond

For purposes of this section, the term "qualified hospital bond" means any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used with respect to a hospital.

(d) Restrictions on bonds used to provide residential rental housing for family units

(1) In general

Except as otherwise provided in this subsection, a bond which is part of an issue shall not be a qualified 501(c)(3) bond if any portion of the net proceeds of the issue are to be used directly or indirectly to provide residential rental property for family units.

(2) Exception for bonds used to provide qualified residential rental projects

Paragraph (1) shall not apply to any bond issued as part of an issue if the portion of such issue which is to be used as described in paragraph (1) is to be used to provide—

(A) a residential rental property for family units if the first use of such property is pursuant to such issue,

(B) qualified residential rental projects (as defined in section 142 (d)), or

(C) property which is to be substantially rehabilitated in a rehabilitation beginning within the 2-year period ending 1 year after the date of the acquisition of such property.

(3) Certain property treated as new property

Solely for purposes of determining under paragraph (2)(A) whether the 1st use of property is pursuant to tax-exempt financing—

(A) In general

If—

(i) the 1st use of property is pursuant to taxable financing,

(ii) there was a reasonable expectation (at the time such taxable financing was provided) that such financing would be replaced by tax-exempt financing, and

(iii) the taxable financing is in fact so replaced within a reasonable period after the taxable financing was provided,

then the 1st use of such property shall be treated as being pursuant to the tax-exempt financing.

(B) Special rule where no operating State or local program for tax-exempt financing

If, at the time of the 1st use of property, there was no operating State or local program for tax-exempt financing of the property, the 1st use of the property shall be treated as pursuant to the 1st tax-exempt financing of the property.

(C) Definitions

For purposes of this paragraph—

(i) Tax-exempt financing The term "tax-exempt financing" means financing provided by tax-exempt bonds.

(ii) Taxable financing The term "taxable financing" means financing which is not tax-exempt financing.

(4) Substantial rehabilitation

(A) In general

Except as provided in subparagraph (B), rules similar to the rules of section 47 (c)(1)(C) shall apply in determining for purposes of paragraph (2)(C) whether property is substantially rehabilitated.

(B) Exception

For purposes of subparagraph (A), clause (ii) of section 47 (c)(1)(C) shall not apply, but the Secretary may extend the 24-month period in section 47 (c)(1)(C)(i) where appropriate due to circumstances not within the control of the owner.

(e) Election out

This section shall not apply to an issue if—

(1) the issuer elects not to have this section apply to such issue, and

(2) such issue is an issue of exempt facility bonds, or qualified redevelopment bonds, to which section 146 applies.

26 USC § 146 - Volume cap

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) General rule

A private activity bond issued as part of an issue meets the requirements of this section if the aggregate face amount of the private activity bonds issued pursuant to such issue, when added to the aggregate face amount of tax-exempt private activity bonds previously issued by the issuing authority during the calendar year, does not exceed such authority's volume cap for such calendar year.

(b) Volume cap for State agencies

For purposes of this section—

(1) In general

The volume cap for any agency of the State authorized to issue tax-exempt private activity bonds for any calendar year shall be 50 percent of the State ceiling for such calendar year.

(2) Special rule where State has more than 1 agency

If more than 1 agency of the State is authorized to issue tax-exempt private activity bonds, all such agencies shall be treated as a single agency.

(c) Volume cap for other issuers

For purposes of this section—

(1) In general

The volume cap for any issuing authority (other than a State agency) for any calendar year shall be an amount which bears the same ratio to 50 percent of the State ceiling for such calendar year as—

(A) the population of the jurisdiction of such issuing authority, bears to

(B) the population of the entire State.

(2) Overlapping jurisdictions

For purposes of paragraph (1)(A), if an area is within the jurisdiction of 2 or more governmental units, such area shall be treated as only within the jurisdiction of the unit having jurisdiction over the smallest geographical area unless such unit agrees to surrender all or part of such jurisdiction for such calendar year to the unit with overlapping jurisdiction which has the next smallest geographical area.

(d) State ceiling

For purposes of this section—

(1) In general

The State ceiling applicable to any State for any calendar year shall be the greater of—

(A) an amount equal to $75 ($62.50 in the case of calendar year 2001) multiplied by the State population, or

(B) $225,000,000 ($187,500,000 in the case of calendar year 2001).

(2) Cost-of-living adjustment

In the case of a calendar year after 2002, each of the dollar amounts contained in paragraph (1) shall be increased by an amount equal to—

(A) such dollar amount, multiplied by

(B) the cost-of-living adjustment determined under section 1 (f)(3) for such calendar year by substituting "calendar year 2001" for "calendar year 1992" in subparagraph (B) thereof.

If any increase determined under the preceding sentence is not a multiple of $5 ($5,000 in the case of the dollar amount in paragraph (1)(B)), such increase shall be rounded to the nearest multiple thereof.

(3) Special rule for States with constitutional home rule cities

For purposes of this section—

(A) In general

The volume cap for any constitutional home rule city for any calendar year shall be determined under paragraph (1) of subsection (c) by substituting "100 percent" for "50 percent".

(B) Coordination with other allocations

In the case of any State which contains 1 or more constitutional home rule cities, for purposes of applying subsections (b) and (c) with respect to issuing authorities in such State other than constitutional home rule cities, the State ceiling for any calendar year shall be reduced by the aggregate volume caps determined for such year for all constitutional home rule cities in such State.

(C) Constitutional home rule city

For purposes of this section, the term "constitutional home rule city" means, with respect to any calendar year, any political subdivision of a State which, under a State constitution which was adopted in 1970 and effective on July 1, 1971, had home rule powers on the 1st day of the calendar year.

(4) Special rule for possessions with populations of less than the population of the least populous State

(A) In general

If the population of any possession of the United States for any calendar year is less than the population of the least populous State (other than a possession) for such calendar year, the limitation under paragraph (1)(A) shall not be less than the amount determined under subparagraph (B) for such calendar year.

(B) Limitation

The limitation determined under this subparagraph, with respect to a possession, for any calendar year is an amount equal to the product of—

(i) the fraction—

(I) the numerator of which is the amount applicable under paragraph (1)(B) for such calendar year, and

(II) the denominator of which is the State population of the least populous State (other than a possession) for such calendar year, and

(ii) the population of such possession for such calendar year.

(5) Increase and set aside for housing bonds for 2008

(A) Increase for 2008

In the case of calendar year 2008, the State ceiling for each State shall be increased by an amount equal to $11,000,000,000 multiplied by a fraction—

(i) the numerator of which is the State ceiling applicable to the State for calendar year 2008, determined without regard to this paragraph, and

(ii) the denominator of which is the sum of the State ceilings determined under clause (i) for all States.

(B) Set aside

(i) In general Any amount of the State ceiling for any State which is attributable to an increase under this paragraph shall be allocated solely for one or more qualified housing issues.

(ii) Qualified housing issue For purposes of this paragraph, the term "qualified housing issue" means—

(I) an issue described in section 142 (a)(7) (relating to qualified residential rental projects), or

(II) a qualified mortgage issue (determined by substituting "12-month period" for "42-month period" each place it appears in section 143 (a)(2)(D)(i)).

(e) State may provide for different allocation

For purposes of this section—

(1) In general

Except as provided in paragraph (3), a State may, by law provide a different formula for allocating the State ceiling among the governmental units (or other authorities) in such State having authority to issue tax-exempt private activity bonds.

(2) Interim authority for Governor

(A) In general

Except as otherwise provided in paragraph (3), the Governor of any State may proclaim a different formula for allocating the State ceiling among the governmental units (or other authorities) in such State having authority to issue private activity bonds.

(B) Termination of authority

The authority provided in subparagraph (A) shall not apply to bonds issued after the earlier of—

(i) the last day of the 1st calendar year after 1986 during which the legislature of the State met in regular session, or

(ii) the effective date of any State legislation with respect to the allocation of the State ceiling.

(3) State may not alter allocation to constitutional home rule cities

Except as otherwise provided in a State constitutional amendment (or law changing the home rule provision adopted in the manner provided by the State constitution), the authority provided in this subsection shall not apply to that portion of the State ceiling which is allocated to any constitutional home rule city in the State unless such city agrees to such different allocation.

(f) Elective carryforward of unused limitation for specified purpose

(1) In general

If—

(A) an issuing authority's volume cap for any calendar year after 1985, exceeds

(B) the aggregate amount of tax-exempt private activity bonds issued during such calendar year by such authority,

such authority may elect to treat all (or any portion) of such excess as a carryforward for 1 or more carryforward purposes.

(2) Election must identify purpose

In any election under paragraph (1), the issuing authority shall—

(A) identify the purpose for which the carryforward is elected, and

(B) specify the portion of the excess described in paragraph (1) which is to be a carryforward for each such purpose.

(3) Use of carryforward

(A) In general

If any issuing authority elects a carryforward under paragraph (1) with respect to any carryforward purpose, any private activity bonds issued by such authority with respect to such purpose during the 3 calendar years following the calendar year in which the carryforward arose shall not be taken into account under subsection (a) to the extent the amount of such bonds does not exceed the amount of the carryforward elected for such purpose.

(B) Order in which carryforward used

Carryforwards elected with respect to any purpose shall be used in the order of the calendar years in which they arose.

(4) Election

Any election under this paragraph (and any identification or specification contained therein), once made, shall be irrevocable.

(5) Carryforward purpose

The term "carryforward purpose" means—

(A) the purpose of issuing exempt facility bonds described in 1 of the paragraphs of section 142 (a),

(B) the purpose of issuing qualified mortgage bonds or mortgage credit certificates,

(C) the purpose of issuing qualified student loan bonds, and

(D) the purpose of issuing qualified redevelopment bonds.

(6) Special rules for increased volume cap under subsection (d)(5)

No amount which is attributable to the increase under subsection (d)(5) may be used—

(A) for any issue other than a qualified housing issue (as defined in subsection (d)(5)), or

(B) to issue any bond after calendar year 2010.

(g) Exception for certain bonds

Only for purposes of this section, the term "private activity bond" shall not include—

(1) any qualified veterans' mortgage bond,

(2) any qualified 501(c)(3) bond,

(3) any exempt facility bond issued as part of an issue described in paragraph (1), (2), (12), (13), (14), or (15) of section 142 (a), and

(4) 75 percent of any exempt facility bond issued as part of an issue described in paragraph (11) of section 142 (a) (relating to high-speed intercity rail facilities).

Paragraph (4) shall be applied without regard to "75 percent of" if all of the property to be financed by the net proceeds of the issue is to be owned by a governmental unit (within the meaning of section 142 (b)(1)).

(h) Exception for government-owned solid waste disposal facilities

(1) In general

Only for purposes of this section, the term "private activity bond" shall not include any exempt facility bond described in section 142 (a)(6) which is issued as part of an issue if all of the property to be financed by the net proceeds of such issue is to be owned by a governmental unit.

(2) Safe harbor for determination of government ownership

In determining ownership for purposes of paragraph (1), section 142 (b)(1)(B) shall apply, except that a lease term shall be treated as satisfying clause (ii) thereof if it is not more than 20 years.

(i) Treatment of refunding issues

For purposes of the volume cap imposed by this section—

(1) In general

The term "private activity bond" shall not include any bond which is issued to refund another bond to the extent that the amount of such bond does not exceed the outstanding amount of the refunded bond.

(2) Special rules for student loan bonds

In the case of any qualified student loan bond, paragraph (1) shall apply only if the maturity date of the refunding bond is not later than the later of—

(A) the average maturity date of the qualified student loan bonds to be refunded by the issue of which the refunding bond is a part, or

(B) the date 17 years after the date on which the refunded bond was issued (or in the case of a series of refundings, the date on which the original bond was issued).

(3) Special rules for qualified mortgage bonds

In the case of any qualified mortgage bond, paragraph (1) shall apply only if the maturity date of the refunding bond is not later than the later of—

(A) the average maturity date of the qualified mortgage bonds to be refunded by the issue of which the refunding bond is a part, or

(B) the date 32 years after the date on which the refunded bond was issued (or in the case of a series of refundings, the date on which the original bond was issued).

(4) Average maturity

For purposes of paragraphs (2) and (3), average maturity shall be determined in accordance with section 147 (b)(2)(A).

(5) Exception for advance refunding

This subsection shall not apply to any bond issued to advance refund another bond.

(6) Treatment of certain residential rental project bonds as refunding bonds irrespective of obligor

(A) In general

If, during the 6-month period beginning on the date of a repayment of a loan financed by an issue 95 percent or more of the net proceeds of which are used to provide projects described in section 142 (d), such repayment is used to provide a new loan for any project so described, any bond which is issued to refinance such issue shall be treated as a refunding issue to the extent the principal amount of such refunding issue does not exceed the principal amount of the bonds refunded.

(B) Limitations

Subparagraph (A) shall apply to only one refunding of the original issue and only if—

(i) the refunding issue is issued not later than 4 years after the date on which the original issue was issued,

(ii) the latest maturity date of any bond of the refunding issue is not later than 34 years after the date on which the refunded bond was issued, and

(iii) the refunding issue is approved in accordance with section 147 (f) before the issuance of the refunding issue.

(j) Population

For purposes of this section, determinations of the population of any State (or issuing authority) shall be made with respect to any calendar year on the basis of the most recent census estimate of the resident population of such State (or issuing authority) released by the Bureau of Census before the beginning of such calendar year.

(k) Facility must be located within State

(1) In general

Except as provided in paragraphs (2) and (3), no portion of the State ceiling applicable to any State for any calendar year may be used with respect to financing for a facility located outside such State.

(2) Exception for certain facilities where State will get proportionate share of benefits

Paragraph (1) shall not apply to any exempt facility bond described in paragraph (4), (5), (6), or (10) of section 142 (a) if the issuer establishes that the State's share of the use of the facility (or its output) will equal or exceed the State's share of the private activity bonds issued to finance the facility.

(3) Treatment of governmental bonds to which volume cap allocated

Paragraph (1) shall not apply to any bond to which volume cap is allocated under section 141 (b)(5)—

(A) for an output facility, or

(B) for a facility of a type described in paragraph (4), (5), (6), or (10) of section 142 (a), if the issuer establishes that the State's share of the private business use (as defined by section 141(b)(6)) of the facility will equal or exceed the State's share of the volume cap allocated with respect to bonds issued to finance the facility.

(l) Issuer of qualified scholarship funding bonds

In the case of a qualified scholarship funding bond, such bond shall be treated for purposes of this section as issued by a State or local issuing authority (whichever is appropriate).

(m) Treatment of amounts allocated to private activity portion of government use bonds

(1) In general

The volume cap of an issuer shall be reduced by the amount allocated by the issuer to an issue under section 141 (b)(5).

(2) Advance refundings

Except as otherwise provided by the Secretary, any advance refunding of any part of an issue to which an amount was allocated under section 141 (b)(5) (or would have been allocated if such section applied to such issue) shall be taken into account under this section to the extent of the amount of the volume cap which was (or would have been) so allocated.

(n) Reduction for mortgage credit certificates, etc.

The volume cap of any issuing authority for any calendar year shall be reduced by the sum of—

(1) the amount of qualified mortgage bonds which such authority elects not to issue under section 25 (c)(2)(A)(ii) during such year, plus

(2) the amount of any reduction in such ceiling under section 25 (f) applicable to such authority for such year.

26 USC § 147 - Other requirements applicable to certain private activity bonds

There are 2 Updates Pending. Select the tab below to view.

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Substantial user requirement

(1) In general

Except as provided in subsection (h), a private activity bond shall not be a qualified bond for any period during which it is held by a person who is a substantial user of the facilities or by a related person of such a substantial user.

(2) Related person

For purposes of paragraph (1), the following shall be treated as related persons—

(A) 2 or more persons if the relationship between such persons would result in a disallowance of losses under section 267 or 707 (b),

(B) 2 or more persons which are members of the same controlled group of corporations (as defined in section 1563 (a), except that "more than 50 percent" shall be substituted for "at least 80 percent" each place it appears therein),

(C) a partnership and each of its partners (and their spouses and minor children), and

(D) an S corporation and each of its shareholders (and their spouses and minor children).

(b) Maturity may not exceed 120 percent of economic life

(1) General rule

Except as provided in subsection (h), a private activity bond shall not be a qualified bond if it is issued as part of an issue and—

(A) the average maturity of the bonds issued as part of such issue, exceeds

(B) 120 percent of the average reasonably expected economic life of the facilities being financed with the net proceeds of such issue.

(2) Determination of averages

For purposes of paragraph (1)—

(A) the average maturity of any issue shall be determined by taking into account the respective issue prices of the bonds issued as part of such issue, and

(B) the average reasonably expected economic life of the facilities being financed with any issue shall be determined by taking into account the respective cost of such facilities.

(3) Special rules

(A) Determination of economic life

For purposes of this subsection, the reasonably expected economic life of any facility shall be determined as of the later of—

(i) the date on which the bonds are issued, or

(ii) the date on which the facility is placed in service (or expected to be placed in service).

(B) Treatment of land

(i) Land not taken into account Except as provided in clause (ii), land shall not be taken into account under paragraph (1)(B).

(ii) Issues where 25 percent or more of proceeds used to finance land If 25 percent or more of the net proceeds of any issue is to be used to finance land, such land shall be taken into account under paragraph (1)(B) and shall be treated as having an economic life of 30 years.

(4) Special rule for pooled financing of 501(c)(3) organization

(A) In general

At the election of the issuer, a qualified 501(c)(3) bond shall be treated as meeting the requirements of paragraph (1) if such bond meets the requirements of subparagraph (B).

(B) Requirements

A qualified 501(c)(3) bond meets the requirements of this subparagraph if—

(I) 95 percent or more of the net proceeds of the issue of which such bond is a part are to be used to make or finance loans to 2 or more 501(c)(3) organizations or governmental units for acquisition of property to be used by such organizations,

(ii) each loan described in clause (i) satisfies the requirements of paragraph (1) (determined by treating each loan as a separate issue),

(iii) before such bond is issued, a demand survey was conducted which shows a demand for financing greater than an amount equal to 120 percent of the lendable proceeds of such issue, and

(iv) 95 percent or more of the net proceeds of such issue are to be loaned to 501(c)(3) organizations or governmental units within 1 year of issuance and, to the extent there are any unspent proceeds after such 1-year period, bonds issued as part of such issue are to be redeemed as soon as possible thereafter (and in no event later than 18 months after issuance).

A bond shall not meet the requirements of this subparagraph if the maturity date of any bond issued as part of such issue is more than 30 years after the date on which the bond was issued (or, in the case of a refunding or series of refundings, the date on which the original bond was issued).

(5) Special rule for certain FHA insured loans

Paragraph (1) shall not apply to any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to finance mortgage loans insured under FHA 242 or under a similar Federal Housing Administration program (as in effect on the date of the enactment of the Tax Reform Act of 1986) where the loan term approved by such Administration plus the maximum maturity of debentures which could be issued by such Administration in satisfaction of its obligations exceeds the term permitted under paragraph (1).

(c) Limitation on use for land acquisition

(1) In general

Except as provided in subsection (h), a private activity bond shall not be a qualified bond if—

(A) it is issued as part of an issue and 25 percent or more of the net proceeds of such issue are to be used (directly or indirectly) for the acquisition of land (or an interest therein), or

(B) any portion of the proceeds of such issue is to be used (directly or indirectly) for the acquisition of land (or an interest therein) to be used for farming purposes.

(2) Exception for first-time farmers

(A) In general

If the requirements of subparagraph (B) are met with respect to any land, paragraph (1) shall not apply to such land, and subsection (d) shall not apply to property to be used thereon for farming purposes, but only to the extent of expenditures (financed with the proceeds of the issue) not in excess of $450,000.

(B) Acquisition by first-time farmers

The requirements of this subparagraph are met with respect to any land if—

(i) such land is to be used for farming purposes, and

(ii) such land is to be acquired by an individual who is a first-time farmer, who will be the principal user of such land, and who will materially and substantially participate on the farm of which such land is a part in the operation of such farm.

(C) First-time farmer

For purposes of this paragraph—

(i) In general The term "first-time farmer" means any individual if such individual—

(I) has not at any time had any direct or indirect ownership interest in substantial farmland in the operation of which such individual materially participated, and

(II) has not received financing under this paragraph in an amount which, when added to the financing to be provided under this paragraph, exceeds the amount in effect under subparagraph (A).

(ii) Aggregation rules Any ownership or material participation, or financing received, by an individual's spouse or minor child shall be treated as ownership and material participation, or financing received, by the individual.

(iii) Insolvent farmer For purposes of clause (i), farmland which was previously owned by the individual and was disposed of while such individual was insolvent shall be disregarded if section 108 applied to indebtedness with respect to such farmland.

(D) Farm

For purposes of this paragraph, the term "farm" has the meaning given such term by section 6420 (c)(2).

(E) Substantial farmland

For purposes of this paragraph, the term "substantial farmland" means any parcel of land unless such parcel is smaller than 30 percent of the median size of a farm in the county in which such parcel is located.

(F) Used equipment limitation

For purposes of this paragraph, in no event may the amount of financing provided by reason of this paragraph to a first-time farmer for personal property—

(i) of a character subject to the allowance for depreciation,

(ii) the original use of which does not begin with such farmer, and

(iii) which is to be used for farming purposes,

exceed $62,500. A rule similar to the rule of subparagraph (C)(ii) shall apply for purposes of the preceding sentence.

(G) Acquisition from related person

For purposes of this paragraph and section 144 (a), the acquisition by a first-time farmer of land or personal property from a related person (within the meaning of section 144 (a)(3)) shall not be treated as an acquisition from a related person, if—

(i) the acquisition price is for the fair market value of such land or property, and

(ii) subsequent to such acquisition, the related person does not have a financial interest in the farming operation with respect to which the bond proceeds are to be used.

(H) Adjustments for inflation

In the case of any calendar year after 2008, the dollar amount in subparagraph (A) shall be increased by an amount equal to—

(i) such dollar amount, multiplied by

(ii) the cost-of-living adjustment determined under section 1 (f)(3) for the calendar year, determined by substituting "calendar year 2007" for "calendar year 1992" in subparagraph (B) thereof.

If any amount as increased under the preceding sentence is not a multiple of $100, such amount shall be rounded to the nearest multiple of $100.

(3) Exception for certain land acquired for environmental purposes, etc.

Any land acquired by a governmental unit (or issuing authority) in connection with an airport, mass commuting facility, high-speed intercity rail facility, dock, or wharf shall not be taken into account under paragraph (1) if—

(A) such land is acquired for noise abatement or wetland preservation, or for future use as an airport, mass commuting facility, high-speed intercity rail facility, dock, or wharf, and

(B) there is not other significant use of such land.

(d) Acquisition of existing property not permitted

(1) In general

Except as provided in subsection (h), a private activity bond shall not be a qualified bond if issued as part of an issue and any portion of the net proceeds of such issue is to be used for the acquisition of any property (or an interest therein) unless the 1st use of such property is pursuant to such acquisition.

(2) Exception for certain rehabilitations

Paragraph (1) shall not apply with respect to any building (and the equipment therefor) if—

(A) the rehabilitation expenditures with respect to such building, equal or exceed

(B) 15 percent of the portion of the cost of acquiring such building (and equipment) financed with the net proceeds of the issue.

A rule similar to the rule of the preceding sentence shall apply in the case of structures other than a building except that subparagraph (B) shall be applied by substituting "100 percent" for "15 percent".

(3) Rehabilitation expenditures

For purposes of this subsection—

(A) In general

Except as provided in this paragraph, the term "rehabilitation expenditures" means any amount properly chargeable to capital account which is incurred by the person acquiring the building for property (or additions or improvements to property) in connection with the rehabilitation of a building. In the case of an integrated operation contained in a building before its acquisition, such term includes rehabilitating existing equipment in such building or replacing it with equipment having substantially the same function. For purposes of this subparagraph, any amount incurred by a successor to the person acquiring the building or by the seller under a sales contract with such person shall be treated as incurred by such person.

(B) Certain expenditures not included

The term "rehabilitation expenditures" does not include any expenditure described in section 47 (c)(2)(B).

(C) Period during which expenditures must be incurred

The term "rehabilitation expenditures" shall not include any amount which is incurred after the date 2 years after the later of—

(i) the date on which the building was acquired, or

(ii) the date on which the bond was issued.

(4) Special rule for certain projects

In the case of a project involving 2 or more buildings, this subsection shall be applied on a project basis.

(e) No portion of bonds may be issued for skyboxes, airplanes, gambling establishments, etc.

A private activity bond shall not be a qualified bond if issued as part of an issue and any portion of the proceeds of such issue is to be used to provide any airplane, skybox or other private luxury box, health club facility, facility primarily used for gambling, or store the principal business of which is the sale of alcoholic beverages for consumption off premises. The preceding sentence shall not apply to any fixed-wing aircraft equipped for, and exclusively dedicated to providing, acute care emergency medical services (within the meaning of section 4261 (g)(2)).

(f) Public approval required for private activity bonds

(1) In general

A private activity bond shall not be a qualified bond unless such bond satisfies the requirements of paragraph (2).

(2) Public approval requirement

(A) In general

A bond shall satisfy the requirements of this paragraph if such bond is issued as a part of an issue which has been approved by—

(i) the governmental unit—

(I) which issued such bond, or

(II) on behalf of which such bond was issued, and

(ii) each governmental unit having jurisdiction over the area in which any facility, with respect to which financing is to be provided from the net proceeds of such issue, is located (except that if more than 1 governmental unit within a State has jurisdiction over the entire area within such State in which such facility is located, only 1 such unit need approve such issue).

(B) Approval by a governmental unit

For purposes of subparagraph (A), an issue shall be treated as having been approved by any governmental unit if such issue is approved—

(i) by the applicable elected representative of such governmental unit after a public hearing following reasonable public notice, or

(ii) by voter referendum of such governmental unit.

(C) Special rules for approval of facility

If there has been public approval under subparagraph (A) of the plan for financing a facility, such approval shall constitute approval under subparagraph (A) for any issue—

(i) which is issued pursuant to such plan within 3 years after the date of the 1st issue pursuant to the approval, and

(ii) all or substantially all of the proceeds of which are to be used to finance such facility or to refund previous financing under such plan.

(D) Refunding bonds

No approval under subparagraph (A) shall be necessary with respect to any bond which is issued to refund (other than to advance refund) a bond approved under subparagraph (A) (or treated as approved under subparagraph (C)) unless the average maturity date of the issue of which the refunding bond is a part is later than the average maturity date of the bonds to be refunded by such issue. For purposes of the preceding sentence, average maturity shall be determined in accordance with subsection (b)(2)(A).

(E) Applicable elected representative

For purposes of this paragraph—

(i) In general The term "applicable elected representative" means with respect to any governmental unit—

(I) an elected legislative body of such unit, or

(II) the chief elected executive officer, the chief elected State legal officer of the executive branch, or any other elected official of such unit designated for purposes of this paragraph by such chief elected executive officer or by State law. If the office of any elected official described in subclause (II) is vacated and an individual is appointed by the chief elected executive officer of the governmental unit and confirmed by the elected legislative body of such unit (if any) to serve the remaining term of the elected official, the individual so appointed shall be treated as the elected official for such remaining term.

(ii) No applicable elected representative If (but for this clause) a governmental unit has no applicable elected representative, the applicable elected representative for purposes of clause (i) shall be the applicable elected representative of the governmental unit—

(I) which is the next higher governmental unit with such a representative, and

(II) from which the authority of the governmental unit with no such representative is derived.

(3) Special rule for approval of airports or high-speed intercity rail facilities

If—

(A) the proceeds of an issue are to be used to finance a facility or facilities located at an airport or high-speed intercity rail facilities, and

(B) the governmental unit issuing such bonds is the owner or operator of such airport or high-speed intercity rail facilities,

such governmental unit shall be deemed to be the only governmental unit having jurisdiction over such airport or high-speed intercity rail facilities for purposes of this subsection.

(4) Special rules for scholarship funding bond issues and volunteer fire department bond issues

(A) Scholarship funding bonds

In the case of a qualified scholarship funding bond, any governmental unit which made a request described in section 150 (d)(2)(B) with respect to the issuer of such bond shall be treated for purposes of paragraph (2) of this subsection as the governmental unit on behalf of which such bond was issued. Where more than one governmental unit within a State has made a request described in section 150 (d)(2)(B), the State may also be treated for purposes of paragraph (2) of this subsection as the governmental unit on behalf of which such bond was issued.

(B) Volunteer fire department bonds

In the case of a bond of a volunteer fire department which meets the requirements of section 150 (e), the political subdivision described in section 150 (e)(2)(B) with respect to such department shall be treated for purposes of paragraph (2) of this subsection as the governmental unit on behalf of which such bond was issued.

(g) Restriction on issuance costs financed by issue

(1) In general

A private activity bond shall not be a qualified bond if the issuance costs financed by the issue (of which such bond is a part) exceed 2 percent of the proceeds of the issue.

(2) Special rule for small mortgage revenue bond issues

In the case of an issue of qualified mortgage bonds or qualified veterans' mortgage bonds, paragraph (1) shall be applied by substituting "3.5 percent" for "2 percent" if the proceeds of the issue do not exceed $20,000,000.

(h) Certain rules not to apply to certain bonds

(1) Mortgage revenue bonds and qualified student loan bonds

Subsections (a), (b), (c), and (d) shall not apply to any qualified mortgage bond, qualified veterans' mortgage bond, or qualified student loan bond.

(2) Qualified 501(c)(3) bonds

Subsections (a), (c), and (d) shall not apply to any qualified 501(c)(3) bond and subsection (e) shall be applied as if it did not contain "health club facility" with respect to such a bond.

(3) Exempt facility bonds for qualified public-private schools

Subsection (c) shall not apply to any exempt facility bond issued as part of an issue described in section 142 (a)(13) (relating to qualified public educational facilities).

26 USC § 148 - Arbitrage

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Arbitrage bond defined

For purposes of section 103, the term "arbitrage bond" means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly—

(1) to acquire higher yielding investments, or

(2) to replace funds which were used directly or indirectly to acquire higher yielding investments.

For purposes of this subsection, a bond shall be treated as an arbitrage bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraph (1) or (2).

(b) Higher yielding investments

For purposes of this section—

(1) In general

The term "higher yielding investments" means any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue.

(2) Investment property

The term "investment property" means—

(A) any security (within the meaning of section 165 (g)(2)(A) or (B)),

(B) any obligation,

(C) any annuity contract,

(D) any investment-type property, or

(E) in the case of a bond other than a private activity bond, any residential rental property for family units which is not located within the jurisdiction of the issuer and which is not acquired to implement a court ordered or approved housing desegregation plan.

(3) Alternative minimum tax bonds treated as investment property in certain cases

(A) In general

Except as provided in subparagraph (B), the term "investment property" does not include any tax-exempt bond.

(B) Exception

With respect to an issue other than an issue a part of which is a specified private activity bond (as defined in section 57 (a)(5)(C)), the term "investment property" includes a specified private activity bond (as so defined).

(4) Safe harbor for prepaid natural gas

(A) In general

The term "investment-type property" does not include a prepayment under a qualified natural gas supply contract.

(B) Qualified natural gas supply contract

For purposes of this paragraph, the term "qualified natural gas supply contract" means any contract to acquire natural gas for resale by a utility owned by a governmental unit if the amount of gas permitted to be acquired under the contract by the utility during any year does not exceed the sum of—

(i) the annual average amount during the testing period of natural gas purchased (other than for resale) by customers of such utility who are located within the service area of such utility, and

(ii) the amount of natural gas to be used to transport the prepaid natural gas to the utility during such year.

(C) Natural gas used to generate electricity

Natural gas used to generate electricity shall be taken into account in determining the average under subparagraph (B)(i)—

(i) only if the electricity is generated by a utility owned by a governmental unit, and

(ii) only to the extent that the electricity is sold (other than for resale) to customers of such utility who are located within the service area of such utility.

(D) Adjustments for changes in customer base

(i) New business customers if—

(I) after the close of the testing period and before the date of issuance of the issue, the utility owned by a governmental unit enters into a contract to supply natural gas (other than for resale) for a business use at a property within the service area of such utility, and

(II) the utility did not supply natural gas to such property during the testing period or the ratable amount of natural gas to be supplied under the contract is significantly greater than the ratable amount of gas supplied to such property during the testing period, then a contract shall not fail to be treated as a qualified natural gas supply contract by reason of supplying the additional natural gas under the contract referred to in subclause (I).

(ii) Lost customers The average under subparagraph (B)(i) shall not exceed the annual amount of natural gas reasonably expected to be purchased (other than for resale) by persons who are located within the service area of such utility and who, as of the date of issuance of the issue, are customers of such utility.

(E) Ruling requests

The Secretary may increase the average under subparagraph (B)(i) for any period if the utility owned by the governmental unit establishes to the satisfaction of the Secretary that, based on objective evidence of growth in natural gas consumption or population, such average would otherwise be insufficient for such period.

(F) Adjustment for natural gas otherwise on hand

(i) In general The amount otherwise permitted to be acquired under the contract for any period shall be reduced by—

(I) the applicable share of natural gas held by the utility on the date of issuance of the issue, and

(II) the natural gas (not taken into account under subclause (I)) which the utility has a right to acquire during such period (determined as of the date of issuance of the issue).

(ii) Applicable share For purposes of the clause (i), the term "applicable share" means, with respect to any period, the natural gas allocable to such period if the gas were allocated ratably over the period to which the prepayment relates.

(G) Intentional acts

Subparagraph (A) shall cease to apply to any issue if the utility owned by the governmental unit engages in any intentional act to render the volume of natural gas acquired by such prepayment to be in excess of the sum of—

(i) the amount of natural gas needed (other than for resale) by customers of such utility who are located within the service area of such utility, and

(ii) the amount of natural gas used to transport such natural gas to the utility.

(H) Testing period

For purposes of this paragraph, the term "testing period" means, with respect to an issue, the most recent 5 calendar years ending before the date of issuance of the issue.

(I) Service area

For purposes of this paragraph, the service area of a utility owned by a governmental unit shall be comprised of—

(i) any area throughout which such utility provided at all times during the testing period—

(I) in the case of a natural gas utility, natural gas transmission or distribution services, and

(II) in the case of an electric utility, electricity distribution services,

(ii) any area within a county contiguous to the area described in clause (i) in which retail customers of such utility are located if such area is not also served by another utility providing natural gas or electricity services, as the case may be, and

(iii) any area recognized as the service area of such utility under State or Federal law.

(c) Temporary period exception

(1) In general

For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such bond is a part may be invested in higher yielding investments for a reasonable temporary period until such proceeds are needed for the purpose for which such issue was issued.

(2) Limitation on temporary period for pooled financings

(A) In general

The temporary period referred to in paragraph (1) shall not exceed 6 months with respect to the proceeds of an issue which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons.

(B) Shorter temporary period for loan repayments, etc.

Subparagraph (A) shall be applied by substituting "3 months" for "6 months" with respect to the proceeds from the sale or repayment of any loan which are to be used to make or finance any loan. For purposes of the preceding sentence, a nonpurpose investment shall not be treated as a loan.

(C) Bonds used to provide construction financing

In the case of an issue described in subparagraph (A) any portion of which is used to make or finance loans for construction expenditures (within the meaning of subsection (f)(4)(C)(iv))—

(i) rules similar to the rules of subsection (f)(4)(C)(v) shall apply, and

(ii) subparagraph (A) shall be applied with respect to such portion by substituting "2 years" for "6 months".

(D) Exception for mortgage revenue bonds

This paragraph shall not apply to any qualified mortgage bond or qualified veterans' mortgage bond.

(d) Special rules for reasonably required reserve or replacement fund

(1) In general

For purposes of subsection (a), a bond shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of the issue of which such bond is a part may be invested in higher yielding investments which are part of a reasonably required reserve or replacement fund. The amount referred to in the preceding sentence shall not exceed 10 percent of the proceeds of such issue unless the issuer establishes to the satisfaction of the Secretary that a higher amount is necessary.

(2) Limitation on amount in reserve or replacement fund which may be financed by issue

A bond issued as part of an issue shall be treated as an arbitrage bond if the amount of the proceeds from the sale of such issue which is part of any reserve or replacement fund exceeds 10 percent of the proceeds of the issue (or such higher amount which the issuer establishes is necessary to the satisfaction of the Secretary).

(e) Minor portion may be invested in higher yielding investments

Notwithstanding subsections (a), (c), and (d), a bond issued as part of an issue shall not be treated as an arbitrage bond solely by reason of the fact that an amount of the proceeds of such issue (in addition to the amounts under subsections (c) and (d)) is invested in higher yielding investments if such amount does not exceed the lesser of—

(1) 5 percent of the proceeds of the issue, or

(2) $100,000.

(f) Required rebate to the United States

(1) In general

A bond which is part of an issue shall be treated as an arbitrage bond if the requirements of paragraphs (2) and (3) are not met with respect to such issue. The preceding sentence shall not apply to any qualified veterans' mortgage bond.

(2) Rebate to United States

An issue shall be treated as meeting the requirements of this paragraph only if an amount equal to the sum of—

(A) the excess of—

(i) the amount earned on all nonpurpose investments (other than investments attributable to an excess described in this subparagraph), over

(ii) the amount which would have been earned if such nonpurpose investments were invested at a rate equal to the yield on the issue, plus

(B) any income attributable to the excess described in subparagraph (A),

is paid to the United States by the issuer in accordance with the requirements of paragraph (3).

(3) Due date of payments under paragraph (2)

Except to the extent provided by the Secretary, the amount which is required to be paid to the United States by the issuer shall be paid in installments which are made at least once every 5 years. Each installment shall be in an amount which ensures that 90 percent of the amount described in paragraph (2) with respect to the issue at the time payment of such installment is required will have been paid to the United States. The last installment shall be made no later than 60 days after the day on which the last bond of the issue is redeemed and shall be in an amount sufficient to pay the remaining balance of the amount described in paragraph (2) with respect to such issue. A series of issues which are redeemed during a 6-month period (or such longer period as the Secretary may prescribe) shall be treated (at the election of the issuer) as 1 issue for purposes of the preceding sentence if no bond which is part of any issue in such

series has a maturity of more than 270 days or is a private activity bond. In the case of a tax and revenue anticipation bond, the last installment shall not be required to be made before the date 8 months after the date of issuance of the issue of which the bond is a part.

(4) Special rules for applying paragraph (2)

(A) In general

In determining the aggregate amount earned on nonpurpose investments for purposes of paragraph (2)—

(i) any gain or loss on the disposition of a nonpurpose investment shall be taken into account, and

(ii) any amount earned on a bona fide debt service fund shall not be taken into account if the gross earnings on such fund for the bond year is less than $100,000.

In the case of an issue no bond of which is a private activity bond, clause (ii) shall be applied without regard to the dollar limitation therein if the average maturity of the issue (determined in accordance with section 147 (b)(2)(A)) is at least 5 years and the rates of interest on bonds which are part of the issue do not vary during the term of the issue.

(B) Temporary investments

Under regulations prescribed by the Secretary—

(i) In general An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraph (2) if—

(I) the gross proceeds of such issue are expended for the governmental purposes for which the issue was issued no later than the day which is 6 months after the date of issuance of the issue, and

(II) the requirements of paragraph (2) are met with respect to amounts not required to be spent as provided in subclause (I) (other than earnings on amounts in any bona fide debt service fund). Gross proceeds which are held in a bona fide debt service fund or a reasonably required reserve or replacement fund, and gross proceeds which arise after such 6 months and which were not reasonably anticipated as of the date of issuance, shall not be considered gross proceeds for purposes of subclause (I) only.

(ii) Additional period for certain bonds

(I) In general In the case of an issue described in subclause (II), clause (i) shall be applied by substituting "1 year" for "6 months" each place it appears with respect to the portion of the proceeds of the issue which are not expended in accordance with clause (i) if such portion does not exceed 5 percent of the proceeds of the issue.

(II) Issues to which subclause (I) applies An issue is described in this subclause if no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond) or a tax or revenue anticipation bond.

(iii) Safe harbor for determining when proceeds of tax and revenue anticipation bonds are expended

(I) In general For purposes of clause (i), in the case of an issue of tax or revenue anticipation bonds, the net proceeds of such issue (including earnings thereon) shall be treated as expended for the governmental purpose of the issue on the 1st day after the date of issuance that the cumulative cash flow deficit to be financed by such issue exceeds 90 percent of the proceeds of such issue.

(II) Cumulative cash flow deficit For purposes of subclause (I), the term "cumulative cash flow deficit" means, as of the date of computation, the excess of the expenses paid during the period described in subclause (III) which would ordinarily be paid out of or financed by anticipated tax or other revenues over the aggregate amount available (other than from the proceeds of the issue) during such period for the payment of such expenses.

(III) Period involved For purposes of subclause (II), the period described in this subclause is the period beginning on the date of issuance of the issue and ending

on the earlier of the date 6 months after such date of issuance or the date of the computation of cumulative cash flow deficit.

(iv) Payments of principal not to affect requirements For purposes of this subparagraph, payments of principal on the bonds which are part of an issue shall not be treated as expended for the governmental purposes of the issue.

(C) Exception from rebate for certain proceeds to be used to finance construction expenditures

(i) In general In the case of a construction issue, paragraph (2) shall not apply to the available construction proceeds of such issue if the spending requirements of clause (ii) are met.

(ii) Spending requirements The spending requirements of this clause are met if at least—

(I) 10 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 6-month period beginning on the date the bonds are issued,

(II) 45 percent of such proceeds are spent for such purposes within the 1-year period beginning on such date,

(III) 75 percent of such proceeds are spent for such purposes within the 18-month period beginning on such date, and

(IV) 100 percent of such proceeds are spent for such purposes within the 2-year period beginning on such date.

(iii) Exception for reasonable retainage The spending requirement of clause (ii)(IV) shall be treated as met if—

(I) such requirement would be met at the close of such 2-year period but for a reasonable retainage (not exceeding 5 percent of the available construction proceeds of the construction issue), and

(II) 100 percent of the available construction proceeds of the construction issue are spent for the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued.

(iv) Construction issue For purposes of this subparagraph, the term "construction issue" means any issue if—

(I) at least 75 percent of the available construction proceeds of such issue are to be used for construction expenditures with respect to property which is to be owned by a governmental unit or a 501(c)(3) organization, and

(II) all of the bonds which are part of such issue are qualified 501(c)(3) bonds, bonds which are not private activity bonds, or private activity bonds issued to finance property to be owned by a governmental unit or a 501(c)(3) organization.

For purposes of this subparagraph, the term "construction" includes reconstruction and rehabilitation, and rules similar to the rules of section 142 (b)(1)(B) shall apply.

(v) Portions of issues used for construction If—

(I) all of the construction expenditures to be financed by an issue are to be financed from a portion thereof, and

(II) the issuer elects to treat such portion as a construction issue for purposes of this subparagraph, then, for purposes of this subparagraph and subparagraph (B), such portion shall be treated as a separate issue.

(vi) Available construction proceeds For purposes of this subparagraph—

(I) In general The term "available construction proceeds" means the amount equal to the issue price (within the meaning of sections 1273 and 1274) of the construction issue, increased by earnings on the issue price, earnings on amounts in any reasonably required reserve or replacement fund not funded from the issue, and earnings on all of the foregoing earnings, and reduced by the amount of the

issue price in any reasonably required reserve or replacement fund and the issuance costs financed by the issue.

(II) Earnings on reserve included only for certain periods The term "available construction proceeds" shall not include amounts earned on any reasonably required reserve or replacement fund after the earlier of the close of the 2-year period described in clause (ii) or the date the construction is substantially completed.

(III) Payments on acquired purpose obligations excluded The term "available construction proceeds" shall not include payments on any obligation acquired to carry out the governmental purposes of the issue and shall not include earnings on such payments.

(IV) Election to rebate on earnings on reserve At the election of the issuer, the term "available construction proceeds" shall not include earnings on any reasonably required reserve or replacement fund.

(vii) Election to pay penalty in lieu of rebate

(I) In general At the election of the issuer, paragraph (2) shall not apply to available construction proceeds which do not meet the spending requirements of clause (ii) if the issuer pays a penalty, with respect to each 6-month period after the date the bonds were issued, equal to 1 1/2 percent of the amount of the available construction proceeds of the issue which, as of the close of such 6-month period, is not spent as required by clause (ii).

(II) Termination The penalty imposed by this clause shall cease to apply only as provided in clause (viii) or after the latest maturity date of any bond in the issue (including any refunding bond with respect thereto).

(viii) Election to terminate 1 1/2 percent penalty At the election of the issuer (made not later than 90 days after the earlier of the end of the initial temporary period or the date the construction is substantially completed), the penalty under clause (vii) shall not apply to any 6-month period after the initial temporary period under subsection (c) if the requirements of subclauses (I), (II), and (III) are met.

(I) 3 percent penalty The requirement of this subclause is met if the issuer pays a penalty equal to 3 percent of the amount of available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the close of such initial temporary period multiplied by the number of years (including fractions thereof) in the initial temporary period.

(II) Yield restriction at close of temporary period The requirement of this subclause is met if the amount of the available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the close of such initial temporary period is invested at a yield not exceeding the yield on the issue or which is invested in any tax-exempt bond which is not investment property.

(III) Redemption of bonds at earliest call date The requirement of this subclause is met if the amount of the available construction proceeds of the issue which is not spent for the governmental purposes of the issue as of the earliest date on which bonds may be redeemed is used to redeem bonds on such date.

(ix) Election to terminate 1 1/2 percent penalty before end of temporary period If—

(I) the construction to be financed by a construction issue is substantially completed before the end of the initial temporary period,

(II) the issuer identifies an amount of available construction proceeds which will not be spent for the governmental purposes of the issue,

(III) the issuer has made the election under clause (viii), and

(IV) the issuer makes an election under this clause before the close of the initial temporary period and not later than 90 days after the date the construction is substantially completed, then clauses (vii) and (viii) shall be applied to the available construction proceeds so identified as if the initial temporary period ended as of the date the election is made.

(x) Failure to pay penalties In the case of a failure (which is not due to willful neglect) to pay any penalty required to be paid under clause (vii) or (viii) in the amount or at the time prescribed therefor, the Secretary may treat such failure as not occurring if, in addition to paying such penalty, the issuer pays a penalty equal to the sum of—

(I) 50 percent of the amount which was not paid in accordance with clauses (vii) and (viii), plus

(II) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required for the period beginning on such date. The Secretary may waive all or any portion of the penalty under this clause. Bonds which are part of an issue with respect to which there is a failure to pay the amount required under this clause (and any refunding bond with respect thereto) shall be treated as not being, and as never having been, tax-exempt bonds.

(xi) Election for pooled financing bonds At the election of the issuer of an issue the proceeds of which are to be used to make or finance loans (other than nonpurpose investments) to 2 or more persons, the periods described in clauses (ii) and (iii) shall begin on—

(I) the date the loan is made, in the case of loans made within the 1-year period after the date the bonds are issued, and

(II) the date following such 1-year period, in the case of loans made after such 1-year period. If such an election applies to an issue, the requirements of paragraph (2) shall apply to amounts earned before the beginning of the periods determined under the preceding sentence.

(xii) Payments of principal not to affect requirements For purposes of this subparagraph, payments of principal on the bonds which are part of the construction issue shall not be treated as an expenditure of the available construction proceeds of the issue.

(xiii) Refunding bonds

(I) In general Except as provided in this clause, clause (vii)(II), and the last sentence of clause (x), this subparagraph shall not apply to any refunding bond and no proceeds of a refunded bond shall be treated for purposes of this subparagraph as proceeds of a refunding bond.

(II) Determination of construction portion of issue For purposes of clause (v), any portion of an issue which is used to refund any issue (or portion thereof) shall be treated as a separate issue.

(III) Coordination with rebate requirement on refunding bonds The requirements of paragraph (2) shall be treated as met with respect to earnings for any period if a penalty is paid under clause (vii) or (viii) with respect to such earnings for such period.

(xiv) Determination of initial temporary period For purposes of this subpargraph, [1] the end of the initial temporary period shall be determined without regard to section 149 (d)(3)(A)(iv).

(xv) Elections Any election under this subparagraph (other than clauses (viii) and (ix)) shall be made on or before the date the bonds are issued; and, once made, shall be irrevocable.

(xvi) Time for payment of penalties Any penalty under this subparagraph shall be paid to the United States not later than 90 days after the period to which the penalty relates.

(xvii) Treatment of bona fide debt service funds If the spending requirements of clause (ii) are met with respect to the available construction proceeds of a construction issue, then paragraph (2) shall not apply to earnings on a bona fide debt service fund for such issue.

(D) Exception for governmental units issuing $5,000,000 or less of bonds

(i) In general An issue shall, for purposes of this subsection, be treated as meeting the requirements of paragraphs (2) and (3) if—

(I) the issue is issued by a governmental unit with general taxing powers,

(II) no bond which is part of such issue is a private activity bond,

(III) 95 percent or more of the net proceeds of such issue are to be used for local governmental activities of the issuer (or of a governmental unit the jurisdiction of which is entirely within the jurisdiction of the issuer), and

(IV) the aggregate face amount of all tax-exempt bonds (other than private activity bonds) issued by such unit during the calendar year in which such issue is issued is not reasonably expected to exceed $5,000,000.

(ii) Aggregation of issuers For purposes of subclause (IV) of clause (i)—

(I) an issuer and all entities which issue bonds on behalf of such issuer shall be treated as 1 issuer,

(II) all bonds issued by a subordinate entity shall, for purposes of applying such subclause to each other entity to which such entity is subordinate, be treated as issued by such other entity, and

(III) an entity formed (or, to the extent provided by the Secretary, availed of) to avoid the purposes of such subclause (IV) and all other entities benefiting thereby shall be treated as 1 issuer.

(iii) Certain refunding bonds not taken into account in determining small issuer status There shall not be taken into account under subclause (IV) of clause (i) any bond issued to refund (other than to advance refund) any bond to the extent the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iv) Certain issues issued by subordinate governmental units, etc., exempt from rebate requirement An issue issued by a subordinate entity of a governmental unit with general taxing powers shall be treated as described in clause (i)(I) if the aggregate face amount of such issue does not exceed the lesser of—

(I) $5,000,000, or

(II) the amount which, when added to the aggregate face amount of other issues issued by such entity, does not exceed the portion of the $5,000,000 limitation under clause (i)(IV) which such governmental unit allocates to such entity. For purposes of the preceding sentence, an entity which issues bonds on behalf of a governmental unit with general taxing powers shall be treated as a subordinate entity of such unit. An allocation shall be taken into account under subclause (II) only if it is irrevocable and made before the issuance date of such issue and only to the extent that the limitation so allocated bears a reasonable relationship to the benefits received by such governmental unit from issues issued by such entity.

(v) Determination of whether refunding bonds eligible for exception from rebate requirement If any portion of an issue is issued to refund other bonds, such portion shall be treated as a separate issue which does not meet the requirements of paragraphs (2) and (3) by reason of this subparagraph unless—

(I) the aggregate face amount of such issue does not exceed $5,000,000,

(II) each refunded bond was issued as part of an issue which was treated as meeting the requirements of paragraphs (2) and (3) by reason of this subparagraph,

(III) the average maturity date of the refunding bonds issued as part of such issue is not later than the average maturity date of the bonds to be refunded by such issue, and

(IV) no refunding bond has a maturity date which is later than the date which is 30 years after the date the original bond was issued. Subclause (III) shall not apply if the average maturity of the issue of which the original bond was a part (and of the issue of which the bonds to be refunded are a part) is 3 years or less. For purposes

of this clause, average maturity shall be determined in accordance with section 147 (b)(2)(A).

(vi) Refundings of bonds issued under law prior to Tax Reform Act of 1986 If section 141 (a) did not apply to any refunded bond, the issue of which such refunded bond was a part shall be treated as meeting the requirements of subclause (II) of clause (v) if—

(I) such issue was issued by a governmental unit with general taxing powers,

(II) no bond issued as part of such issue was an industrial development bond (as defined in section 103 (b)(2), but without regard to subparagraph (B) of section 103 (b)(3)) or a private loan bond (as defined in section 103 (o)(2)(A), but without regard to any exception from such definition other than section 103 (o)(2)(C)), and

(III) the aggregate face amount of all tax-exempt bonds (other than bonds described in subclause (II)) issued by such unit during the calendar year in which such issue was issued did not exceed $5,000,000. References in subclause (II) to section 103 shall be to such section as in effect on the day before the date of the enactment of the Tax Reform Act of 1986. Rules similar to the rules of clauses (ii) and (iii) shall apply for purposes of subclause (III). For purposes of subclause (II) of clause (i), bonds described in subclause (II) of this clause to which section 141 (a) does not apply shall not be treated as private activity bonds.

(vii) Increase in exception for bonds financing public school capital expenditures Each of the $5,000,000 amounts in the preceding provisions of this subparagraph shall be increased by the lesser of $10,000,000 or so much of the aggregate face amount of the bonds as are attributable to financing the construction (within the meaning of subparagraph (C)(iv)) of public school facilities.

(5) Exemption from gross income of sum rebated

Gross income shall not include the sum described in paragraph (2). Notwithstanding any other provision of this title, no deduction shall be allowed for any amount paid to the United States under paragraph (2).

(6) Definitions

For purposes of this subsection and subsections (c) and (d)—

(A) Nonpurpose investment

The term "nonpurpose investment" means any investment property which—

(i) is acquired with the gross proceeds of an issue, and

(ii) is not acquired in order to carry out the governmental purpose of the issue.

(B) Gross proceeds

Except as otherwise provided by the Secretary, the gross proceeds of an issue include—

(i) amounts received (including repayments of principal) as a result of investing the original proceeds of the issue, and

(ii) amounts to be used to pay debt service on the issue.

(7) Penalty in lieu of loss of tax exemption

In the case of an issue which would (but for this paragraph) fail to meet the requirements of paragraph (2) or (3), the Secretary may treat such issue as not failing to meet such requirements if—

(A) no bond which is part of such issue is a private activity bond (other than a qualified 501(c)(3) bond),

(B) the failure to meet such requirements is not due to willful neglect, and

(C) the issuer pays to the United States a penalty in an amount equal to the sum of—

(i) 50 percent of the amount which was not paid in accordance with paragraphs (2) and (3), plus

(ii) interest (at the underpayment rate established under section 6621) on the portion of the amount which was not paid on the date required under paragraph (3) for the period beginning on such date.

The Secretary may waive all or any portion of the penalty under this paragraph.

(g) Student loan incentive payments

Except to the extent otherwise provided in regulations, payments made by the Secretary of Education pursuant to section 438 of the Higher Education Act of 1965 are not to be taken into account, for purposes of subsection (a)(1), in determining yields on student loan notes.

(h) Determinations of yield

For purposes of this section, the yield on an issue shall be determined on the basis of the issue price (within the meaning of sections 1273 and 1274).

(i) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this section.

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[1] So in original. Probably should be "subparagraph,".

26 USC § 149 - Bonds must be registered to be tax exempt; other requirements

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) Bonds must be registered to be tax exempt

(1) General rule

Nothing in section 103 (a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any registration-required bond unless such bond is in registered form.

(2) Registration-required bond

For purposes of paragraph (1), the term "registration-required bond" means any bond other than a bond which—

(A) is not of a type offered to the public, or

(B) has a maturity (at issue) of not more than 1 year.

(3) Special rules

(A) Book entries permitted

For purposes of paragraph (1), a book entry bond shall be treated as in registered form if the right to the principal of, and stated interest on, such bond may be transferred only through a book entry consistent with regulations prescribed by the Secretary.

(B) Nominees

The Secretary shall prescribe such regulations as may be necessary to carry out the purpose of paragraph (1) where there is a nominee or chain of nominees.

(b) Federally guaranteed bond is not tax exempt

(1) In general

Section 103 (a) shall not apply to any State or local bond if such bond is federally guaranteed.

(2) Federally guaranteed defined

For purposes of paragraph (1), a bond is federally guaranteed if—

(A) the payment of principal or interest with respect to such bond is guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof),

(B) such bond is issued as part of an issue and 5 percent or more of the proceeds of such issue is to be—

(i) used in making loans the payment of principal or interest with respect to which are to be guaranteed (in whole or in part) by the United States (or any agency or instrumentality thereof), or

(ii) invested (directly or indirectly) in federally insured deposits or accounts, or

(C) the payment of principal or interest on such bond is otherwise indirectly guaranteed (in whole or in part) by the United States (or an agency or instrumentality thereof).

(3) Exceptions

(A) Certain insurance programs

A bond shall not be treated as federally guaranteed by reason of—

(i) any guarantee by the Federal Housing Administration, the Veterans' Administration, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association,

(ii) any guarantee of student loans and any guarantee by the Student Loan Marketing Association to finance student loans,

(iii) any guarantee by the Bonneville Power Authority pursuant to the Northwest Power Act (16 U.S.C. 839d) as in effect on the date of the enactment of the Tax Reform Act of 1984, or

(iv) subject to subparagraph (E), any guarantee by a Federal home loan bank made in connection with the original issuance of a bond during the period beginning on the date of the enactment of this clause and ending on December 31, 2010 (or a renewal or extension of a guarantee so made).

(B) Debt service, etc.

Paragraph (1) shall not apply to—

(i) proceeds of the issue invested for an initial temporary period until such proceeds are needed for the purpose for which such issue was issued,

(ii) investments of a bona fide debt service fund,

(iii) investments of a reserve which meet the requirements of section 148 (d),

(iv) investments in bonds issued by the United States Treasury, or

(v) other investments permitted under regulations.

(C) Exception for housing programs

(i) In general Except as provided in clause (ii), paragraph (1) shall not apply to—

(I) a private activity bond for a qualified residential rental project or a housing program obligation under section 11(b) of the United States Housing Act of 1937,

(II) a qualified mortgage bond, or

(III) a qualified veterans' mortgage bond.

(ii) Exception not to apply where bond invested in federally insured deposits or accounts Clause (i) shall not apply to any bond which is federally guaranteed within the meaning of paragraph (2)(B)(ii).

(D) Loans to, or guarantees by, financial institutions

Except as provided in paragraph (2)(B)(ii), a bond which is issued as part of an issue shall not be treated as federally guaranteed merely by reason of the fact that the proceeds of such issue are used in making loans to a financial institution or there is a guarantee by a financial institution unless such guarantee constitutes a federally insured deposit or account.

(E) Safety and soundness requirements for Federal home loan banks

Clause (iv) of subparagraph (A) shall not apply to any guarantee by a Federal home loan bank unless such bank meets safety and soundness collateral requirements for such guarantees which are at least as stringent as such requirements which apply under regulations applicable to such guarantees by Federal home loan banks as in effect on April 9, 2008.

(4) Definitions

For purposes of this subsection—

(A) Treatment of certain entities with authority to borrow from United States

To the extent provided in regulations prescribed by the Secretary, any entity with statutory authority to borrow from the United States shall be treated as an instrumentality of the United States. Except in the case of an exempt facility bond, a qualified small issue bond, and a qualified student loan bond, nothing in the preceding sentence shall be construed as treating the District of Columbia or any possession of the United States as an instrumentality of the United States.

(B) Federally insured deposit or account

The term "federally insured deposit or account" means any deposit or account in a financial institution to the extent such deposit or account is insured under Federal law by the Federal Deposit Insurance Corporation, the Federal Savings and Loan Insurance Corporation, the National Credit Union Administration, or any similar federally chartered corporation.

(c) Tax exemption must be derived from this title

(1) General rule

Except as provided in paragraph (2), no interest on any bond shall be exempt from taxation under this title unless such interest is exempt from tax under this title without regard to any provision of law which is not contained in this title and which is not contained in a revenue Act.

(2) Certain prior exemptions

(A) Prior exemptions continued

For purposes of this title, notwithstanding any provision of this part, any bond the interest on which is exempt from taxation under this title by reason of any provision of law (other than a provision of this title) which is in effect on January 6, 1983, shall be treated as a bond described in section 103 (a).

(B) Additional requirements for bonds issued after 1983

Subparagraph (A) shall not apply to a bond (not described in subparagraph (C)) issued after 1983 if the appropriate requirements of this part (or the corresponding provisions of prior law) are not met with respect to such bond.

(C) Description of bond

A bond is described in this subparagraph (and treated as described in subparagraph (A)) if—

(i) such bond is issued pursuant to the Northwest Power Act (16 U.S.C. 839d), as in effect on July 18, 1984;

(ii) such bond is issued pursuant to section 608(a)(6)(A) ofPublic Law 97-468, as in effect on the date of the enactment of the Tax Reform Act of 1986; or

(iii) such bond is issued before June 19, 1984 under section 11(b) of the United States Housing Act of 1937.

(d) Advance refundings

(1) In general

Nothing in section 103 (a) or in any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond issued as part of an issue described in paragraph (2), (3), or (4).

(2) Certain private activity bonds

An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund a private activity bond (other than a qualified 501(c)(3) bond).

(3) Other bonds

(A) In general

· Securities

An issue is described in this paragraph if any bond (issued as part of such issue), hereinafter in this paragraph referred to as the "refunding bond", is issued to advance refund a bond unless—

(i) the refunding bond is only—

(I) the 1st advance refunding of the original bond if the original bond is issued after 1985, or

(II) the 1st or 2nd advance refunding of the original bond if the original bond was issued before 1986,

(ii) in the case of refunded bonds issued before 1986, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed at par or at a premium of 3 percent or less,

(iii) in the case of refunded bonds issued after 1985, the refunded bond is redeemed not later than the earliest date on which such bond may be redeemed,

(iv) the initial temporary period under section 148 (c) ends—

(I) with respect to the proceeds of the refunding bond not later than 30 days after the date of issue of such bond, and

(II) with respect to the proceeds of the refunded bond on the date of issue of the refunding bond, and

(v) in the case of refunded bonds to which section 148 (e) did not apply, on and after the date of issue of the refunding bond, the amount of proceeds of the refunded bond invested in higher yielding investments (as defined in section 148 (b)) which are nonpurpose investments (as defined in section 148 (f)(6)(A)) does not exceed—

(I) the amount so invested as part of a reasonably required reserve or replacement fund or during an allowable temporary period, and

(II) the amount which is equal to the lesser of 5 percent of the proceeds of the issue of which the refunded bond is a part or $100,000 (to the extent such amount is allocable to the refunded bond).

(B) Special rules for redemptions

(i) Issuer must redeem only if debt service savings Clause (ii) and (iii) of subparagraph (A) shall apply only if the issuer may realize present value debt service savings (determined without regard to administrative expenses) in connection with the issue of which the refunding bond is a part.

(ii) Redemptions not required before 90th day For purposes of clauses (ii) and (iii) of subparagraph (A), the earliest date referred to in such clauses shall not be earlier than the 90th day after the date of issuance of the refunding bond.

(4) Abusive transactions prohibited

An issue is described in this paragraph if any bond (issued as part of such issue) is issued to advance refund another bond and a device is employed in connection with the issuance of such issue to obtain a material financial advantage (based on arbitrage) apart from savings attributable to lower interest rates.

(5) Advance refunding

For purposes of this part, a bond shall be treated as issued to advance refund another bond if it is issued more than 90 days before the redemption of the refunded bond.

(6) Special rules for purposes of paragraph (3)

For purposes of paragraph (3), bonds issued before the date of the enactment of this subsection shall be taken into account under subparagraph (A)(i) thereof except—

(A) a refunding which occurred before 1986 shall be treated as an advance refunding only if the refunding bond was issued more than 180 days before the redemption of the refunded bond, and

(B) a bond issued before 1986, shall be treated as advance refunded no more than once before March 15, 1986.

(7) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection.

(e) Information reporting

(1) In general

Nothing in section 103 (a) or any other provision of law shall be construed to provide an exemption from Federal income tax for interest on any bond unless such bond satisfies the requirements of paragraph (2).

(2) Information reporting requirements

A bond satisfies the requirements of this paragraph if the issuer submits to the Secretary, not later than the 15th day of the 2d calendar month after the close of the calendar quarter in which the bond is issued (or such later time as the Secretary may prescribe with respect to any portion of the statement), a statement concerning the issue of which the bond is a part which contains—

(A) the name and address of the issuer,

(B) the date of issue, the amount of net proceeds of the issue, the stated interest rate, term, and face amount of each bond which is part of the issue, the amount of issuance costs of the issue, and the amount of reserves of the issue,

(C) where required, the name of the applicable elected representative who approved the issue, or a description of the voter referendum by which the issue was approved,

(D) the name, address, and employer identification number of—

(i) each initial principal user of any facility provided with the proceeds of the issue,

(ii) the common parent of any affiliated group of corporations (within the meaning of section 1504(a)) of which such initial principal user is a member, and

(iii) if the issue is treated as a separate issue under section 144 (a)(6)(A), any person treated as a principal user under section 144 (a)(6)(B),

(E) a description of any property to be financed from the proceeds of the issue,

(F) a certification by a State official designated by State law (or, where there is no such official, the Governor) that the bond meets the requirements of section 146 (relating to cap on private activity bonds), if applicable, and

(G) such other information as the Secretary may require.

Subparagraphs (C) and (D) shall not apply to any bond which is not a private activity bond. The Secretary may provide that certain information specified in the 1st sentence need not be included in the statement with respect to an issue where the inclusion of such information is not necessary to carry out the purposes of this subsection.

(3) Extension of time

The Secretary may grant an extension of time for the filing of any statement required under paragraph (2) if the failure to file in a timely fashion is not due to willful neglect.

(f) Treatment of certain pooled financing bonds

(1) In general

Section 103 (a) shall not apply to any pooled financing bond unless, with respect to the issue of which such bond is a part, the requirements of paragraphs (2), (3), (4), and (5) are met.

(2) Reasonable expectation requirement

(A) In general

The requirements of this paragraph are met with respect to an issue if the issuer reasonably expects that—

(i) as of the close of the 1-year period beginning on the date of issuance of the issue, at least 30 percent of the net proceeds of the issue (as of the close of such period) will have been used directly or indirectly to make or finance loans to ultimate borrowers, and

(ii) as of the close of the 3-year period beginning on such date of issuance, at least 95 percent of the net proceeds of the issue (as of the close of such period) will have been so used.

(B) Certain factors may not be taken into account in determining expectations

Expectations as to changes in interest rates or in the provisions of this title (or in the regulations or rulings thereunder) may not be taken into account in determining whether expectations are reasonable for purposes of this paragraph.

(C) Net proceeds

For purposes of subparagraph (A), the term "net proceeds" has the meaning given such term by section 150 but shall not include proceeds used to finance issuance costs and shall not include proceeds necessary to pay interest (during such period) on the bonds which are part of the issue.

(D) Refunding bonds

For purposes of subparagraph (A), in the case of a refunding bond, the date of issuance taken into account is the date of issuance of the original bond.

(3) Cost of issuance payment requirements

The requirements of this paragraph are met with respect to an issue if—

(A) the payment of legal and underwriting costs associated with the issuance of the issue is not contingent, and

(B) at least 95 percent of the reasonably expected legal and underwriting costs associated with the issuance of the issue are paid not later than the 180th day after the date of the issuance of the issue.

(4) Written loan commitment requirement

(A) In general

The requirement of this paragraph is met with respect to an issue if the issuer receives prior to issuance written loan commitments identifying the ultimate potential borrowers of at least 30 percent of the net proceeds of such issue.

(B) Exception

Subparagraph (A) shall not apply with respect to any issuer which—

(i) is a State (or an integral part of a State) issuing pooled financing bonds to make or finance loans to subordinate governmental units of such State, or

(ii) is a State-created entity providing financing for water-infrastructure projects through the federally-sponsored State revolving fund program.

(5) Redemption requirement

The requirement of this paragraph is met if to the extent that less than the percentage of the proceeds of an issue required to be used under clause (i) or (ii) of paragraph (2)(A) is used by the close of the period identified in such clause, the issuer uses an amount of proceeds equal to the excess of—

(A) the amount required to be used under such clause, over

(B) the amount actually used by the close of such period,

to redeem outstanding bonds within 90 days after the end of such period.

(6) Pooled financing bond

For purposes of this subsection—

(A) In general

The term "pooled financing bond" means any bond issued as part of an issue more than $5,000,000 of the proceeds of which are reasonably expected (at the time of the issuance of the bonds) to be used (or are intentionally used) directly or indirectly to make or finance loans to 2 or more ultimate borrowers.

(B) Exceptions

Such term shall not include any bond if—

(i) section 146 applies to the issue of which such bond is a part (other than by reason of section 141 (b)(5)) or would apply but for section 146 (i), or

(ii) section 143 (l)(3) applies to such issue.

(7) Definition of loan; treatment of mixed use issues

(A) Loan

For purposes of this subsection, the term "loan" does not include—

(i) any loan which is a nonpurpose investment (within the meaning of section 148 (f)(6)(A), determined without regard to section 148 (b)(3)), and

(ii) any use of proceeds by an agency of the issuer unless such agency is a political subdivision or instrumentality of the issuer.

(B) Portion of issue to be used for loans treated as separate issue

If only a portion of the proceeds of an issue is reasonably expected (at the time of issuance of the bond) to be used (or is intentionally used) as described in paragraph (6)(A), such portion and the other portion of such issue shall be treated as separate issues for purposes of determining whether such portion meets the requirements of this subsection.

(g) Treatment of hedge bonds

(1) In general

Section 103 (a) shall not apply to any hedge bond unless, with respect to the issue of which such bond is a part—

(A) the requirement of paragraph (2) is met, and

(B) the requirement of subsection (f)(3) is met.

(2) Reasonable expectations as to when proceeds will be spent

An issue meets the requirement of this paragraph if the issuer reasonably expects that—

(A) 10 percent of the spendable proceeds of the issue will be spent for the governmental purposes of the issue within the 1-year period beginning on the date the bonds are issued,

(B) 30 percent of the spendable proceeds of the issue will be spent for such purposes within the 2-year period beginning on such date,

(C) 60 percent of the spendable proceeds of the issue will be spent for such purposes within the 3-year period beginning on such date, and

(D) 85 percent of the spendable proceeds of the issue will be spent for such purposes within the 5-year period beginning on such date.

(3) Hedge bond

(A) In general

For purposes of this subsection, the term "hedge bond" means any bond issued as part of an issue unless—

(i) the issuer reasonably expects that 85 percent of the spendable proceeds of the issue will be used to carry out the governmental purposes of the issue within the 3-year period beginning on the date the bonds are issued, and

(ii) not more than 50 percent of the proceeds of the issue are invested in nonpurpose investments (as defined in section 148 (f)(6)(A)) having a substantially guaranteed yield for 4 years or more.

(B) Exception for investment in tax-exempt bonds not subject to minimum tax

(i) In general Such term shall not include any bond issued as part of an issue 95 percent of the net proceeds of which are invested in bonds—,

(I) the interest on which is not includible in gross income under section 103, and

(II) which are not specified private activity bonds (as defined in section 57 (a)(5)(C)).

(ii) Amounts in bona fide debt service fund Amounts in a bona fide debt service fund shall be treated as invested in bonds described in clause (i).

(iii) Amounts held pending reinvestment or redemption Amounts held for not more than 30 days pending reinvestment or bond redemption shall be treated as invested in bonds described in clause (i).

(C) Exception for refunding bonds

(i) In general A refunding bond shall be treated as meeting the requirements of this subsection only if the original bond met such requirements.

(ii) General rule for refunding of pre-effective date bonds A refunding bond shall be treated as meeting the requirements of this subsection if—

(I) this subsection does not apply to the original bond,

(II) the average maturity date of the issue of which the refunding bond is a part is not later than the average maturity date of the bonds to be refunded by such issue, and

(III) the amount of the refunding bond does not exceed the outstanding amount of the refunded bond.

(iii) Refunding of pre-effective date bonds entitled to 5-year temporary period A refunding bond shall be treated as meeting the requirements of this subsection if—

(I) this subsection does not apply to the original bond,

(II) the issuer reasonably expected that 85 percent of the spendable proceeds of the issue of which the original bond is a part would be used to carry out the governmental purposes of the issue within the 5-year period beginning on the date the original bonds were issued but did not reasonably expect that 85 percent of such proceeds would be so spent within the 3-year period beginning on such date, and

(III) at least 85 percent of the spendable proceeds of the original issue (and all other prior original issues issued to finance the governmental purposes of such issue) were spent before the date the refunding bonds are issued.

(4) Special rules

For purposes of this subsection—

(A) Construction period in excess of 5 years

The Secretary may, at the request of any issuer, provide that the requirement of paragraph (2) shall be treated as met with respect to the portion of the spendable proceeds of an issue which is to be used for any construction project having a construction period in excess of 5 years if it is reasonably expected that such proceeds will be spent over a reasonable construction schedule specified in such request.

(B) Rules for determining expectations

The rules of subsection (f)(2)(B) shall apply.

(5) Regulations

26 USC § 150 - Definitions and special rules

US Code Notes Updates

Current through Pub. L. 113-36. (See Public Laws for the current Congress.)

(a) General rule

For purposes of this part—

(1) Bond

The term "bond" includes any obligation.

(2) Governmental unit not to include Federal Government

The term "governmental unit" does not include the United States or any agency or instrumentality thereof.

(3) Net proceeds

The term "net proceeds" means, with respect to any issue, the proceeds of such issue reduced by amounts in a reasonably required reserve or replacement fund.

(4) 501(c)(3) organization

The term "501(c)(3) organization" means any organization described in section 501 (c) (3) and exempt from tax under section 501 (a).

(5) Ownership of property

Property shall be treated as owned by a governmental unit if it is owned on behalf of such unit.

(6) Tax-exempt bond

The term "tax-exempt" means, with respect to any bond (or issue), that the interest on such bond (or on the bonds issued as part of such issue) is excluded from gross income.

(b) Change in use of facilities financed with tax-exempt private activity bonds

(1) Mortgage revenue bonds

(A) In general

In the case of any residence with respect to which financing is provided from the proceeds of a tax-exempt qualified mortgage bond or qualified veterans' mortgage bond, if there is a continuous period of at least 1 year during which such residence is not the principal residence of at least 1 of the mortgagors who received such financing, then no deduction shall be allowed under this chapter for interest on such financing which accrues on or after the date such period began and before the date such residence is again the principal residence of at least 1 of the mortgagors who received such financing.

(B) Exception

Subparagraph (A) shall not apply to the extent the Secretary determines that its application would result in undue hardship and that the failure to meet the

requirements of subparagraph (A) resulted from circumstances beyond the mortgagor's control.

(2) Qualified residential rental projects

In the case of any project for residential rental property—

(A) with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt bond described in paragraph (7) of section 142 (a), and

(B) which does not meet the requirements of section 142 (d),

no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the 1st day of the taxable year in which such project fails to meet such requirements and ending on the date such project meets such requirements. If the provisions of prior law corresponding to section 142 (d) apply to a refunded bond, such provisions shall apply (in lieu of section 142 (d)) to the refunding bond.

(3) Qualified 501(c)(3) bonds

(A) In general

In the case of any facility with respect to which financing is provided from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt qualified 501(c)(3) bond, if any portion of such facility—

(i) is used in a trade or business of any person other than a 501(c)(3) organization or a governmental unit, but

(ii) continues to be owned by a 501(c)(3) organization,

then the owner of such portion shall be treated for purposes of this title as engaged in an unrelated trade or business (as defined in section 513) with respect to such portion. The amount of gross income attributable to such portion for any period shall not be less than the fair rental value of such portion for such period.

(B) Denial of deduction for interest

No deduction shall be allowed under this chapter for interest on financing described in subparagraph (A) which accrues during the period beginning on the date such facility is used as described in subparagraph (A)(i) and ending on the date such facility is not so used.

(4) Certain exempt facility bonds and small issue bonds

(A) In general

In the case of any facility with respect to which financing is provided from the proceeds of any private activity bond to which this paragraph applies, if such facility is not used for a purpose for which a tax-exempt bond could be issued on the date of such issue, no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the date such facility is not so used and ending on the date such facility is so used.

(B) Bonds to which paragraph applies

This paragraph applies to any private activity bond which, when issued, purported to be a tax-exempt exempt facility bond described in a paragraph (other than paragraph (7)) of section 142 (a) or a qualified small issue bond.

(5) Facilities required to be owned by governmental units or 501(c)(3) organizations

If—

(A) financing is provided with respect to any facility from the proceeds of any private activity bond which, when issued, purported to be a tax-exempt bond,

(B) such facility is required to be owned by a governmental unit or a 501(c)(3) organization as a condition of such tax exemption, and

(C) such facility is not so owned,

then no deduction shall be allowed under this chapter for interest on such financing which accrues during the period beginning on the date such facility is not so owned and ending on the date such facility is so owned.

(6) Small issue bonds which exceed capital expenditure limitation

In the case of any financing provided from the proceeds of any bond which, when issued, purported to be a qualified small issue bond, no deduction shall be allowed under this chapter for interest on such financing which accrues during the period such bond is not a qualified small issue bond.

(c) Exception and special rules for purposes of subsection (b)

For purposes of subsection (b)—

(1) Exception

Any use with respect to facilities financed with proceeds of an issue which are not required to be used for the exempt purpose of such issue shall not be taken into account.

(2) Treatment of amounts other than interest

If the amounts payable for the use of a facility are not interest, subsection (b) shall apply to such amounts as if they were interest but only to the extent such amounts for any period do not exceed the amount of interest accrued on the bond financing for such period.

(3) Use of portion of facility

In the case of any person which uses only a portion of the facility, only the interest accruing on the financing allocable to such portion shall be taken into account by such person.

(4) Cessation with respect to portion of facility

In the case of any facility where part but not all of the facility is not used for an exempt purpose, only the interest accruing on the financing allocable to such part shall be taken into account.

(5) Regulations

The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of this subsection and subsection (b).

(d) Qualified scholarship funding bond

For purposes of this part and section 103—

(1) Treatment as State or local bond

A qualified scholarship funding bond shall be treated as a State or local bond.

(2) Qualified scholarship funding bond defined

The term "qualified scholarship funding bond" means a bond issued by a corporation which—

(A) is a corporation not for profit established and operated exclusively for the purpose of acquiring student loan notes incurred under the Higher Education Act of 1965, and

(B) is organized at the request of the State or 1 or more political subdivisions thereof or is requested to exercise such power by 1 or more political subdivisions and required by its corporate charter and bylaws, or required by State law, to devote any income (after payment of expenses, debt service, and the creation of reserves for the same) to the purchase of additional student loan notes or to pay over any income to the United States.

(3) Election to cease status as qualified scholarship funding corporation

(A) In general

Any qualified scholarship funding bond, and qualified student loan bond, outstanding on the date of the issuer's election under this paragraph (and any bond (or series of bonds) issued to refund such a bond) shall not fail to be a tax-exempt bond solely

because the issuer ceases to be described in subparagraphs (A) and (B) of paragraph (2) if the issuer meets the requirements of subparagraphs (B) and (C) of this paragraph.

(B) Assets and liabilities of issuer transferred to taxable subsidiary

The requirements of this subparagraph are met by an issuer if—

(i) all of the student loan notes of the issuer and other assets pledged to secure the repayment of qualified scholarship funding bond indebtedness of the issuer are transferred to another corporation within a reasonable period after the election is made under this paragraph;

(ii) such transferee corporation assumes or otherwise provides for the payment of all of the qualified scholarship funding bond indebtedness of the issuer within a reasonable period after the election is made under this paragraph;

(iii) to the extent permitted by law, such transferee corporation assumes all of the responsibilities, and succeeds to all of the rights, of the issuer under the issuer's agreements with the Secretary of Education in respect of student loans;

(iv) immediately after such transfer, the issuer, together with any other issuer which has made an election under this paragraph in respect of such transferee, hold all of the senior stock in such transferee corporation; and

(v) such transferee corporation is not exempt from tax under this chapter.

(C) Issuer to operate as independent organization described in section 501(c)(3)

The requirements of this subparagraph are met by an issuer if, within a reasonable period after the transfer referred to in subparagraph (B)—

(i) the issuer is described in section 501 (c)(3) and exempt from tax under section 501 (a);

(ii) the issuer no longer is described in subparagraphs (A) and (B) of paragraph (2); and

(iii) at least 80 percent of the members of the board of directors of the issuer are independent members.

(D) Senior stock

For purposes of this paragraph, the term "senior stock" means stock—

(i) which participates pro rata and fully in the equity value of the corporation with all other common stock of the corporation but which has the right to payment of liquidation proceeds prior to payment of liquidation proceeds in respect of other common stock of the corporation;

(ii) which has a fixed right upon liquidation and upon redemption to an amount equal to the greater of—

(I) the fair market value of such stock on the date of liquidation or redemption (whichever is applicable); or

(II) the fair market value of all assets transferred in exchange for such stock and reduced by the amount of all liabilities of the corporation which has made an election under this paragraph assumed by the transferee corporation in such transfer;

(iii) the holder of which has the right to require the transferee corporation to redeem on a date that is not later than 10 years after the date on which an election under this paragraph was made and pursuant to such election such stock was issued; and

(iv) in respect of which, during the time such stock is outstanding, there is not outstanding any equity interest in the corporation having any liquidation, redemption or dividend rights in the corporation which are superior to those of such stock.

(E) Independent member

The term "independent member" means a member of the board of directors of the issuer who (except for services as a member of such board) receives no compensation directly or indirectly—

(i) for services performed in connection with such transferee corporation, or

(ii) for services as a member of the board of directors or as an officer of such transferee corporation.

For purposes of clause (ii), the term "officer" includes any individual having powers or responsibilities similar to those of officers.

(F) Coordination with certain private foundation taxes

For purposes of sections 4942 (relating to the excise tax on a failure to distribute income) and 4943 (relating to the excise tax on excess business holdings), the transferee corporation referred to in subparagraph (B) shall be treated as a functionally related business (within the meaning of section 4942 (j)(4)) with respect to the issuer during the period commencing with the date on which an election is made under this paragraph and ending on the date that is the earlier of—

(i) the last day of the last taxable year for which more than 50 percent of the gross income of such transferee corporation is derived from, or more than 50 percent of the assets (by value) of such transferee corporation consists of, student loan notes incurred under the Higher Education Act of 1965; or

(ii) the last day of the taxable year of the issuer during which occurs the date which is 10 years after the date on which the election under this paragraph is made.

(G) Election

An election under this paragraph may be revoked only with the consent of the Secretary.

(e) Bonds of certain volunteer fire departments

For purposes of this part and section 103—

(1) In general

A bond of a volunteer fire department shall be treated as a bond of a political subdivision of a State if—

(A) such department is a qualified volunteer fire department with respect to an area within the jurisdiction of such political subdivision, and

(B) such bond is issued as part of an issue 95 percent or more of the net proceeds of which are to be used for the acquisition, construction, reconstruction, or improvement of a firehouse (including land which is functionally related and subordinate thereto) or firetruck used or to be used by such department.

(2) Qualified volunteer fire department

For purposes of this subsection, the term "qualified volunteer fire department" means, with respect to a political subdivision of a State, any organization—

(A) which is organized and operated to provide firefighting or emergency medical services for persons in an area (within the jurisdiction of such political subdivision) which is not provided with any other firefighting services, and

(B) which is required (by written agreement) by the political subdivision to furnish firefighting services in such area.

For purposes of subparagraph (A), other firefighting services provided in an area shall be disregarded in determining whether an organization is a qualified volunteer fire department if such other firefighting services are provided by a qualified volunteer fire department (determined with the application of this sentence) and such organization and the provider of such other services have been continuously providing firefighting services to such area since January 1, 1981.

(3) Treatment as private activity bonds only for certain purposes

Bonds which are part of an issue which meets the requirements of paragraph (1) shall not be treated as private activity bonds except for purposes of sections 147 (f) and 149 (d).

EXHIBIT 2

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
Chapter 24. Of the Consolidated Laws
Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 852

§ 852. Policy and purposes of article

Effective: August 17, 2011
Currentness

It is hereby declared to be the policy of this state to promote the economic welfare, recreation opportunities and prosperity of its inhabitants and to actively promote, attract, encourage and develop recreation, economically sound commerce and industry and economically sound projects identified and called for to implement a state heritage area management plan as provided in title G of the parks, recreation and historic preservation law through governmental action for the purpose of preventing unemployment and economic deterioration by the creation of industrial development agencies which are hereby declared to be governmental agencies and instrumentalities and to grant to such industrial development agencies the rights and powers provided in this article.

It is hereby further declared to be the policy of this state to protect and promote the health of the inhabitants of this state by the conservation, protection and improvement of the natural and cultural or historic resources and environment and to control land, sewer, water, air, noise or general environmental pollution derived from the operation of industrial, manufacturing, warehousing, commercial, recreation, horse racing facilities, railroad facilities, automobile racing facilities and research facilities and to grant such industrial development agencies the rights and powers provided by this article with respect to industrial pollution control facilities.

It is hereby further declared to be the policy of this state to protect and promote the health of the inhabitants of this state and to increase trade through promoting the development of facilities to provide recreation for the citizens of the state and to attract tourists from other states.

The use of all such rights and powers is a public purpose essential to the public interest, and for which public funds may be expended.

Credits

(Added L.1969, c. 1030, § 1. Amended L.1971, c. 978, § 1; L.1974, c. 954, § 1; L.1977, c. 267, § 16; L.1977, c. 630, § 1; L.1980, c. 803, § 1; L.1982, c. 541, § 5; L.2005, c. 747, § 15, eff. Oct. 18, 2005; L.2011, c. 478, § 1, eff. Aug. 17, 2011.)

McKinney's General Municipal Law § 852, NY GEN MUN § 852
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
Chapter 24. Of the Consolidated Laws
Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 854

§ 854. Definitions

Effective: March 28, 2013
Currentness

As used in this act, unless the context otherwise requires:

(1) "Agency"--shall mean an Industrial Development Agency created pursuant to this act.

(2) "Bonds"--shall mean the bonds, notes, interim certificates and other obligations issued by the agency pursuant to this act.

(3) "Municipality"--shall mean any county, city, village, town or Indian reservation in the state.

(4) "Project"--shall mean any land, any building or other improvement, and all real and personal properties located within the state of New York and within or outside or partially within and partially outside the municipality for whose benefit the agency was created, including, but not limited to, machinery, equipment and other facilities deemed necessary or desirable in connection therewith, or incidental thereto, whether or not now in existence or under construction, which shall be suitable for manufacturing, warehousing, research, commercial or industrial purposes or other economically sound purposes identified and called for to implement a state designated urban cultural park management plan as provided in title G of the parks, recreation and historic preservation law and which may include or mean an industrial pollution control facility, a recreation facility, educational or cultural facility, a horse racing facility, a railroad facility or an automobile racing facility, provided, however, no agency shall use its funds or provide financial assistance in respect of any project wholly or partially outside the municipality for whose benefit the agency was created without the prior consent thereto by the governing body or bodies of all the other municipalities in which a part or parts of the project is, or is to be, located, and such portion of the project located outside such municipality for whose benefit the agency was created shall be contiguous with the portion of the project inside such municipality.

(5) "Governing body"--shall mean the board or body in which the general legislative powers of the municipality are vested.

(6) "Mortgage"--shall mean a mortgage or other security device.

(7) "Revenues"--shall mean all rents, revenues, fees, charges and other sources of income derived by the agency from the leasing, sale or other disposition of a project or projects.

(8) "Industrial pollution control facility"--shall mean any equipment, improvement, structure or facility or any land and any building, structure, facility or other improvement thereon, or any combination thereof, and all real and personal property deemed necessary therewith, which if within any city are not of a character or nature then or formerly furnished or supplied by the city, having to do with or the end purpose of which is the control, abatement or prevention of land, sewer, water, air, noise or general environmental pollution deriving from the operation of industrial, manufacturing, warehousing, commercial, recreation and research facilities, including, but not limited to any air pollution control facility, noise abatement facility, water management facility, waste water collecting system, waste water treatment works, sewage treatment works system, sewage treatment system or solid waste disposal facility or site.

(9) "Recreation facility"--shall mean any facility for the use of the general public as spectators or participants in recreation activities, including but not limited to skiing, golfing, swimming, tennis, ice skating or ice hockey facilities, together with all buildings, structures, machinery, equipment, facilities and appurtenances thereto which the agency may deem necessary, useful or desirable in connection with the construction, improvement or operation of any such facility, including overnight accommodations and other facilities incidental thereto and facilities that may permit the use of recreation facilities by the general public as participants in recreation activities, but shall not include facilities for automobile or horse racing or other similar activities.

(10) "Horse racing facility"--shall mean any facility for the use of the general public for purpose of conducting pari-mutuel wagering, licensed by the state gaming commission, as of January first, nineteen hundred seventy-seven, except non-profit racing associations, including buildings, structures, machinery, equipments, facilities and appurtenances thereto, the construction, reconstruction, acquisition and/or improvement of which shall have been approved by the state gaming commission, and which the agency may deem necessary, useful or desirable in connection with the construction, improvement or operation of such racing facility.

(11) "Railroad facility"--shall mean, but shall not be limited to, railroad rights-of-way, beds, bridges, viaducts, tracks, switches and rolling stock and any other attendant structure, equipment, facility or property necessary or appropriate to railroading conducted in conjunction with industrial, commercial, manufacturing, recreational or warehousing operations; provided, however, that (i) no agency shall itself operate a railroad facility for freight or passenger service, but may lease or otherwise make such facility available to an operator, subject to an agreement for the maintenance and operation of such facility for freight or passenger service, provided that passenger service does not constitute the primary purpose of the railroad facility; (ii) prior to undertaking any project involving acquisition, construction, reconstruction, improvement, maintenance, equipping or furnishing of a railroad facility, an agency shall submit its plans for the proposed project to the commissioner of transportation; the commissioner shall, within sixty days of his receipt of the proposal, submit an analysis of the financial and operational feasibility of the proposed project, along with any recommendations for modification for improving the project's viability, to the agency, the governor, the commissioner of commerce, the temporary president of the senate, the speaker of the assembly and the governing body of the municipality in which the agency is located; and (iii) no agency shall enter into any contract for the acquisition, construction, reconstruction, improvement, maintenance, equipping or furnishing of a railroad facility until fifteen days after the submission of the analysis and recommendations of the commissioner of transportation, or seventy-five days after submission of the agency's plan to the commissioner, whichever is earlier.

(12) "Educational or cultural facility"--shall mean any facility identified and called for to implement a state designated heritage area management plan as provided in title G of the parks, recreation and historic preservation law that is open to the public at large as participants in educational and cultural activities including but not limited to theaters, museums, exhibitions and festival and interpretive facilities, together with buildings, structures, machinery, equipment, facilities and appurtenances thereto which the agency may deem necessary, useful or desirable in connection with the construction, improvement or operation of any such

facility, including overnight accommodations and other facilities incidental thereto and facilities that may permit the use of educational or cultural facilities by the general public.

(13) Expired and deemed repealed January 31, 2008, pursuant to L.1986, c. 905, § 5; L.1997, c. 444, § 8(3).

(14) "Financial assistance" -- shall mean the proceeds of bonds issued by an agency, straight-leases, or exemptions from taxation claimed by a project occupant as a result of an agency taking title, possession or control (by lease, license or otherwise) to the property or equipment of such project occupant or of such project occupant acting as an agent of an agency.

(15) "Straight-lease transaction" -- shall mean a transaction in which an agency takes title, possession or control (by lease, license or otherwise) to the property or equipment of a project occupant, entitling such property or equipment to be exempt from taxation according to the provisions of section eight hundred seventy-four of this article, and no financial assistance in the form of the proceeds of bonds issued by the agency is provided to the project occupant.

(16) "Affected tax jurisdiction" -- shall mean any municipality or school district, in which a project is located, which will fail to receive real property tax payments, or other tax payments which would otherwise be due, except for the tax exempt status of an agency involved in a project.

(17) "Payments in lieu of taxes" -- shall mean any payment made to an agency, or affected tax jurisdiction equal to the amount, or a portion of, real property taxes, or other taxes, which would have been levied by or on behalf of an affected tax jurisdiction if the project was not tax exempt by reason of agency involvement.

(18) "Highly distressed area" -- shall mean (a) a census tract or tracts or block numbering areas or areas or such census tract or block numbering area contiguous thereto which, according to the most recent census data available, has:

(i) a poverty rate of at least twenty percent for the year to which the data relates or at least twenty percent of households receiving public assistance; and

(ii) an unemployment rate of at least 1.25 times the statewide unemployment rate for the year to which the data relates; or

(b) a city, town, village or county within a city with a population of one million or more for which: (i) the ratio of the full value property wealth, as determined by the comptroller for the year nineteen hundred ninety, per resident to the statewide average full value property wealth per resident; and (ii) the ratio of the income per resident; as shown in the nineteen hundred ninety census to the statewide average income per resident; are each fifty-five percent or less of the statewide average; or

(c) an area which was designated an empire zone pursuant to article eighteen-B of this chapter.

(19) "Continuing care retirement community"--shall mean any facility that has been granted a certificate of authority pursuant to article forty-six or forty-six-A of the public health law and is established to provide, pursuant to continuing care retirement contracts approved pursuant to article forty-six of the public health law, or fee-for-service continuing care contracts approved pursuant to article forty-six-A of the public health law, a comprehensive, cohesive living arrangement for the elderly, and

certified by the commissioner of health, that (i) has been approved for the issuance of industrial development agency bonds by the continuing care retirement community council pursuant to section forty-six hundred four-a of the public health law except that paragraphs b and g of subdivision two of section forty-six hundred four-a of the public health law shall not apply to a continuing care retirement community granted a certificate of authority pursuant to article forty-six-A of the public health law and (ii) is a not-for-profit corporation as defined in section one hundred two of the not-for-profit corporation law that is (a) eligible for tax-exempt financing under section forty-six hundred four-a of the public health law and this chapter and (b) is exempt from taxation pursuant to section 501(c)(3) of the federal internal revenue code; [1] except that "continuing care retirement community" shall not include a facility granted a certificate of authority upon application of a state or local government applicant.

(20) "Automobile racing facility" shall mean any closed-course motorsports complex and its ancillary grounds that has at least fifty thousand fixed seats for race patrons and hosts at least one NASCAR Sprint Cup series race and at least two other nationally recognized racing events each calendar year.

Credits

(Added L.1969, c. 1030, § 1. Amended L.1971, c. 978, §§ 2, 3; L.1972, c. 190, § 1; L.1973, c. 353, § 1; L.1974, c. 954, §§ 2 to 4; L.1977, c. 267, §§ 17, 18; L.1977, c. 630, §§ 2, 3; L.1980, c. 803, §§ 2, 3; L.1982, c. 541, §§ 6, 7; L.1986, c. 905, §§ 1, 2; L.1988, c. 633, § 1; L.1993, c. 356, §§ 3, 4; L.1994, c. 66, §§ 8, 9; L.1997, c. 444, § 2, eff. Oct. 19, 1997; L.1997, c. 659, §§ 70, 71, eff. Sept. 24, 1997; L.1999, c. 444, § 1, eff. Aug. 31, 1999; L.2005, c. 58, pt. C, § 49, eff. April 12, 2005, deemed eff. April 1, 2005; L.2005, c. 747, § 16, eff. Oct. 18, 2005; L.2011, c. 478, §§ 2, 3, eff. Aug. 17, 2011; L.2012, c. 60, pt. A, § 10; L.2013, c. 59, pt. J, § 6, eff. March 28, 2013.)

Notes of Decisions (12)

Footnotes

1 26 USCA § 1 et seq.

McKinney's General Municipal Law § 854, NY GEN MUN § 854

Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
Chapter 24. Of the Consolidated Laws
Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 856

§ 856. Organization of industrial development agencies

Currentness

1. (a) Upon the establishment of an industrial development agency by special act of the legislature, the governing body of the municipality for whose benefit such agency is established shall file within six months after the effective date of the special act of the legislature establishing such agency or before the first day of July, nineteen hundred sixty-nine, whichever date shall be later, in the office of the secretary of state, a certificate setting forth: (1) the date of passage of the special act establishing the agency; (2) the name of the agency; (3) the names of the members and their terms of office, specifying which member is the chairman; and (4) facts establishing the need for the establishment of an agency in such municipality.

(b) Every such agency shall be perpetual in duration, except that if (1) such certificate is not filed with the secretary of state within six months after the effective date of the special act of the legislature establishing such agency or before the first day of July, nineteen hundred sixty-nine, whichever date shall be later, or if (2) at the expiration of ten years subsequent to the effective date of the special act, there shall be outstanding no bonds or other obligations theretofore issued by such agency or by the municipality for or in behalf of the agency, then the corporate existence of such agency shall thereupon terminate and it shall thereupon be deemed to be and shall be dissolved.

(c) On or before March first of each year, the secretary of state shall prepare a list of agencies which failed to file a certificate in accordance with provisions of paragraph (a) of this subdivision within the preceding calendar year and transmit a copy of such list to the state comptroller and the commissioner of the department of economic development. On or before March first of each year the commissioner of the department of economic development shall prepare a list of agencies which have dissolved pursuant to paragraph (b) of this subdivision or have ceased to exist pursuant to section eight hundred eighty-two of this chapter and shall transmit a copy of such list to the state comptroller.

2. An agency shall be a corporate governmental agency, constituting a public benefit corporation. Except as otherwise provided by special act of the legislature, an agency shall consist of not less than three nor more than seven members who shall be appointed by the governing body of each municipality and who shall serve at the pleasure of the appointing authority. Such members may include representatives of local government, school boards, organized labor and business. A member shall continue to hold office until his successor is appointed and has qualified. The governing body of each municipality shall designate the first chairman and file with the secretary of state a certificate of appointment or reappointment of any member. Such members shall receive no compensation for their services but shall be entitled to the necessary expenses, including traveling expenses, incurred in the discharge of their duties.

3. A majority of the members of an agency shall constitute a quorum.

4. Any one or more of the members of an agency may be an official or an employee of the municipality. In the event that an official or an employee of the municipality shall be appointed as a member of the agency, acceptance or retention of such appointment shall not be deemed a forfeiture of his municipal office or employment, or incompatible therewith or affect his tenure or compensation in any way. The term of office of a member of an agency who is an official or an employee of the municipality when appointed as a member thereof by special act of the legislature creating the industrial development agency shall terminate at the expiration of the term of his municipal office.

Credits

(Added L.1969, c. 1030, § 1. Amended L.1978, c. 143, § 1; L.1989, c. 692, § 3; L.1993, c. 356, § 5.)

Notes of Decisions (7)

McKinney's General Municipal Law § 856, NY GEN MUN § 856
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
Chapter 24. Of the Consolidated Laws
Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 858

§ 858. Purposes and powers of the agency

Effective: August 17, 2011
Currentness

The purposes of the agency shall be to promote, develop, encourage and assist in the acquiring, constructing, reconstructing, improving, maintaining, equipping and furnishing industrial, manufacturing, warehousing, commercial, research and recreation facilities including industrial pollution control facilities, educational or cultural facilities, railroad facilities, horse racing facilities, automobile racing facilities and continuing care retirement communities, provided, however, that, of agencies governed by this article, only agencies created for the benefit of a county and the agency created for the benefit of the city of New York shall be authorized to provide financial assistance in any respect to a continuing care retirement community, and thereby advance the job opportunities, health, general prosperity and economic welfare of the people of the state of New York and to improve their recreation opportunities, prosperity and standard of living; and to carry out the aforesaid purposes, each agency shall have the following powers:

(1) To sue and be sued;

(2) To have a seal and alter the same at pleasure;

(3) To acquire, hold and dispose of personal property for its corporate purposes;

(4) To acquire by purchase, grant, lease, gift, pursuant to the provisions of the eminent domain procedure law, or otherwise and to use, real property or rights or easements therein necessary for its corporate purposes in compliance with the local zoning and planning regulations and shall take into consideration regional and local comprehensive land use plans and state designated heritage area management plans, and to sell, convey, mortgage, lease, pledge, exchange or otherwise dispose of any such property in such manner as the agency shall determine. In the case of railroad facilities, however, the phrase to use real property or rights or easements therein shall not be interpreted to include operation by the agency of rail service upon or in conjunction with such facilities.

(5) To make by-laws for the management and regulation of its affairs and, subject to agreements with its bondholders, for the regulation of the use of a project or projects.

(6) With the consent of the municipality, to use agents, employees and facilities of the municipality, paying the municipality its agreed proportion of the compensation or costs;

(7) To appoint officers, agents and employees, to prescribe their qualifications and to fix their compensation and to pay the same out of funds of the agency;

(8)(a) To appoint an attorney, who may be the counsel of the municipality, and to fix the attorney's compensation for services which shall be payable to the attorney, and to retain and employ private consultants for professional and technical assistance and advice;

(b) An attorney acting as bond counsel for a project must file with the agency a written statement in which the attorney identifies each party to the transaction which such attorney represents. If bond counsel provides any legal services to parties other than the agency the written statement must describe the nature of legal services provided by such bond counsel to all parties to the transaction, including the nature of the services provided to the agency.

(9) To make contracts and leases, and to execute all instruments necessary or convenient to or with any person, firm, partnership or corporation, either public or private; provided, however, that any extension of an existing contract, lease or other agreement entered into by an agency with respect to a project shall be guided by the provisions of this article;

(10) To acquire, construct, reconstruct, lease, improve, maintain, equip or furnish one or more projects;

(11) To accept gifts, grants, loans, or contributions from, and enter into contracts or other transactions with, the United States and the state or any agency of either of them, any municipality, any public or private corporation or any other legal entity, and to use any such gifts, grants, loans or contributions for any of its corporate purposes;

(12) To borrow money and to issue bonds and to provide for the rights of the holders thereof;

(13) To grant options to renew any lease with respect to any project or projects and to grant options to buy any project at such price as the agency may deem desirable;

(14) To designate the depositories of its money either within or without the state;

(15) To enter into agreements requiring payments in lieu of taxes. Such agreements shall be in writing and in addition to other terms shall contain: the amount due annually to each affected tax jurisdiction (or a formula by which the amount due can be calculated), the name and address of the person, office or agency to which payment shall be delivered, the date on which payment shall be made, and the date on which payment shall be considered delinquent if not paid. Unless otherwise agreed by the affected tax jurisdictions, any such agreement shall provide that payments in lieu of taxes shall be allocated among affected tax jurisdictions in proportion to the amount of real property tax and other taxes which would have been received by each affected tax jurisdiction had the project not been tax exempt due to the status of the agency involved in the project. A copy of any such agreement shall be delivered to each affected tax jurisdiction within fifteen days of signing the agreement. In the absence of any such written agreement, payments in lieu of taxes made by an agency shall be allocated in the same proportions as they had been prior to January first, nineteen hundred ninety-three for so long as the agency's activities render a project non-taxable by affected tax jurisdictions;

(16) To establish and re-establish its fiscal year; and

(17) To do all things necessary or convenient to carry out its purposes and exercise the powers expressly given in this title.

Credits

(Added L.1969, c. 1030, § 1. Amended L.1971, c. 978, § 4; L.1974, c. 669, § 1; L.1974, c. 954, § 5; L.1977, c. 276, § 19; L.1977, c. 630, § 4; L.1978, c. 727, § 6; L.1980, c. 803, §§ 4, 5; L.1982, c. 541, § 8; L.1993, c. 356, §§ 6, 7; L.1994, c. 66, § 10; L.1997, c. 444, § 7, eff. Aug. 20, 1997; L.1997, c. 659, § 72, eff. Sept. 24, 1997; L.2005, c. 747, § 17, eff. Oct. 18, 2005; L.2011, c. 478, § 4, eff. Aug. 17, 2011.)

Notes of Decisions (37)

McKinney's General Municipal Law § 858, NY GEN MUN § 858
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
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Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 858-a

§ 858-a. Compensation, procurement and investment

Currentness

1. The compensation of an officer or full-time employee of the agency (but not including part-time employees or consultants, including accountants, attorneys and bond counsel to the agency) shall not be contingent on the granting of financial assistance by an agency.

2. The provisions of section one hundred four-b of this chapter shall be applicable to the procurement of goods and services paid for by an agency for its own use and account.

3. The provisions of sections ten and eleven of this chapter shall be applicable to deposits and investments of funds for an agency's own use and account.

Credits
(Added L.1993, c. 356, § 8.)

Notes of Decisions (1)

McKinney's General Municipal Law § 858-a, NY GEN MUN § 858-a
Current through L.2013, chapters 1 to 340.

End of Document

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General Municipal Law (Refs & Annos)
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McKinney's General Municipal Law § 858-b

§ 858-b. Equal employment opportunities

Currentness

1. Each agency shall ensure that all employees and applicants for employment are afforded equal employment opportunity without discrimination.

2. Except as is otherwise provided by collective bargaining contracts or agreements, new employment opportunities created as a result of projects of the agency shall be listed with the New York state department of labor community services division, and with the administrative entity of the service delivery area created by the federal job training partnership act (P.L. No. 97-300) in which the project is located. Except as is otherwise provided by collective bargaining contracts or agreements, sponsors of projects shall agree, where practicable, to first consider persons eligible to participate in the federal job training partnership (P.L. No. 97-300) programs who shall be referred by administrative entities of service delivery areas created pursuant to such act or by the community services division of the department of labor for such such [1] new employment opportunities.

Credits
(Added L.1993, c. 356, § 9.)

Footnotes
1 So in original. Inadvertently added second "such".
McKinney's General Municipal Law § 858-b, NY GEN MUN § 858-b
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
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Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 859

§ 859. Financial records

Effective: May 15, 2003
Currentness

1. (a) Each agency shall maintain books and records in such form as may be prescribed by the state comptroller.

(b) Within ninety days following the close of its fiscal year, each agency or authority shall prepare a financial statement for that fiscal year in such form as may be prescribed by the state comptroller. Such statement shall be audited within such ninety day period by an independent certified public accountant in accordance with government accounting standards established by the United States general accounting office. The audited financial statement shall include supplemental schedules listing all straight-lease transactions and bonds and notes issued, outstanding or retired during the applicable accounting period whether or not such bonds, notes or transactions are considered obligations of the agency. For each issue of bonds or notes such schedules shall provide the name of each project financed with proceeds of each issue, and whether the project occupant is a not-for-profit corporation, the name and address of each owner of each project, the estimated amount of tax exemptions authorized for each project, the purpose for which each bond or note was issued, date of issue, interest rate at issuance and if variable the range of interest rates applicable, maturity date, federal tax status of each issue, and an estimate of the number of jobs created and retained by each project. For each straight-lease transaction, such schedules shall provide the name of each project, and whether the project occupant is a not-for-profit corporation, the name and address of each owner of each project, the estimated amount of tax exemptions authorized for each project, the purpose for which each transaction was made, the method of financial assistance utilized by the project, other than the tax exemptions claimed by the project and an estimate of the number of jobs created and retained by each project.

(c) Within thirty days after completion, a copy of the audited financial statement shall be transmitted to the commissioner of the department of economic development, the state comptroller and the governing body of the municipality for whose benefit the agency was created.

(d) An agency with no bonds or notes issued or outstanding and no projects during the applicable accounting period may apply to the state comptroller for a waiver of the required audited financial statement. Application shall be made on such form as the comptroller may prescribe.

(e) If an agency or authority shall fail to file or substantially complete, as determined by the state comptroller, the financial statement required by this section, the state comptroller shall provide notice to the agency or authority. The notice shall state the following:

(i) that the failure to file a financial statement as required is a violation of this section, or in the case of an insufficient financial statement, the manner in which the financial statement submitted is deficient;

(ii) that the agency or authority has thirty days to comply with this section or provide an adequate written explanation to the comptroller of the agency's or authority's reasons for the inability to comply; and

(iii) that the agency's or authority's failure to provide either the required financial statement or an adequate explanation will result in the notification of the chief executive officer of the municipality for whose benefit the agency or authority was created of the agency's noncompliance with this section. Where such agency or authority has failed to file the required statement, the comptroller shall additionally notify the agency or authority that continued failure to file the required statement may result in loss of the agency's or authority's authority to provide exemptions from state taxes.

(iv) If an agency or authority after thirty days has failed to file the required statement or the explanation in the manner required by subparagraph (i) of this paragraph, or provides an insufficient explanation, the comptroller shall notify the chief executive officer of the municipality for whose benefit the agency or authority was created and the agency of the agency's or authority's noncompliance with this section. Such notice from the state comptroller shall further delineate in what respect the agency or authority has failed to comply with this section. If the agency or authority has failed to file the required statement, the notice shall additionally state that continued failure to file the required statement may result in loss of the agency's or authority's authority to provide exemptions from state taxes.

(v) If, thirty days after notification of the chief executive officer of the municipality for whose benefit the agency or authority was created of the agency's or authority's noncompliance, the agency or authority fails to file the required statement, the comptroller shall notify the chief executive officer of the municipality for whose benefit that agency or authority was created and the agency or authority that if such report is not provided within sixty days, that the agency or authority will no longer be authorized to provide exemptions from state taxes.

(vi) If, sixty days after the notification required by subparagraph (v) of this paragraph, the comptroller has not received the required statement, the agency or authority shall not offer financial assistance which provides exemptions from state taxes until such financial statement is filed and the comptroller shall so notify the agency or authority and the chief executive officer of the municipality for whose benefit the agency was created. Provided, however, that nothing contained in this paragraph shall be deemed to modify the terms of any existing agreements.

(f) Within thirty days after completion, a copy of an audited financial statement which contains transactions of or bonds or notes of civic facilities as defined in paragraph (b) of subdivision thirteen of section eight hundred fifty-four of this article, shall be transmitted by the agency to the commissioner of health, the chair of the senate finance committee, the chair of the assembly ways and means committee, the chair of the senate health committee and the chair of the assembly health committee.

2. On or before September first of each year, the commissioner of the department of economic development shall prepare and submit to the governor, speaker of the assembly, majority leader of the senate, and the state comptroller, a report setting forth a summary of the significant trends in operations and financing by agencies and authorities; departures from acceptable practices by agencies and authorities; a compilation by type of the bonds and notes outstanding; a compilation of all outstanding straight-lease transactions; an estimate of the total number of jobs created and retained by agency or authority projects; and any other information which in the opinion of the commissioner bears upon the discharge of the statutory functions of agencies and authorities.

3. On or before April first, nineteen hundred ninety-six, the commissioner shall submit to the director of the division of the budget, the temporary president of the senate, the speaker of the assembly, the chairman of the senate finance committee, the chairman of the assembly ways and means committee, the chairman of the senate local government committee, the chairman of the senate committee on commerce, economic development and small business, the chairman of the assembly committee on commerce, industry and economic development, the chairman of the assembly local governments committee and the chairman of the assembly real property taxation committee an evaluation of the activities of industrial development agencies and authorities in the state prepared by an entity independent of the department. Such evaluation shall identify the effect of agencies and authorities on: (a) job creation and retention in the state, including the types of jobs created and retained; (b) the value of tax exemptions provided by such agencies and authorities; (c) the value of payments received in lieu of taxes received by municipalities and school districts as a result of projects sponsored by such entities; (d) a summary of the types of projects that received financial assistance; (e) a summary of the types of financial assistance provided by the agencies and authorities; (f) a summary of criteria for evaluation of projects used by agencies and authorities; (g) a summary of tax exemption policies of agencies and authorities; and (h) such other factors as may be relevant to an assessment of the performance of such agencies and authorities in creating and retaining job opportunities for residents of the state. Such evaluation shall also assess the process by which agencies and authorities grant exemptions from state taxes and make recommendations for the most efficient and effective procedures for the use of such exemptions. Such evaluation shall further include any recommendations for changes in laws governing the operations of industrial development agencies and authorities which would enhance the creation and retention of jobs in the state.

Credits

(Added L.1989, c. 692, § 4. Amended L.1993, c. 356, §§ 10 to 12; L.1993, c. 357, §§ 1, 2; L.2003, c. 62, pt. A3, § 28, eff. May 15, 2003.)

McKinney's General Municipal Law § 859, NY GEN MUN § 859
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 859-a

§ 859-a. Additional prerequisites to the provisions of financial assistance

Effective: January 31, 2008
Currentness

Prior to providing any financial assistance of more than one hundred thousand dollars to any project, the agency must comply with the following prerequisites:

1. The agency must adopt a resolution describing the project and the financial assistance that the agency is contemplating with respect to such project. Such assistance shall be consistent with the uniform tax exemption policy adopted by the agency pursuant to subdivision four of section eight hundred seventy-four of this chapter, unless the agency has followed the procedures for deviation from such policy specified in paragraph (b) of such subdivision.

2. The agency must hold a public hearing with respect to the project and the proposed financial assistance being contemplated by the agency. Said public hearing shall be held in a city, town or village where the project proposes to locate. At said public hearing, interested parties shall be provided reasonable opportunity, both orally and in writing, to present their views with respect to the project.

3. The agency must give at least ten days published notice of said public hearing and shall, at the same time, provide notice of such hearing to the chief executive officer of each affected tax jurisdiction within which the project is located. The notice of hearing must state the time and place of the hearing, contain a general, functional description of the project, describe the prospective location of the project, identify the initial owner, operator or manager of the project and generally describe the financial assistance contemplated by the agency with respect to the project.

Credits
(Added L.1993, c. 356, § 13. Amended L.1997, c. 444, § 3, eff. Oct. 19, 1997.)

Notes of Decisions (1)

McKinney's General Municipal Law § 859-a, NY GEN MUN § 859-a
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 859-b

§ 859-b. Special procedure for the provision of financial assistance to continuing care retirement communities

Currentness

1. Any applicant for financing of a continuing care retirement community shall present a completed application for a certificate of authority and documentation establishing the continuing care retirement community council's approval of that application, pursuant to article forty-six of the public health law.

2. If requested by the agency, the applicant shall present an analysis dealing with any of the issues identified in paragraph (a) of subdivision four of section eight hundred seventy-four of this article.

3. Applicants shall present the financial feasibility study, including a financial forecast and market study, and the analysis of economic costs and benefits required by article forty-six of the public health law.

4. Any information presented by the applicant pursuant to subdivisions one, two and three of this section shall be made available at the time required for published notice of the public hearing required by section eight hundred fifty-nine-a of this article. The agency shall make such information available during regular office hours in at least two locations, at least one of which shall be in the city, town or village within which the proposed project is located. Such notice shall include a statement indicating the location and times of availability of the information required by this section.

5. The industrial development agency may require the applicant to provide any additional information which it requires in order to meet the purposes of this article.

Credits
(Added L.1994, c. 66, § 11. Amended L.1997, c. 659, § 73, eff. Sept. 24, 1997.)

McKinney's General Municipal Law § 859-b, NY GEN MUN § 859-b
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 860

§ 860. Moneys of the agency

Currentness

The agency shall have power to contract with the holders of any of its bonds or notes as to the custody, collection, securing, investment and payment of any moneys of the agency or any moneys held in trust or otherwise for the payment of bonds or notes or in any way to secure bonds or notes and to carry out any such contract. Moneys held in trust or otherwise for the payment of bonds or notes or in any way to secure bonds or notes and deposits of such moneys may be secured in the same manner as moneys of the agency, and all banks and trust companies are authorized to give such security for such deposits.

Credits
(Added L.1969, c. 1030, § 1.)

Notes of Decisions (1)

McKinney's General Municipal Law § 860, NY GEN MUN § 860
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 861

§ 861. Notification of budget

Currentness

Each agency shall mail or deliver to the chief executive officer and the governing body of the municipality for whose benefit the agency was established and make available for public inspection and comment its proposed budget for the forthcoming fiscal year, no later than twenty business days before adoption. At such time, the agency shall file its proposed budget with the clerk of the municipality for whose benefit the agency was established. Such proposed budget shall contain detailed estimates in writing of the amount of revenues to be received and expenditures to be made during the forth coming fiscal year. Following its consideration of the comments received, the agency may revise its budget accordingly and shall file the revised budget with the clerk of the municipality.

Credits
(Added L.1993, c. 356, § 14.)

McKinney's General Municipal Law § 861, NY GEN MUN § 861
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 862

§ 862. Restrictions on funds of the agency

Effective: March 28, 2013
Currentness

(1) No funds of the agency shall be used in respect of any project if the completion thereof would result in the removal of an industrial or manufacturing plant of the project occupant from one area of the state to another area of the state or in the abandonment of one or more plants or facilities of the project occupant located within the state, provided, however, that neither restriction shall apply if the agency shall determine on the basis of the application before it that the project is reasonably necessary to discourage the project occupant from removing such other plant or facility to a location outside the state or is reasonably necessary to preserve the competitive position of the project occupant in its respective industry.

(2)(a) Except as provided in paragraph (b) of this subdivision, no financial assistance of the agency shall be provided in respect of any project where facilities or property that are primarily used in making retail sales to customers who personally visit such facilities constitute more than one-third of the total project cost. For the purposes of this article, "retail sales" shall mean: (i) sales by a registered vendor under article twenty-eight of the tax law primarily engaged in the retail sale of tangible personal property, as defined in subparagraph (i) of paragraph four of subdivision (b) of section eleven hundred one of the tax law; or (ii) sales of a service to such customers. Except, however, that tourism destination projects shall not be prohibited by this subdivision. For the purpose of this paragraph, "tourism destination" shall mean a location or facility which is likely to attract a significant number of visitors from outside the economic development region as established by section two hundred thirty of the economic development law, in which the project is located.

(b) Notwithstanding the provisions of paragraph (a) of this subdivision, financial assistance may, however, be provided to a project where facilities or property that are primarily used in making retail sales of goods or services to customers who personally visit such facilities to obtain such goods or services constitute more than one-third of the total project cost, where: (i) the predominant purpose of the project would be to make available goods or services which would not, but for the project, be reasonably accessible to the residents of the city, town, or village within which the proposed project would be located because of a lack of reasonably accessible retail trade facilities offering such goods or services; or (ii) the project is located in a highly distressed area.

(c) With respect to projects authorized pursuant to paragraph (b) of this subdivision, no project shall be approved unless the agency shall find after the public hearing required by section eight hundred fifty-nine-a of this title that undertaking the project will serve the public purposes of this article by preserving permanent, private sector jobs or increasing the overall number of permanent, private sector jobs in the state. Where the agency makes such a finding, prior to providing financial assistance to the project by the agency, the chief executive officer of the municipality for whose benefit the agency was created shall confirm the proposed action of the agency.

Credits

(Added L.1969, c. 1030, § 1. Amended L.1993, c. 356, § 15; L.1993, c. 357, § 3; L.1997, c. 444, § 4, eff. Aug. 20, 1997; L.2013, c. 59, pt. J, § 1, eff. March 28, 2013.)

Notes of Decisions (14)

McKinney's General Municipal Law § 862, NY GEN MUN § 862
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McKinney's General Municipal Law § 862-a

§ 862-a. Additional restrictions on funds of the agency in connection with continuing care retirement communities

Currentness

No resolution authorizing the issuance of bonds, notes or other obligations of the agency, or for providing financial assistance in any respect, for any continuing care retirement community project shall be adopted unless and until the project has received a certificate of authorization pursuant to section forty-six hundred four-a of the public health law, and unless the project will serve the public purposes of this article by preserving permanent, private sector jobs or increasing the overall number of permanent, private sector jobs in the state.

Credits

(Added L.1994, c. 66, § 12. Amended L.1997, c. 659, § 74, eff. Sept. 24, 1997.)

McKinney's General Municipal Law § 862-a, NY GEN MUN § 862-a
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 864

§ 864. Bonds of the agency

Currentness

(1) The agency shall have the power and is hereby authorized from time to time to issue negotiable bonds for any of its corporate purposes without limitation as to amount. The agency shall have power from time to time and whenever it deems refunding expedient, to refund any bonds by the issuance of new bonds, whether the bonds to be refunded have or have not matured, and may issue bonds partly to refund bonds then outstanding and partly for any other purpose hereinabove described. The refunding bonds may be exchanged for the bonds to be refunded, with such cash adjustments as may be agreed, or may be sold and the proceeds applied to the purchase or redemption of the bonds to be refunded. Except as may otherwise be expressly provided by the agency, the bonds of every issue shall be special obligations of the agency payable solely from revenues derived from the leasing, sale or other disposition of a project, subject only to any agreements with the holders of particular bonds pledging any particular moneys or revenues. Whether or not the bonds are of such form and character as to be negotiable instruments under article eight of the uniform commercial code, [1] the bonds shall be, and are hereby made, negotiable instruments within the meaning of and for all the purposes of the uniform commercial code, subject only to the provisions of the bonds for registration.

(2) The bonds shall be authorized by resolution of the agency and shall bear such date or dates, mature at such time or times, bear interest at such rate or rates, payable at such time or times, be in such denominations, be in such form, either coupon or registered, carry such registration privileges, be executed in such manner, be payable in lawful money of the United States of America at such place or places, either within or without the state, and be subject to such terms of redemption as such resolution or resolutions may provide. The bonds may be sold at public or private sale at such price or prices as the agency shall determine.

(3) Any resolution or resolutions authorizing any bonds or any issue of bonds may contain provisions, which shall be a part of the contract with the holders of the bonds thereby authorized, as to:

(a) pledging all or any part of the revenues derived from the leasing, sale or other disposition of a project or projects to secure the payment of the bonds, subject to such agreements with bondholders as may then exist;

(b) the rentals, fees, and other charges to be charged, and the amounts to be raised in each year thereby, and the use and disposition of the revenues;

(c) the setting aside of reserves or sinking funds, and the regulation and disposition thereof;

(d) limitations on the right of the agency to restrict and regulate the use of a project;

(e) limitations on the purpose to which the proceeds of sale of any issue of bonds then or thereafter to be issued may be applied and pledging such proceeds to secure the payment of the bonds or any issue of the bonds;

(f) the terms upon which additional bonds may be issued and secured; the refunding of outstanding or other bonds;

(g) the procedure, if any, by which the terms of any contract with bondholders may be amended or abrogated, the amount of bonds the holders of which must consent thereto, and the manner in which such consent may be given;

(h) vesting in a trustee or trustees such property, rights, powers and duties in trust as the agency may determine which may include any or all the rights, powers and duties of the trustees appointed by the bondholders and limiting or abrogating the right of the bondholders to appoint a trustee or limiting the rights, duties and powers of trustee;

(i) any other matters, of like or different character, which in any way affect the security or protection of the bonds.

Credits

(Added L.1969, c. 1030, § 1.)

Footnotes

1 Uniform Commercial Code § 8-101 et seq.

McKinney's General Municipal Law § 864, NY GEN MUN § 864

Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 866

§ 866. Notes of the agency

Currentness

The agency shall have power from time to time to issue notes and from time to time to issue renewal notes (herein referred to as notes) maturing not later than five years from their respective original dates for any purpose or purposes for which bonds may be issued, whenever the agency shall determine that payment thereof can be made in full from any moneys or revenues which the agency expects to receive from any source. The agency may secure the notes in the same manner and with the same effect as herein provided for bonds. The notes shall be issued in the same manner as bonds. The agency shall have power to make contracts for the future sale from time to time of the notes, by which the purchasers shall be committed to purchase the notes from time to time on terms and conditions stated in such contracts, and the agency shall have power to pay such consideration as it shall deem proper for such commitments. In case of default on its notes or violation of any of the obligations of the agency to the noteholders, the noteholders shall have all the remedies provided herein for bondholders. Such notes shall be as fully negotiable as the bonds of the agency.

Credits
(Added L.1969, c. 1030, § 1.)

McKinney's General Municipal Law § 866, NY GEN MUN § 866
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 868

§ 868. Agreements of the municipality and state

Currentness

The municipality is authorized to, and the state does hereby, pledge to and agree with the holders of the bonds or notes that neither the municipality nor the state, respectively, will limit or alter the rights, hereby vested in the agency to acquire, construct, reconstruct, improve, maintain, equip and furnish the project or projects, to establish and collect rentals, fees and other charges and to fulfill the terms of any agreements made with the holders of the bonds or notes nor in any way impair the rights and remedies of the bondholders or noteholders until the bonds or notes, together with interest thereon, with interest on any unpaid installments of interest and all costs and expenses in connection with any action or proceeding by or on behalf of the bondholders or noteholders are fully met and discharged.

Credits
(Added L.1969, c. 1030, § 1.)

McKinney's General Municipal Law § 868, NY GEN MUN § 868
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 870

§ 870. State and municipality not liable on bonds or notes

Currentness

The bonds or notes and other obligations of the authority shall not be a debt of the state or of the municipality, and neither the state nor the municipality shall be liable thereon, nor shall they be payable out of any funds other than those of the agency.

Credits
(Added L.1969, c. 1030, § 1.)

Notes of Decisions (2)

McKinney's General Municipal Law § 870, NY GEN MUN § 870
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McKinney's General Municipal Law § 872

§ 872. Bonds and notes as legal investment

Currentness

The bonds and notes are hereby made securities in which all public officers and bodies of this state and all municipalities and municipal subdivisions, all insurance companies and associations and other persons carrying on an insurance business, all banks, bankers, trust companies, savings banks and savings associations, including savings and loan associations, building and loan associations, investment companies and other persons carrying on a banking business, and all other persons whatsoever except as hereinafter provided, who are now or may hereafter be authorized to invest in bonds or notes or other obligations of the state, may properly and legally invest funds including capital in their control or belonging to them. The bonds or notes are also hereby made securities which may be deposited with and shall be received by all public officers and bodies of this state and all municipalities and municipal subdivisions for any purpose for which the deposit of bonds or other obligations of this state is now or may hereafter be authorized.

Credits
(Added L.1969, c. 1030, § 1.)

Notes of Decisions (1)

McKinney's General Municipal Law § 872, NY GEN MUN § 872
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 874

§ 874. Tax exemptions

Effective: March 28, 2013
Currentness

(1) It is hereby determined that the creation of the agency and the carrying out of its corporate purposes is in all respects for the benefit of the people of the state of New York and is a public purpose, and the agency shall be regarded as performing a governmental function in the exercise of the powers conferred upon it by this title and shall be required to pay no taxes or assessments upon any of the property acquired by it or under its jurisdiction or control or supervision or upon its activities.

(2) Any bonds or notes issued pursuant to this title, together with the income therefrom, as well as the property of the agency, shall be exempt from taxation, except for transfer and estate taxes.

(3) Payments in lieu of taxes received by the agency shall be remitted to each affected tax jurisdiction within thirty days of receipt.

(4)(a) The agency shall establish a uniform tax exemption policy, with input from affected tax jurisdictions, which shall be applicable to the provision of financial assistance pursuant to section eight hundred fifty-nine-a of this chapter and shall provide guidelines for the claiming of real property, mortgage recording, and sales tax exemptions. Such guidelines shall include, but not be limited to: period of exemption; percentage of exemption; types of projects for which exemptions can be claimed; procedures for payments in lieu of taxes and instances in which real property appraisals are to be performed as a part of an application for tax exemption; in addition, agencies shall in adopting such policy consider such issues as: the extent to which a project will create or retain permanent, private sector jobs; the estimated value of any tax exemptions to be provided; whether affected tax jurisdictions shall be reimbursed by the project occupant if a project does not fulfill the purposes for which an exemption was provided; the impact of a proposed project on existing and proposed businesses and economic development projects in the vicinity; the amount of private sector investment generated or likely to be generated by the proposed project; the demonstrated public support for the proposed project; the likelihood of accomplishing the proposed project in a timely fashion; the effect of the proposed project upon the environment; the extent to which the proposed project will require the provision of additional services, including, but not limited to additional educational, transportation, police, emergency medical or fire services; and the extent to which the proposed project will provide additional sources of revenue for municipalities and school districts.

(b) The agency shall establish a procedure for deviation from the uniform tax exemption policy required pursuant to this subdivision. The agency shall set forth in writing the reasons for deviation from such policy, and shall further notify the affected local taxing jurisdictions of the proposed deviation from such policy and the reasons therefor.

(c) Expired and deemed repealed January 31, 2008, pursuant to L.1997, c. 444, § 8(3).

(5) Payments in lieu of taxes which are delinquent under the agreement or which an agency fails to remit pursuant to subdivision three of this section, shall be subject to a late payment penalty of five percent of the amount due which shall be paid by the project occupant (where taxes are delinquent because of the occupant's failure to make the required payment) or the agency (because of the agency's failure to remit pursuant to subdivision three of this section) to the affected tax jurisdiction at the time the payment in lieu of taxes is paid. For each month, or part thereof, that the payment in lieu of taxes is delinquent beyond the first month, interest shall accrue to and be paid to the affected tax jurisdiction on the total amount due plus a late payment penalty in the amount of one percent per month until the payment is made.

(6) An affected tax jurisdiction which has not received a payment in lieu of taxes due to it under an agreement may commence legal action in any court of competent jurisdiction directly against any person, firm, corporation, organization or agency which is obligated to make payments in lieu of taxes under an agreement and has failed to do so. In such an action, the affected tax jurisdiction shall be entitled to recover the amount due, the late payment penalty, interest, expenses, costs and disbursements together with the reasonable attorneys' fees necessary to prosecute such action. Nothing herein shall be construed as providing an affected tax jurisdiction with the right to sue and recover from an agency which has not received payments in lieu of taxes from a project occupant.

(7) Any refinancing of a project shall be subject to the provisions of section eight hundred fifty-nine-a of this chapter, except where such refinancing was previously approved pursuant to such section.

(8) Agents of an agency and project operators shall annually file a statement with the state department of taxation and finance, on a form and in such a manner as is prescribed by the commissioner of taxation and finance, of the value of all sales and use tax exemptions claimed by such agents or agents of such agents or project operators, including, but not limited to, consultants or subcontractors of such agents or project operators, under the authority granted pursuant to this section. The penalty for failure to file such statement shall be the removal of authority to act as an agent of an agency or a project operator.

(9)(a) Within thirty days of the date that the agency designates a project operator or other person to act as agent of the agency for purposes of providing financial assistance consisting of any sales and compensating use tax exemption to such person, the agency shall file a statement with the department of taxation and finance relating thereto, on a form and in such manner as is prescribed by the commissioner of taxation and finance, identifying each such agent so named by the agency, setting forth the taxpayer identification number of each such agent, giving a brief description of the property and/or services intended to be exempted from such taxes as a result of such appointment as agent, indicating the agency's rough estimate of the value of the property and/or services to which such appointment as agent relates, indicating the date when such designation as agent became effective and indicating the date upon which such designation as agent shall cease.

(b) Within thirty days of the date that the agency's designation described in paragraph (a) of this subdivision has been amended, terminated, been revoked, or become invalid or ineffective for any reason, the agency shall file a statement with the department of taxation and finance relating thereto, on a form and in such manner as is prescribed by the commissioner of taxation and finance, identifying each such agent so named by the agency in the original designation and setting forth the taxpayer identification number and other identifying information of each such agent, the date as of which the original designation was amended, terminated, revoked, or became invalid or ineffective and the reason therefor, together with a copy of the original designation.

Credits

(Added L.1969, c. 1030, § 1. Amended L.1992, c. 772, § 1; L.1993, c. 356, §§ 16, 17; L.1993, c. 357, § 4; L.1997, c. 444, § 1, eff. Oct. 19, 1997; L.2010, c. 57, pt. S, subpt. C, § 1, eff. Aug. 11, 2010, deemed eff. Jan. 31, 2008; L.2013, c. 59, pt. J, § 8, eff. March 28, 2013.)

Notes of Decisions (26)

McKinney's General Municipal Law § 874, NY GEN MUN § 874
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McKinney's General Municipal Law § 875

§ 875. Special provisions applicable to state sales and compensating use taxes and certain types of facilities

Effective: March 28, 2013
Currentness

1. For purposes of this section: "state sales and use taxes" means sales and compensating use taxes and fees imposed by article twenty-eight or twenty-eight-A of the tax law but excluding such taxes imposed in a city by section eleven hundred seven or eleven hundred eight of such article twenty-eight. "IDA" means an industrial development agency established by this article or an industrial development authority created by the public authorities law. "Commissioner" means the commissioner of taxation and finance.

2. An IDA shall keep records of the amount of state and local sales and use tax exemption benefits provided to each project and each agent or project operator and shall make such records available to the commissioner upon request. Such IDA shall also, within thirty days of providing financial assistance to a project that includes any amount of state sales and use tax exemption benefits, report to the commissioner the amount of such benefits for such project, the project to which they are being provided, together with such other information and such specificity and detail as the commissioner may prescribe. This report may be made in conjunction with the statement required by subdivision nine of section eight hundred seventy-four of this title or it may be made as a separate report, at the discretion of the commissioner. An IDA that fails to make such records available to the commissioner or to file such reports shall be prohibited from providing state sales and use tax exemption benefits for any project unless and until such IDA comes into compliance with all such requirements.

3. (a) An IDA shall include within its resolutions and project documents establishing any project or appointing an agent or project operator for any project the terms and conditions in this subdivision, and every agent, project operator or other person or entity that shall enjoy state sales and use tax exemption benefits provided by an IDA shall agree to such terms as a condition precedent to receiving or benefiting from such state sales and use exemptions benefits.

(b) The IDA shall recover, recapture, receive, or otherwise obtain from an agent, project operator or other person or entity state sales and use exemptions benefits taken or purported to be taken by any such person to which the person is not entitled or which are in excess of the amounts authorized or which are for property or services not authorized or taken in cases where such agent or project operator, or other person or entity failed to comply with a material term or condition to use property or services in the manner required by the person's agreement with the IDA. Such agent or project operator, or other person or entity shall cooperate with the IDA in its efforts to recover, recapture, receive, or otherwise obtain such state sales and use exemptions benefits and shall promptly pay over any such amounts to the IDA that it requests. The failure to pay over such amounts to the IDA shall be grounds for the commissioner to assess and determine state sales and use taxes due from the person under article twenty-eight of the tax law, together with any relevant penalties and interest due on such amounts.

(c) If an IDA recovers, recaptures, receives, or otherwise obtains, any amount of state sales and use tax exemption benefits from an agent, project operator or other person or entity, the IDA shall, within thirty days of coming into possession of such amount, remit it to the commissioner, together with such information and report that the commissioner deems necessary to administer payment over of such amount. An IDA shall join the commissioner as a party in any action or proceeding that the IDA commences to recover, recapture, obtain, or otherwise seek the return of, state sales and use tax exemption benefits from an agent, project operator or other person or entity.

(d) An IDA shall prepare an annual compliance report detailing its terms and conditions described in paragraph (a) of this subdivision and its activities and efforts to recover, recapture, receive, or otherwise obtain state sales and use exemptions benefits described in paragraph (b) of this subdivision, together with such other information as the commissioner and the commissioner of economic development may require. The report required by this subdivision shall be filed with the commissioner, the director of the division of the budget, the commissioner of economic development, the state comptroller, the governing body of the municipality for whose benefit the agency was created, and may be included with the annual financial statement required by paragraph (b) of subdivision one of section eight hundred fifty-nine of this title. Such report required by this subdivision shall be filed regardless of whether the IDA is required to file such financial statement described by such paragraph (b) of subdivision one of section eight hundred fifty-nine. The failure to file or substantially complete the report required by this subdivision shall be deemed to be the failure to file or substantially complete the statement required by such paragraph (b) of subdivision one of such section eight hundred fifty-nine, and the consequences shall be the same as provided in paragraph (e) of subdivision one of such section eight hundred fifty-nine.

(e) This subdivision shall apply to any amounts of state sales and use tax exemption benefits that an IDA recovers, recaptures, receives, or otherwise obtains, regardless of whether the IDA or the agent, project operator or other person or entity characterizes such benefits recovered, recaptured, received, or otherwise obtained, as a penalty or liquidated or contract damages or otherwise. The provisions of this subdivision shall also apply to any interest or penalty that the IDA imposes on any such amounts or that are imposed on such amounts by operation of law or by judicial order or otherwise. Any such amounts or payments that an IDA recovers, recaptures, receives, or otherwise obtains, together with any interest or penalties thereon, shall be deemed to be state sales and use taxes and the IDA shall receive any such amounts or payments, whether as a result of court action or otherwise, as trustee for and on account of the state.

4. The commissioner shall deposit and dispose of any amount of any payments or moneys received from or paid over by an IDA or from or by any person or entity, or received pursuant to an action or proceeding commenced by an IDA, together with any interest or penalties thereon, pursuant to subdivision three of this section, as state sales and use taxes in accord with the provisions of article twenty-eight of the tax law. The amount of any such payments or moneys, together with any interest or penalties thereon, shall be attributed to the taxes imposed by sections eleven hundred five and eleven hundred ten, on the one hand, and section eleven hundred nine of the tax law, on the other hand, or to any like taxes or fees imposed by such article, based on the proportion that the rates of such taxes or fees bear to each other, unless there is evidence to show that only one or the other of such taxes or fees was imposed or received or paid over.

5. The statement that an IDA is required by subdivision nine of section eight hundred seventy-four of this article to file with the commissioner shall not be considered an exemption or other certificate or document under article twenty-eight or twenty-nine of the tax law. The IDA shall not represent to any agent, project operator, or other person or entity that a copy of such statement may serve as a sales or use tax exemption certificate or document. No agent or project operator may tender a copy of such statement to any person required to collect sales or use taxes as the basis to make any purchase exempt from tax. No such person required to collect sales or use taxes may accept such a statement in lieu of collecting any tax required to be collected. The civil and criminal penalties for misuse of a copy of such statement as an exemption certificate or document or for failure to pay or collect tax shall be as provided in the tax law. In addition, the use by an IDA or agent, project operator, or other person or entity

of such statement, or the IDA's recommendation of the use or tendering of such statement, as such an exemption certificate or document shall be deemed to be, under articles twenty-eight and thirty-seven of the tax law, the issuance of a false or fraudulent exemption certificate or document with intent to evade tax.

6. The commissioner is hereby authorized to audit the records, actions, and proceedings of an IDA and of its agents and project operators to ensure that the IDA and its agents and project operators comply with all the requirements of this section. Any information the commissioner finds in the course of such audit may be used by the commissioner to assess and determine state and local taxes of the IDA's agent or project operator.

7. In addition to any other reporting or filing requirements an IDA has under this article or other law, an IDA shall also report and make available on the internet, without charge, copies of its resolutions and agreements appointing an agent or project operator or otherwise related to any project it establishes. It shall also provide, without charge, copies of all such reports and information to a person who asks for it in writing or in person. The IDA may, at the request of its agent or project operator delete from any such copies posted on the internet or provided to a person described in the prior sentence portions of its records that are specifically exempted from disclosure under article six of the public officers law.

8. In consultation with the commissioner of economic development, the commissioner of taxation and finance is hereby authorized to adopt rules and regulations and to issue publications and other guidance implementing the provisions of this section and of the other sections of this article relating to any state or local tax or fee, or exemption or exclusion therefrom, that the commissioner administers and that may be affected by any provision of this article, and any such rules and regulations of the commissioner shall have the same force and effect with respect to such taxes and fees, or amounts measured in respect of them, as if they had been adopted by the commissioner pursuant to the authority of the tax law.

9. To the extent that a provision of this section conflicts with a provision of any other section of this article, the provisions of this section shall control.

Credits

(Added L.2013, c. 59, pt. J, § 2, eff. March 28, 2013.)

McKinney's General Municipal Law § 875, NY GEN MUN § 875
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
Chapter 24. Of the Consolidated Laws
Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 876

§ 876. Tax contract by the state

Currentness

The state covenants with the purchasers and with all subsequent holders and transferees of bonds or notes issued by the agency pursuant to this title, in consideration of the acceptance of and payment for the bonds or notes, that the bonds and notes of the agency issued pursuant to this title and the income therefrom, and all moneys, funds and revenues pledged to pay or secure the payment of such bonds or notes shall at all times be free from taxation except for estate taxes and taxes on transfers by or in contemplation of death.

Credits
(Added L.1969, c. 1030, § 1.)

McKinney's General Municipal Law § 876, NY GEN MUN § 876
Current through L.2013, chapters 1 to 340.

End of Document

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General Municipal Law (Refs & Annos)
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Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 878

§ 878. Remedies of bondholders and noteholders

Currentness

(1) In the event that the agency shall default in the payment of principal or of interest on any issue of the bonds or notes after the same shall become due, whether at maturity or upon call for redemption, and such default shall continue for a period of thirty days, or in the event that the agency shall fail or refuse to comply with the provisions of this title, or shall default in any agreement made with the holders of any issue of the bonds or notes, the holders of twenty-five per centum in aggregate principal amount of the bonds of such issue then outstanding, by instrument or instruments filed in the office of the clerk of the county and proved or acknowledged in the same manner as a deed to be recorded, may appoint a trustee to represent the holders of such bonds for the purposes herein provided.

(2) Such trustee may, and upon written request of the holders of twenty-five per centum in principal amount of such bonds or notes, then outstanding shall, in his or its own name:

(a) by suit, action or special proceeding enforce all rights of the bondholders or noteholders, including the right to require the agency to collect revenues adequate to carry out any agreement as to, or pledge of, such revenues, and to require the agency to carry out any other agreements with the holders of such bonds or notes and to perform its duties under this title;

(b) bring suit upon such bonds or notes;

(c) by action or special proceeding, require the authority to account as if it were the trustee of an express trust for the holders of such bonds or notes;

(d) by action or special proceeding, enjoin any acts or things which may be unlawful or in violation of the rights of the holders of such bonds or notes;

(e) declare all such bonds or notes due and payable, and if all defaults shall be made good then with the consent of the holders of twenty-five per centum of the principal amount of such bonds or notes then outstanding, to annul such declaration and its consequences.

(3) The supreme court shall have jurisdiction of any suit, action or proceeding by the trustee on behalf of bondholders or noteholders. The venue of any such suit, action or proceeding shall be laid in the county in which the project or projects are located.

(4) Before declaring the principal of all such bonds due and payable, the trustee shall first give thirty days' notice in writing to the agency.

(5) Any such trustee, whether or not the issue of bonds represented by such trustee has been declared due and payable, shall be entitled as of right to the appointment of a receiver of any part or parts of a project, the revenues of which are pledged for the security of the bonds of such issue, and such receiver may enter and take possession of such part or parts of the project and, subject to any pledge or agreement with bondholders or noteholders, shall take possession of all moneys and other property derived from or applicable to the acquisition, construction, operation, maintenance and reconstruction of such part or parts of the project and proceed with the acquisition of any necessary real property in connection with the project that the agency has covenanted to construct, and with any construction which the agency is under obligation to do and to operate, maintain and reconstruct such part or parts of the project and collect and receive all revenues thereafter arising therefrom subject to any pledge thereof or agreement with bondholders or noteholders relating thereto and perform the public duties and carry out the agreements and obligations of the agency under the direction of the court. In any suit, action or proceeding by the trustee, the fee, counsel fees and expenses of the trustee and of the receiver, if any, shall constitute taxable disbursements and all costs and disbursements allowed by the court shall be a first charge on any revenues derived from such project.

(6) Such trustee shall, in addition to the foregoing, have and possess all of the powers necessary or appropriate for the exercise of any functions specifically set forth herein or incident to the general representation of bondholders or noteholders in the enforcement and protection of their rights.

Credits
(Added L.1969, c. 1030, § 1.)

Notes of Decisions (1)

McKinney's General Municipal Law § 878, NY GEN MUN § 878
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
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McKinney's General Municipal Law § 880

§ 880. Actions against the agency

Effective: June 15, 2013
Currentness

(1) In an action against the agency founded upon tort, the complaint shall contain an allegation that at least thirty days have elapsed since the demand, claim or claims upon which the action is founded were presented to a member of the agency and to its secretary or to its chief executive officer, and that the agency has neglected or refused to make an adjustment or payment thereof for thirty days after the presentment.

(2) In a case founded upon tort, a notice of claim shall be required as a condition precedent to the commencement of an action or special proceeding against the agency or an officer, appointee or employee thereof, and the provisions of section fifty-e of this chapter shall govern the giving of such notice. No action shall be commenced more than one year and ninety days after the cause of action therefor shall have accrued.

Credits
(Added L.1969, c. 1030, § 1. Amended L.2012, c. 500, § 7, eff. June 15, 2013.)

McKinney's General Municipal Law § 880, NY GEN MUN § 880
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 882

§ 882. Termination of the agency

Effective: January 1, 2002
Currentness

Whenever all of the bonds or notes issued by the agency shall have been redeemed or cancelled, and all straight-lease transactions have been terminated, the agency shall cease to exist and all rights, titles, and interest and all obligations and liabilities thereof vested in or possessed by the agency shall thereupon vest in and be possessed by the municipality.

Credits
(Added L.1969, c. 1030, § 1. Amended L.2012, c. 373, § 191, eff. Oct. 15, 2012, deemed eff. Jan. 1, 2002.)

McKinney's General Municipal Law § 882, NY GEN MUN § 882
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 883

§ 883. Conflicts of interest

Effective: March 28, 2013
Currentness

All members, officers, and employees of an agency or industrial development authority established by this chapter or created by the public authorities law shall be subject to the provisions of article eighteen of this chapter.

Credits
(Added L.1993, c. 356, § 18. Amended L.2013, c. 59, pt. J, § 7, eff. March 28, 2013.)

McKinney's General Municipal Law § 883, NY GEN MUN § 883
Current through L.2013, chapters 1 to 340.

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McKinney's General Municipal Law § 884

§ 884. Public bidding

Currentness

The provisions of any law relating to the requirement of public bidding with respect to the construction of public facilities or projects shall not be applicable to the acquisition, construction, reconstruction, improvement, maintenance, equipping and furnishing of projects authorized by this act.

Credits
(Added L.1969, c. 1030, § 1.)

Notes of Decisions (2)

McKinney's General Municipal Law § 884, NY GEN MUN § 884
Current through L.2013, chapters 1 to 340.

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General Municipal Law (Refs & Annos)
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Article 18-A. Industrial Development
Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 886

§ 886. Title not affected if in part unconstitutional or ineffective

Currentness

If any section, clause or provision of this title shall be unconstitutional or be ineffective in whole or in part, to the extent that it is not unconstitutional or ineffective, it shall be valid and effective and no other section, clause or provision shall on account thereof be deemed invalid or ineffective.

Credits
(Added L.1969, c. 1030, § 1.)

McKinney's General Municipal Law § 886, NY GEN MUN § 886
Current through L.2013, chapters 1 to 340.

End of Document

McKinney's Consolidated Laws of New York Annotated
General Municipal Law (Refs & Annos)
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Title 1. Agencies, Organization and Powers (Refs & Annos)

McKinney's General Municipal Law § 888

§ 888. Inconsistent provisions in other acts superseded

Currentness

Insofar as the provisions of this title are inconsistent with the provisions of any other act, general or special, or of any local laws of the municipality, the provisions of this title shall be controlling except in cases of inconsistency with the Indian law.

Credits
(Added L.1969, c. 1030, § 1. Amended L.1972, c. 190, § 2.)

McKinney's General Municipal Law § 888, NY GEN MUN § 888
Current through L.2013, chapters 1 to 340.

End of Document

EXHIBIT 3

Westlaw.
15 S.Ct. 673
157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759, 3 A.F .T.R. 2557
(Cite as: 157 U.S. 429, 15 S.Ct. 673)

Supreme Court of the United States
POLLOCK
v.
FARMERS' LOAN & TRUST CO. et al.[FN1]

FN1 In this case, and in the case of Hyde v. Trust Co., 15 Sup. Ct. 717, petitions for rehearing were filed, upon which the following order was announced on April 23, 1895: 'It is ordered by the court that the consideration of the two petitions for rehearing in these cases be reserved until Monday, May 6th, next, when a full bench is expected, and in that event two counsel on a side will be heard at that time.''

No. 893.
April 8, 1895.

Appeal from the Circuit Court of the United States for the Southern District of New York.

**674 This was a bill filed by Charles Pollock, a citizen of the state of Massachusetts, on behalf of himself and all other stockholders of the defendant company similarly situated, against the Farmers' Loan & Trust Company, a corporation of the state of New York, and its directors, alleging that the capital stock of the corporation consisted of $1,000,000, divided into 40,000 shares of the par value of $25 each; that the company was authorized to invest its assets in public stocks and bonds of the United States, of individual states, or of any incorporated city or county, or in such real or personal securities as it might deem proper; and also to take, accept, and execute all such trusts of every description as might be committed to it by any person or persons or any corporation, by grant, assignment, devise, or bequest, or by order of any court of record of New York, and to receive and take any real estate which might be the subject of such trust; that the property and assets of the company amounted to more than $5,000,000, or which at least $1,000,000 was invested in real estate owned by the company in fee, at least $2,000,000 in bonds of the city of New York, and at least $1,000,000 in the bonds and stocks of other corporations of the United States; that the net profits or income of the defendant company during the year ending December 31, 1894, amounted to more than the sum of $3,000,000 above its actual operation and business expenses, including lossess and interest on bonded and other indebtedness; that from its real estate the company derived an income of $50,000 per annum, after deducting all county, state, and municipal taxes; and that the company derived an income or profit of about $60,000 per annum fro its investments in municipal bonds.

It was further alleged that under and by virtue of the powers conferred upon the company it had from time to time taken and executed, and was holding and executing, numerous trusts committed to the company by many persons, copartnerships, unincorporated associations, and corporations, by grant, assinment, devise, and bequest, and by orders of various courts, and that the company now held as trustee for many minors, individuals, corpartnerships, associations, and corporations, resident in the United States and elsewhere, many parcels of real estate situated in the various states of the United States, and amounting in the aggregate, to a value exceeding $5,000,000, the rents and income of which real estate collected and received by said defendant in its fiduciary capacity annually exceeded the sum of *200,000.

The bill also averred that complainant was, and had been since May 20, 1892, the owner and registered holder of 10 shares of the capital stock of the company, of a value exceeding the sum of $5,000; that the capital stock was divied among a large number of different persons, who, as such stockholders, constituted a large body; that the bill was filed for an object common to them all, and that he therefore brought suit not only in his own

behalf as a stockholder of the company, but also as a representative of and on behalf of such of the other stockholders similarly situated and interested as might choose to intervene and become parties.

It was then alleged that the management of the stock, property, affairs, and concerns of the company was committed, under its acts of incorporation, to its directors, and charged that the company and a majority of its directors claimed and asserted that under and by virtue of the alleged authority of the provisions of an act of congress of the United States entitled 'An act to reduce taxation, to provide revenue for the government, and for other purposes,' passed August 15, 1894, the company was liable, and that they intended to pay, to the United States, before July 1, 1895, a tax of 2 per centum on the net profits of said company for the year ending December 31, 1894, above actual operating and business expenses, including the income derived from its real estate and its bonds of the city of New York; and that the directors claimed and asserted that a similar tax must be paid upon the amount of the incomes, gains, and profits, in excess of $4,000, of all **675 minors and others for whom the company was acting in a fiduciary capacity. And, further, that the company and its directors had avowed their intention to make and file with the collector of internal revenue for the Second district of the city of New York a list, return, or statement showing the amount of the net income of the company received during the year 1894, as aforesaid, and likewise to make and render a list or return to said collector of internal revenue, prior to that date, of the amount of the income, gains and profits of all minors and other persons having incomes in excess of $3,500, for whom the company was acting in a fiduciary capacity.

The bill charged that the provisions in respect of said alleged income tax incorporated in the act of congress were unconstututional, null, and void, in that the tax was a direct tax in respect of the real estate held and owned by the company in its own right and in its fiduciary capacity as aforesaid, by being imposed upon the rents, issues, and profits os said real estate, and was likewise a direct tax in respect of its personal property and the personal property held by it for others for whom it acted in its fiduciary capacity as aforesaid, which direct taxes were not, in and by said act, apportioned among the several states, as required by section 2 of article 1 of the constitution; and that, if the income tax so incorporated in the act of congress aforesaid were held not to be a direct tax, nevertheless its provisions were unconstitutional, null, and void, in that they were not uniform throughout the United States, as required in and by section 8 of article 1 of the constitution of the United States, upon many grounds and in many particulars specifically set forth.

The bill further charged that the income-tax provisions of the act were likewise unconstitutional, in that they imposed a tax on incomes not taxable under the constitution, and likewise income derived from the stocks and bonds of the states of the United States, and counties and municipalities therein, which stocks and bonds are among the means and instrumentalities employed for carrying on their repective governments, and are not proper subjects of the taxing power of congress, and which states and their counties and muncipalities are independent of the general government of the United States, and the respective stocks and bonds of which are, together with the power of the states to borrow in any form, exempt from federal taxation.

Other grounds of unconstitutionality were assigned, and the violation of articles 4 and 5 of the constitution asserted.

The bill further averred that the suit was not a collusive one, to confer on a court of the United States jurisdiction of the case, of which it would not otherwise have cognizance and that complainant had requested the company and its directors to omit and to refuse to pay said income tax, and to contest the constiutionality of said act, and to refrain from voluntarily making lists, returns, and statements on its own behalf and on behalf of the minors and oth-

er persons for whom its was acting in a fiduciary capacity, and to apply to a court of competent jurisdiction to determine its liability under said act; but that the company and a majority of its directors, after a meeting of the directors, at which the matter and the request of complainant were formally laid before them for action, had rejused, and still refuse, and intend omitting, ot comply with complainant's demand, and had resolved and determined and intended to comply with all and singular the provisions of the said act of congress, and to pay the tax upon all its net profits or income as aforesaid, including its rents from real estate and its income from municipal bonds, and a copy of the refusal of the company was annexed to the complaint.

It was also alleged that if the company and its directors, as they propered and had declared their intention to do, should pay the tax out of its gains, income, and profits, or out of the gains, income, and profits of the property held by it in its fiduciary capacity they will diminish the assets of the company and lessen the dividends thereon and the value of the shares; that voluntary compliance with the income-tax provisions would expose the company to a multiplicity of suits, not only by and on behalf of its numerous shareholders, but by and on behalf of numberous minors and others for whom it acts in a fiduciary capacity, and that such numerous suits would work irreparable injury to the business of the company, and subject it to great and irreparable damage, and to liability to the beneficiaries aforesaid, to the irreparable damage of complainant and all its shareholders.

The bill further averred that this was a suit of a civil nature in equity; that the matter in dispute exceeded, exclusive of costs, the sum of $5,000, and arose under the constitution or laws of the United States; and that there was furthermore a controversy between citizens of different states.

The prayer was that it might be adjudged and decreed that the said provisions known as the income tax incorporated in said act of congress passed August 15, 1894, are unconstitutional, null, and void; that the defendants be restrained from volunarily complying with the provisions of said act, and making the list, returns, and statements above referred to, or paying the tax aforesaid; and for general relief.

The defendants demurred on the ground of want of equity, and, the cause having been brought on to be heard upon the bill and demurrer thereto, the demurrer was sustained, and the bill of complaint dismissed, with costs, whereupon the record recited that the constitutionality of a law of the United States was drawn in question, and an appeal was allowed directly to this court.

**676 An abstract of the act in question will be found in the margin. [FN2]

FN2 By sections 27–37 inclusive of the act of congress entitled 'An act to reduce taxation, to provide revenue for the government, and for other purposes,' received by the president August 15, 1894, and which, not having been returned by him to the house in which it originated within the time prescribed by the constitution of the United States, became a law without approval (28 Stat. 509, c. 349), it was provided that from and after January 1, 1895, and until January 1, 1900, 'there shall be assessed, levied, collected, and paid annually upon the gains, profits, and income received in the preceding calendar year by every citizen of the United States, whether residing at home or abroad, and every person residing therein, whether said gains, profits, or income be derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, emploument, or vocation carried on in the United States or elsewhere, or from any other source whatever, a tax of two per centum on the amount so derived over and above four thousand dollars, and a like tax shall be levied, collected, and paid annually upon the gains, profits, and

income from all property owned and of every business, trade, or profession carried on in the United States by persons residing without the United States. * * *

'Sec. 28. That in estimating the gains, profits, and income of any person there shall be included all income derived from interest upon notes, bonds, and other securities, except such bonds of the United States the principal and interest of which are by the law of their issuance exempt from all federal taxation; profits realized within the year from sales of real estate purchased within two years previous to the close of the year for which income is estimated; interest received or accrued upon all notes, bonds, mortgages, or other forms of indebtedness bearing interest, whether paid or not, if good and collectible, less the interest which has become due from said person or which has been paid by him during the year; the amount of all premium on bonds, notes, or couponds; the amount of sales of live stock, sugar, cotton, wool, butter, cheese, pork, beef, mutton, or other meats, hay, and grain, or other vegetable or other productions, or other forms of indebtedness of the estate of such person, less the amount expended in the purchase or production of said stock or produce, and not including any part thereof consumed directly by the family; money and the value of all personal property acquired by gift or inheritance; all other gains, profits, and income derived from any source whatever except than portion of the salary, compensation, or pay received for services in the civil, military, naval, or other service of the United States, including senators, representatives, and delegates in congress, from which the tax has been deducted, and except that portion of any salary upon which the employer is required by law to withhold, and does withhold the tax and pays the same to the officer authorized to receive it. In computing incomes the necessary expenses actually incurred in carrying on any business, occupation, or profession shall be deducted and also all interest due or paid within the year by such person on existing indebtedness. And all national, state, county, school, and municipal taxes, not including those assessed against local benefits, paid within the year shall be deducted from the gains, profits, or income of the person who has actually paid the same, whether such person be owner, tenant, or mortgagor; also losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated stated for by insurance or otherwise, and debts ascertained to be worthless, but excluding all estimated depreciation of values and losses within the year on sales of real estate purchased within two years previous to the year for which income is estimated: Provided, that no deduction shall be made for any amount paid out for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate: provided further, that only one deduction of four thousand dollars shall be made from the aggregate income of all the members of any family, composed of one or both parents, and one or more minor children, or husband and wife; that guardians shall be allowed to made a deduction in favor of each and every ward, except that in case where two or more wards are comprised in one family and have joint property interests, the aggregate deduction in their favor shall not exceed four thousand dollars: and provided further, that in cases where the salary or other compensation paid to any person in the employment or service of the United States shall not exceed the rate of four thousand dollars ner annum, or shall be by fees, or uncertain or

irregular in the amount or in the time during which the same shall have accrued or been earned, such salary or other compensation shall be included in estimating the annual gains, profits, or income of the person to whom the same shall have been paid, and shall include that portion of any income or salary upon which a tax has not been paid by the employer, where the employer is required by law to pay on the excess over four thousand dollars: provided also, that in computing the income of any person, corporation, company, or association there shall not be included the amount received from any corporation, company, or association as dividends upon the stock of such corporation, company, or association if the tax of two per centum has been paid upon its net profits by said corporation, company, or association as required by this act.

'Sec. 29. That it shall be the duty of all persons of lawful age having an income of more than three thousand five hundred dollars for the taxable year, computed on the basis herein prescribed, to made and render a list or return, on or before the day provided by law, in such form and manner as may be directed by the commissioner of internal revenue, with the approval of the secreatary of the treasury, to the collector or a deputy collector of the district in which they reside, of the amount of their income, gains, and profits, as aforesaid; and all guardians and trustees, executors, administrators, agents, receivers, and all persons or corporations acting in any fiduciary capacity, shall make and render a list or return, as aforesaid, to the collector or a deputy collector of the district in which such person or corporation acting in a fiduciary capacity resides or does business, of the amount of income, gains, and profits of any minor or person for whom they act. but persons having less than three thousand five hundred dollars income are not required to make such report; and the collector or deputy collector, shall require every list or return to verified by the oath or affirmation of the party rendering it, and may increase the amount of any list or return if he has reason to believe that the same is understated: and in case any such person having a taxable income shall neglect or refuse to make and render such list and return, or shall render a willfully false or fraudulent list or return, it shall be the duty of the collector or deputy collector, to make such list, according to the best information he can obtain. by the examination of such person, or any other evidence, and to add fifty per centum as a penalty to the amount of the tax due on such list in all cases of willful neglect or refusal to make and render a list or return; and in all cases of a willfully false or fraudulent list or return having been rendered to add one hundred per centum as a penalty to the amount of tax ascertained to be due, the tax and the additions thereto as a penalty to be assessed and collected in the manner provided for in other cases of willful neglect or refusal to render a list or return. or of rendering a false or fraudulent return.' A proviso was added that any person or corporation might show that he or its ward had no taxable income, or that the same had been paid elsewhere, and the collector might exempt from the tax for that year. 'Any person or company, corporation, or association feeling aggrieved by the decision of of the deputy collector, in such cases may appeal to the collector of the district, and his decision thereon, unless reversed by the commissioner of internal revenue, shall be final. If dissatisfied with the decision of the collector such person or corporation, company, or assiciation may submit the case, with all the papers, to the

commissioner of internal revenue for his decision, and may furnish the testimony of witnesses to prove any relevant facts having served notice to that effect upon the commissioner of internal revenue, as herein prescribed.' Provision was made for notice of time and place for taking testimony on both sides, and that no penalty should be assed until after notice.

By section 30, the taxes on incomes were made payable on or before July 1st of each year, and 5 per cent. penalty levied on taxes unpaid, and interest.

By section 31, any non-resident might receive the benefit of the exemptions provided for, and 'in computing income he shall include all income from every source, but unless he be a citizen of the United States he shall only pay on that part of the income which is derived from any source in the United States. In case such non-resident fails to file such statement, the collector of each district shall collect the tax on the income dervied from property situated in his district, subject to income tax, making no allowance for exemptions, and all property belonging to such non-resident shall be liable to distraint for tax: provided, that non-resident corporations shall be subject to the same laws as to tax as resident corporations, and the collection of the tax shall be made in the same manner as provided for collections of taxes against non-resident persons.'

'Sec. 32. That there shall be assessed, levied, and collected, except as herein otherwise provided, a tax of two per centum annually on the net profits or income above actual operating and business expenses, including expenses for materials pruchased for manufacture or bought for resale, losses, and interest on bonded and other indebtedness of all banks, banking institutions, trust companies, saving institutions, fire, marine, life, and other insurance companies, railroad, canal, turnpike, canal navigation, slack water, telephone, telegraph, express, electric light, gas, water, street railway compainies, and all other corporations, companies, or associations doing business for profit in the United States, no matter how created and organized but not including partnerships.'

The tax is made payable 'on or before the first day of July in each year; and if the president or other chief officer of any corporation, company, or association, or in the case of any foreign corporation, company, or association, the resident manager or agent shall neglect or refuse to file with the collector of the internal revenue district in which said corporation, company, or association shall be located or be engaged in business, a statement verified by his oath or affirmation, in such form as shall be prescribed by the commissioner of internal revenue, with the approval of the secretary of the treamsury, showing the amount of net profits or income received by said corporation, comapny, or association during the whole calendar year last preceding the date of filing said statement as hereinafter required, the corporation, company, or association making default shall forfeit as a penalty the sum of one thousand dollars and two per centum on the amount of taxes due, for each month until the same is apid, the payment of said penalty to be enforced as provided in other cases of neglect and refusal to make return of taxes under the internal revenue laws.

'The net profits or income of all corporations, companies, or associations shall include the amounts paid to sharehoders, or carried to the account of any fund, or used for construction, enlargement of plant, or

any other expenditure or investment paid from the net annual profits made or acquired by said corporations, companies, or associations.

'That nothing herein contained shall apply to states, counties, or municipalities; nor to corporations, companies, or associations organized and conducted solely for charitable, religious, or educational purposes, including fraternal beneficiary societies, orders, or associations operating upon the lodge system and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members; nor to the stocks, shares, funds, or securities held by any fiduciary or trustee for charitable, religious, or educational purposes; nor to building and loan associations or companies which make loans only to their shareholders; nor to such savings banks, savings institutions or societies as shall, first, have no stockholders or members except depositors and no capital except deposits; secondly, shall not receive deposits to an agregate amount, in any one year, of more than one thousand dollars from the same depositor; thirdly, shall not allow an accumulation or total of deposits, by any one depositor, exceeding ten thousand dollars; foruthly, shall actually divide and distribute to its depositors, ratably to deposits, all the earnings over the necessary and proper expenses of such bank, institution, or society, except such as shall be applied to surplus; fifthly, shall not possess, in any form, a surplus fund exceeding ten per centum of its agregate deposits; nor to such savings banks, savings institutions,#e shall be uniform throughout the United States.' And the third clause thus: 'To regulate commerce with foreign nations, and among the several states, and with the Indian tribes.'

'Nor to any insurance company or association which conducts all its business solely upon the mutual plan, and only for the benefit of its policy holders or members, and having no capital stock and no stock or shareholders, and holding all its property in trust and in reserve for its policy holders or members; nor to that part of the business of any insurance company having a capital stock and stock and shareholders, which is conducted on the mutual plan, separate from its stock plan of insurance, and solely for the benefit of the policy holders and members insured on said mutual plan, and holding all the property belonging to and derived from said mutual part of its business in trust and reserve for the benefit of its policy holders and members insured on said mutual plan.

'That all state, county, municipal, and town taxes paid by corporations, companies, or associations, shall be included in the operating and business expenses of such corporations, companies, or associations.

'Sec. 33. That there shall be levied, collected, and paid on all salaries of officers, or payments for services to persons in the civil, military, naval, or other employment or service of the United States, including senators and representatives and delegates in congress, when exceeding the rate of four thousand dollars per annum, a tax of two per centum on the excess above the said four thousand dollars; and it shall be the duty of all paymasters and all disbursing officers under the government of the United States, or persons in the employ thereof, when making any payment to any officers or persons as aforesaid, whose compensation is determined by a fixed salary, or upon settling or adjusting the accounts of such officers or persons, to deduct and withhold the aforesaid tax of two

per centum; and the pay roll, receipts, or account of officers or persons paying such tax as aforesaid shall be made to exhibit the fact of such payment. And it shall be the duty of the accounting officers of the treasury department, when auditing the accounts of any paymaster or disbursing officer, or any officer withholding his salary from moneys received by him, or when settling or adjusting the accounts of any such officer, to require evidence that the taxes mentioned in this section have been deducted and paid over to the treasurer of the United States, or other officer authorized to receive the same. Every corporation which pays to any employe a salary or compensation exceeding four thousand dollars per annum shall report the same to the collector or deputy collector of his district and said employe shall pay thereon, subject to the exemptions herein provided for, the tax of two per centum on the excess of his salary over four thousand dollars: provided, that salaries due to sstate county, or municipal officers shall be exempt from the income tax herein levied.'

By section 34, sections 3167, 3172, 3173, and 3176 of the Revised Statutes of the United States as amended were amended so as to provide that it should be unalwful for the collector and other officers to make known, or to publish, amount or source of income, under penalty; that every collector should 'from tiem to time cause his deputies to proceed through every part of his district and inquire after and concerning all persons therein who are liable to pay any internal revenue tax, and all persons owning or having the care and management of any objects liable to pay any tax, and to make a list of such persons and enumberate said object'; that the tax returns must be made on or before the first Monday in March; that the collectors may make returns when particulars are furnished: that notice be given to absentees to render returns; that collectors may summon persons to produce books and testify concerning returns; that collectors may enter other districts to examine persons and books, and may make returns; and that penalties may be imposed on false returns.

By section 35 it was provided that corporations doing business for profit should make returns on or before the first Monday of March of each year 'of all the following matters for the whole calendar year last preceding the date of such return:

'First. The gross profits of such corporation, company, or association, from all kinds of business of every name and nature.

'Second. The expenses of such corporation, company, or association, exclusive of interest, annuities, and dividends.

'Third. The net profits of such corporation, company, or association, without allowance for interest, annuities, or dividends.

'Fourth. The amount paid on account of interest, annuities, and dividends, stated separately.

'Fifth. The amount paid in salaries of four thousand dollars or less to each person employed.

'Sixth. The amount paid in salaries of more than four thousand dollars to each person employed and the name and address of each of such persons and the amount paid to each.'

By section 36, that books of account should be kept by corporations as prescribed, and inspection thereof be granted under penalty.

> By section 37 provision is made for receipts for taxes paid.
>
> By a joint resolution of February 21, 1895, the time for making returns of income for the year 1894 was extended, and it was provided that 'in computing incomes under said act the amounts necessarily paid for fire insurance premiums and for ordinary reparis shall be deducted'; and that 'in computing incomes under said act the amounts received as dividends upon the stock of any corporation, company or association shall not be included in case such dividends are also liable to the tax of two per centum upon the net profits of said corporation, company or association, although such tax may not have been actually paid by said corporation, company or association at the time of making returns by the person, corporation or association receiving such dividends, and returns or reports of the names and salaries of employes shall not be required from employers unless called for by the collector in order to verify the returns of employes.'

By the third clause of section 2 of article 1 of the constitution it was provided: 'Representatives and direct taxes shall be apportioned among the several states which may be included within this Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three-fifths of all other persons.' This was amended by the second section of the fourteenth amendment, declared ratified July 28, 1868, so that the whole number of persons in each state should be counted, Indians **677 not taxed excluded, and the provision, as thus amended, remains in force.

The acutal enumeration was prescribed to be made within three years after the first meeting of congrees, and within every subsequent term of ten years, in such manner as should be directed.

Section 7 requires 'all bills for raising revenue shall originate in the house or representatives.'

The first clause of section 8 reads thus: 'The congress shall have power to lay and collect taxes, duties, imposts and excises, to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts and excises **678 shall be uniform throughout the United States.' And the third clause thus: 'To regulate commerce with foreigh nation, and among the several states, and with the Indian tribes.'

The fourth, fifth, and sixth clauses of section 9 are as follows:

'No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken.

'No tax or duty shall be laid on articles exported from any state.

'No preference shall be given by any regulation of commerce or revenue to the ports of one state over those of another; nor shall **679 vessels bount to, or from, one state, be obliged to enter, clear, or pay duties in another.'

It is also provided by the second clause of section 10 that 'no state shall, without consent of the congress, lay any imposts or duties on imports or exports, except what may be absolutely necessary for executing its inspection laws': and, by the third clause, that 'no state shall, without the consent of congress, lay any duty of tonnage.'

The first clause of section 9 provides: 'The migration or importation of such persons as any of the states now existing shall think proper to admit, shall not be prohibited by the congress prior to the year one thousand and eight hundred and eight, but a tax or duty may be imposed on such importations, ot exeeding ten dollars for each person.'

Article 5 prescribes the mode for the amendment of the constitution, and concludes with this proviso: 'Provided, that no amendment which may be made prior to the year one thousand eight hundred and eight shall in any manner affect the first and fourth clauses in the ninth section of the first article.'

West Headnotes

Equity 150 ⚿53(1)

150 Equity
150I Jurisdiction, Principles, and Maxims
150I(B) Remedy at Law and Multiplicity of Suits
150k53 Waiver of Objections
150k53(1) k. In general. Most Cited Cases

Injunction 212 ⚿1469

212 Injunction
212IV Particular Subjects of Relief
212IV(S) Corporations and Other Private Organizations
212k1469 k. Acquisition and disposition of property; mortgages and security agreements. Most Cited Cases
(Formerly 212k72)

Injunction 212 ⚿1504

212 Injunction
212V Actions and Proceedings
212V(A) In General
212k1504 k. Authority of court; jurisdiction and venue. Most Cited Cases
(Formerly 212k110)

A United States circuit court, as a court of equity, may restrain a corporation at the suit of one of its stockholders, from voluntarily making returns for the imposition of and paying an unconstitutional tax levied under an act of congress, on the ground of the breach of trust or duty in such misapplication or diversion of the corporate funds, and on allegations of threatened multiplicity of suits and irreparable injury, where the objection of adequate remedy at law is not raised, and the question of jurisdiction is waived so far as it is within the power of the government to do so.

Internal Revenue 220 ⚿3061

220 Internal Revenue
220IV Direct Taxes
220k3060 What Constitutes Direct Taxes
220k3061 k. Capitations and taxes on realty or personalty or income therefrom. Most Cited Cases
(Formerly 220k28)

Internal Revenue 220 ⚿3132.10

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3132 Interest Received
220k3132.10 k. Interest paid by state or local governments. Most Cited Cases
(Formerly 220k28)

Internal Revenue 220 ⚿3150

220 Internal Revenue
220V Income Taxes
220V(E) Salaries, Wages or Compensation
220k3150 k. In general. Most Cited Cases
(Formerly 220k28)

The whole law imposing such tax should be declared void, and without any binding force; that part which relates to the tax on the rents, profits, or income from real estate,—that is, so much as constitutes part of the direct tax,—because not imposed by the rule of apportionment according to the representation of the states, as prescribed by the constitution; and that part which imposes a tax upon the bonds and securities of the several states, and upon the bonds and securities of their municipal bodies, and upon the salaries of judges of the courts of the United States, as being beyond the power of congress; and that part which lays duties, imposts, and excises as void in not providing for the uni-

formity required by the constitution in such cases. Per Mr. Justice Field.

Internal Revenue 220 ⚿3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and statutory provisions. Most Cited Cases
(Formerly 220k30)

In so far as the act levies a tax on income derived from municipal bonds, it is invalid, because such tax is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the Constitution.

Internal Revenue 220 ⚿3061

220 Internal Revenue
220IV Direct Taxes
220k3060 What Constitutes Direct Taxes
220k3061 k. Capitations and taxes on realty or personalty or income therefrom. Most Cited Cases
(Formerly 220k213)

Taxes on the rents or income of real estate are direct taxes.

Internal Revenue 220 ⚿3062

220 Internal Revenue
220IV Direct Taxes
220k3060 What Constitutes Direct Taxes
220k3062 k. Income taxes. Most Cited Cases
(Formerly 220k214)

In so far as Act Aug. 15, 1894, 28 Stat. 509, c. 349, imposing taxes on incomes levies a tax on rents and incomes of real estate, it is invalid, because such tax, being equivalent to a tax on the real estate itself, and therefore a direct tax, is not apportioned among the states according the rule prescribed by U.S.C.A.Const. art. 1, § 2, cl. 3 and § 9, cl. 4, for direct taxes.

Internal Revenue 220 ⚿3062

220 Internal Revenue
220IV Direct Taxes
220k3060 What Constitutes Direct Taxes
220k3062 k. Income taxes. Most Cited Cases
(Formerly 220k214)

The inclusion, under the income tax law provisions of Act Aug. 27, 1894, 28 Stat. 509, c. 349, of the rentals from real estate in the sum going to make up the aggregate income from which, in order to arrive at taxable income, is to be deducted insurance, repairs, losses in business, and $4,000 exemption, does not make the tax on income so ascertained a direct tax on such real estate, within the constitutional provisions requiring apportionment of direct taxes among the several states. Per Mr. Justice White and Mr. Justice Harlan.

Internal Revenue 220 ⚿4930

220 Internal Revenue
220XXVII Remedies for Wrongful Enforcement
220XXVII(C) Grounds for Injunction
220XXVII(C)2 Special Grounds of Equity Jurisprudence and Exceptional Circumstances
220k4930 k. In general. Most Cited Cases
(Formerly 220k1921)

Under the provision of Rev.St. § 3224, 26 U.S.C.A.Int.Rev.Code § 3653(a), that "no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court," a suit by a stockholder in a corporation to restrain the corporation from voluntarily making the returns required, and paying the tax levied under an act of congress alleged to be unconstitutional, should not be sustained on the ground of a right to equitable relief arising from the fact that the stockholder is without other remedy; the proper course, in case of illegal taxation, being to pay the tax under protest or with notice of suit, and then bring an action against the officer who collected it. Per Mr. Justice White and Mr. Justice Harlan.

Courts 106 ⚿90(3)

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k90 Decisions of Same Court or Co-Ordinate Court
106k90(3) k. Constitutional questions. Most Cited Cases

Internal Revenue 220 ⚿3059

220 Internal Revenue
220IV Direct Taxes
220k3059 k. In general. Most Cited Cases
(Formerly 92k20)

The interpretation of the constitutional provisions requiring direct taxes to be apportioned among the several states, which confines the word "direct" to capitation taxes and taxes on land, having been adopted by the legislative, executive, and judicial departments of the government, soon after the formation of the constitution, and thereafter continuously acted upon, and having been reiterated in repeated adjudications of the supreme court, should be regarded as the established construction. Per Mr. Justice White and Mr. Justice Harlan.

Constitutional Law 92 ⚿965

92 Constitutional Law
92VI Enforcement of Constitutional Provisions
92VI(C) Determination of Constitutional Questions
92VI(C)1 In General
92k964 Form and Sufficiency of Objection, Allegation, or Pleading
92k965 k. In general. Most Cited Cases
(Formerly 92k46(2))

Where a law of a public nature, affecting the whole community, is assailed as unconstitutional in some of its provisions, the court may consider other unconstitutional features brought to its notice in examining the law, though the particular points of their objection may not have been mentioned by counsel. Per Mr. Justice Field.

Courts 106 ⚿89

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k89 k. In general. Most Cited Cases

Courts 106 ⚿92

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k92 k. Dicta. Most Cited Cases

Although, under the rule stare decisis, an adjudication need not be extended beyond the principle which it decides, yet, if decided cases do directly, affirmatively, and necessarily, in principle, adjudicate the very question involved in a subsequent case, they should conclude such question. Per Mr. Justice White and Mr. Justice Harlan.

Courts 106 ⚿90(1)

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k90 Decisions of Same Court or Co-Ordinate Court
106k90(1) k. In general. Most Cited Cases

The supreme court, being clothed with the power and intrusted with the duty to maintain the fundamental law of the constitution, is not required

under the rule of stare decisis, to extend the scope of any decision upon a constitutional question, if it is convinced that error in principle might super- vene.

Courts 106 ⇐92

106 Courts
106II Establishment, Organization, and Procedure
106II(G) Rules of Decision
106k88 Previous Decisions as Controlling or as Precedents
106k92 k. Dicta. Most Cited Cases

The court is not bound, under the rule state decisis, to extend the scope of decisions holding taxes on gains, profits, or income to be excises or duties, and not direct taxes, so far as to sustain a tax on the income of realty on the ground of being an excise or duty, where none of such decisions discussed the question whether a tax on the income from personalty is equivalent to a tax on that personalty, but all of them held real estate liable to direct taxation only.

***532** Jos. H. Choate, ***452** C. A. Seward, ***442** B. H. Bristow, Wm. D. Gurtrie, David Willcox, Charles Steele, and Charles F. Southmayd, for appellants Pollock and Hyde.

***513** Herbert B. Turner, for appellee Farmers' Loan & Trust Company.

James C. Carter, Wm. C. Gulliver, and F. B. Candler, for appellee Continental Trust Company.

Attorney General Olney and ***469** Assistant Attorney General Whitney, for the United States.

Mr. Chief Justice FULLER, after stating the facts in the foregoing language, delivered the opinion of the court.

The jurisdiction of a court of equity to prevent any threatened breach of trust in the misapplication or diversion of the funds of a corporation by illegal payments out of its capital or profits has been frequently sustained. Dodge v. Woolsey, 18 How. 331; Hawes v. Oakland, 104 U. S. 450.

***554** As in Dodge v. Woolsey, this bill proceeds on the ground that the defendants would be guilty of such breach of trust or duty in voluntarily making returns for the imposition of, and paying, an unconstitutional tax; and also on allegations of threatened multiplicity of suits and irreparable injury.

The objection of adequate remedy at law was not raised below, nor is it now raised by appellees, if it could be entertained at all at this stage of the proceedings; and, so far as it was within the power of the government to do so, the question of jurisdiction, for the purposes of the case, was explicitly waived on the argument. The relief sought was in respect of voluntary action by the defendant company, and not in respect of the assessment and collection themselves. Under these circumstances, we should not be justified in declining to proceed to judgment upon the merits. Pelton v. Bank, 101 U. S. 143, 148; Cummings v. Bank, Id. 153, 157; Reynes v. Dumont, 130 U. S. 354, 9 Sup. Ct. 486.

Since the opinion in Marbury v. Madison, 1 Cranch, 137, 177, was delivered, it has not been doubted that it is within judicial competency, by express provisions of the constitution or by necessary inference and implication, to determine whether a given law of the United States is or is not made in pursuance of the constitution, and to hold it valid or void accordingly. 'If,' said Chief Justice Marshall, 'both the law and the constitution apply to a particular case, so that the court must either decide that case conformably to the law, disregarding the constitution, or conformably to the constitution, disregarding the law, the court must determine which of these conflicting rules governs the case. This is of the very essence of judicial duty.' And the chief justice added that the doctrine 'that courts must close their eyes on the constitution, and see only the law,' 'would subvert the very foundation of all written constitutions.' Necessarily the power to declare a law unconstitutional is always exer-

cised with reluctance; but the duty to do so, in a proper case, cannot be declined, and must be discharged in accordance with the deliberate judgment of the tribunal in which the validity of the enactment is directly drawn in question.

***555** The contention of the complainant is:

First. That the law in question, in imposing a tax on the income or rents of real estate, imposes a tax upon the real estate itself; and in imposing a tax on the interest or other income of bonds or other personal property, held for the purposes of income or ordinarily yielding income, imposes a tax upon the personal estate itself; that such tax is a direct tax, and void because imposed without regard to the rule of apportionment; and that by reason thereof the whole law is invalidated.

Second. That the law is invalid, because imposing indirect taxes in violation of the constitutional requirement of uniformity, and therein also in violation of the implied limitation upon taxation that all tax laws must apply equally, impartially, and unformly to all similarly situated. Under the second head, it is contended that the rule of uniformity is violated, in that the law taxes the income of certain corporations, companies, and associations, no matter how created or organized, at a higher rate than the incomes of individuals or partnerships derived from precisely similar property or business; in that it exempts from the operation of the act and from the burden of taxation numerous corporations, companies, and associations having similar property and carrying on similar business to those expressly taxed; in that it denies to individuals deriving their income from shares in certain corporations, companies, and associations the benefit of the exemption of $4,000 granted to other persons ****680** interested in similar property and business; in the exemption of $4,000; in the exemption of building and loan associations, savings banks, mutual life, fire, marine, and accident insurance companies, existing solely for the pecuniary profit of their members,—these and other exemptions being alleged to be purely arbitrary and capricious, justified by no public purpose, and of such magnitude as to invalidate the entire enactment; and in other particulars.

Third. That the law is invalid so far as imposing a tax upon income received from state and municipal bonds.

The constitution provides that representatives and direct ***556** taxes shall be apportioned among the several states according to numbers, and that no direct tax shall be laid except according to the enumeration provided for; and also that all duties, imposts, and excises shall be uniform throughout the United States.

The men who framed and adopted that instrument had just emerged from the struggle for independence whose rallying cry had been that 'taxation and representation go together.'

The mother country had taught the colonists, in the contests waged to establish that taxes could not be imposed by the sovereign except as they were granted by the representatives of the realm, that self-taxation constituted the main security against oppression. As Burke declared, in his speech on conciliation with America, the defenders of the excellence of the English constitution 'took infinite pains to inculcate, as a fundamental principle, that, in all monarchies, the people must, in effect, themselves, mediately or immediately, possess the power of granting their own money, or no shadow of liberty could subsist.' The principle was that the consent of those who were expected to pay it was essential to the validity of any tax.

The states were about, for all national purposes embraced in the constitution, to become one, united under the same sovereign authority, and governed by the same laws. But as they still retained their jurisdiction over all persons and things within their territorial limits, except where surrendered to the general government or restrained by the constitution, they were careful to see to it that taxation and representation should go together, so that the sovereignty reserved should not be impaired, and that

when congress, and especially the house of representatives, where it was specifically provided that all revenue bills must originate, voted a tax upon property, it should be with the consciousness, and under the responsibility, that in so doing the tax so voted would proportionately fall upon the immediate constituents of those who imposed it.

More than this, by the constitution the states not only gave to the nation the concurrent power to tax persons and ***557** property directly, but they surrendered their own power to levy taxes on imports and to regulate commerce. All the 13 were seaboard states, but they varied in maritime importance, and differences existed between them in population, in wealth, in the character of property and of business interests. Moreover, they looked forward to the coming of new states from the great West into the vast empire of their anticipations. So when the wealthier states as between themselves and their less favored associates, and all as between themselves and those who were to come, gave up for the common good the great sources of revenue derived through commerce, they did so in reliance on the protection afforded by restrictions on the grant of power.

Thus, in the matter of taxation, the constitution recognizes the two great classes of direct and indirect taxes, and lays down two rules by which their imposition must be governed, namely, the rule of apportionment as to direct taxes, and the rule of uniformity as to duties, imposts, and excises.

The rule of uniformity was not prescribed to the exercise of the power granted by the first paragraph of section 8 to lay and collect taxes, because the rule of apportionment as to taxes had already been laid down in the third paragraph of the second section.

And this view was expressed by Mr. Chief Justice Cause in The License Tax Cases, 5 Wall. 462, 471, when he said: 'It is true that the power of congress to tax is a very extensive power. It is given in the constitution, with only one exception and only two qualifications. Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject, and may be exercised at discretion.'

And although there have been, from time to time, intimations that there might be some tax which was not a direct tax, nor included under the words 'duties, imports, and excises,' such a tax, for more than 100 years of national existence, has as yet remained undiscovered, notwithstanding the stress of particular circumstances has invited thorough investigation into sources of revenue.

***558** The first question to be considered is whether a tax on the rents or income of real estate is a direct tax within the meaning of the constitution. Ordinarily, all taxes paid primarily by persons who can shift the burden upon some one else, or who are under no legal compulsion to pay them, are considered indirect taxes; but a tax upon property holders in respect of their estates, whether real or personal, or of the income yielded by such estates, and the payment of which cannot be avoided, are direct taxes. Nevertheless, it may be admitted that, although this definition of direct taxes is prima facie correct, and to be applied in the consideration of the question before us, yet the constitution may bear a different meaning, and that such different meaning must be recognized. But in arriving at any conclusion upon this point we are at ****681** liberty to refer to the historical circumstances attending the framing and adoption of the constitution, as well as the entire frame and scheme of the instrument, and the consequences naturally attendant upon the one construction or the other.

We inquire, therefore, what, at the time the constitution was framed and adopted, were recognized as direct taxes? What did those who framed and adopted it understand the terms to designate and include?

We must remember that the 55 members of the constitutional convention were men of great saga-

city, fully conversant with governmental problems, deeply conscious of the nature of their task, and profoundly convinced that they were laying the foundations of a vast future empire. 'To many in the assembly the work of the great French magistrate on the 'Spirit of Laws,' of which Washington with his own hand had copied an abstract by Madison, was the favorite manual. Some of them had made an analysis of all federal governments in ancient and modern times, and a few were well versed in the best English, Swiss, and Dutch writers on government. They had immediately before them the example of Great Britain, and they had a still better school of political wisdom in the republican constitutions of their several states, which many of them had assisted to frame.' 2 Bancr. Hist. Const. 9.

The Federalist demonstrates the value attached by Hamilton, ***559** Madison, and Jay to historical experience, and shows that they had made a careful study of many forms of government. Many of the framers were particularly versed in the literature of the period,—Franklin, Wilson, and Hamilton for example. Turgot had published in 1764 his work on taxation, and in 1766 his essay on 'The Formation and Distribution of Wealth,' while Adam Smith's 'Wealth of Nations' was published in 1776. Franklin, in 1766, had said, upon his examination before the house of commons, that: 'An external tax is a duty laid on commodities imported; that duty is added to the first cost and other charges on the commodity, and, when it is offered to sale, makes a part of the price. If the people do not like it at that price, they refuse it. They are not obliged to pay it. But an internal tax is forced from the people without their consent, if not laid by their own representatives. The stamp act says we shall have no commerce, make no exchange of property with each other, neither purchase nor grant, nor recover debts; we shall neither marry nor make our wills,—unless we pay such and such sums; and thus it is intended to extort our money from us, or ruin us by the consequences of refusing to pay.' 16 Parl. Hist. 144.

They were, of course, familiar with the modes of taxation pursued in the several states. From the report of Oliver Wolcott, when secretary of the treasury, on direct taxes, to the house of representatives, December 14, 1796,—his most important state paper (Am. St. P. 1 Finance, 431),—and the various state laws then existing, it appears that prior to the adoption of the constitution nearly all the states imposed a poll tax, taxes on land, on cattle of all kinds, and various kinds of personal property, and that, in addition, Massachusetts, Connecticut, Pennsylvania, Delaware, New Jersey, Virginia, and South Carolina assessed their citizens upon their profits from professions, trades, and employments.

Congress, under the articles of confederation, had no actual operative power of taxation. It could call upon the states for their respective contributions or quotas as previously determined on; but, in case of the failure or omission of the states to furnish such contribution, there were no means of ***560** compulsion, as congress had no power whatever to lay any tax upon individuals. This imperatively demanded a remedy; but the opposition to granting the power of direct taxation in addition to the substantially exclusive power of laying imposts and duties was so strong that it required the convention, in securing effective powers of taxation to the federal government, to use the utmost care and skill to so harmonize conflicting interests that the ratification of the instrument could be obtained.

The situation and the result are thus described by Mr. Chief Justice Chase in Lane Co. v. Oregon, 7 Wall. 71, 76: 'The people of the United States constitute one nation, under one government; and this government, within the scope of the powers with which it is invested, is supreme. On the other hand, the people of each state compose a state, having its own government, and endowed with all the functions essential to separate and independent existence. The states disunited might continue to exist. Without the states in union, there could be no such political body as the United States. Both the states and the United States existed before the constitution. The people, through that instrument, es-

tablished a more perfect union by substituting a national government, acting, with ample power, directly upon the citizens, instead of the confederate government, which acted with powers, greatly restricted, only upon the states. But in many articles of the constitution the necessary existence of the states, and, within their proper spheres, the independent authority of the states, is distinctly recognized. To them nearly the whole charge of interior regulation is committed or left; to them and to the people all powers not expressly delegated to the national government are reserved. The general condition was well stated by Mr. Madison in the Federalist, thus: 'The federal and state governments are in fact but different agents and trustees of the people, constituted with different powers, and designated for different purposes.' Now, to the existence of the states, themselves necessary ****682** to the existence of the United States, the power of taxation is indispensable. It is an essantial function of ***561** government. It was exercised by the colonies; and when the colonies became states, both before and after the formation of the confederation, it was exercised by the new governments. Under the articles of confederation the government of the United States was limited in the exercise of this power to requisitions upon the states, while the whole power of direct and indirect taxation of persons and property, whether by taxes on polls, or duties on imports, or duties on internal production, manufacture, or use, was acknowledged to belong exclusively to the states, without any other limitation than that of non-interference with certain treaties made by congress. The constitution, it is true, greatly changed this condition of things. It gave the power to tax, both directly and indirectly, to the national government, and, subject to the one prohibition of any tax upon exports and to the conditions of uniformity in respect to indirect, and of proportion in respect to direct, taxes, the power was given without any express reservation. On the other hand, no power to tax exports, or imports except for a single purpose and to an insignificant extent, or to lay any duty on tonnage, was permitted to the states. In respect, however, to property, business, and persons, within their respective limits, their power of taxation remained and remains entire. It is, indeed, a concurrent power, and in the case of a tax on the same subject by both governments the claim of the United States, as the supreme authority, must be preferred; but with this qualification it is absolute. The extent to which it shall be exercised, the subjects upon which it shall be exercised, and the mode in which it shall be exercised, are all equally within the discretion of the legislatures to which the states commit the exercise of the power. That discretion is restrained only by the will of the people expressed in the state constitutions or through elections, and by the condition that it must not be so used as to burden or embarrass the operations of the national government. There is nothing in the constitution which contemplates or authorizes any direct abridgment of this power by national legislation. To the extent just indicated it is as complete in the states as the like ***562** power, within the limits of the constitution, is complete in congress.'

On May 29, 1787, Charles Pinckney presented his draft of a proposed constitution, which provided that the proportion of direct taxes should be regulated by the whole number of inhabitants of every description, taken in the manner prescribed by the legislature, and that no tax should be paid on articles exported from the United States. 1 Elliot, Deb. 147, 148.

Mr. Randolph's plan declared 'that the right of suffrage, in the national legislature, ought to be proportioned to the quotas of contribution, or to the number of free inhabitants, as the one or the other may seem best, in different cases.' 1 Elliot, Deb. 143.

On June 15, Mr. Paterson submitted several resolutions, among which was one proposing that the United States in congress should be authorized to make requisitions in proportion to the whole number of white and other free citizens and inhabitants, including those bound to servitude for a term of years, and three-fifths of all other person, except Indians not taxed. 1 Elliot, Deb. 175, 176.

On the 9th of July, the proposition that the legislature be authorized to regulate the number of representatives according to wealth and inhabitants was approved, and on the 11th it was voted that, 'in order to ascertain the alterations that may happen in the population and wealth of the several states, a census shall be taken,' although the resolution of which this formed a part was defeated. 5 Elliot, Deb. 288, 295; 1 Elliot, Deb. 200.

On July 12th, Gov. Morris moved to add to the clause empowering the legislature to vary the representatiton according to the amount of wealth and number of the inhabitants a proviso that taxation should be in proportion to representation, and, admitting that some objections lay against his proposition, which would be removed by limiting it to direct taxation, since 'with regard to indirect taxes on exports and imports, and on consumption, the rule would be inapplicable,' varied his motion by inserting the word 'direct,' whereupon it passed as follows: 'Provided, always, that direct taxation ***563** ought to be proportioned to representation.' 5 Elliott, Deb. 302.

Amendments were proposed by Mr. Ellsworth and Mr. Wilson to the effect that the rule of contribution by direct taxation should be according to the number of white inhabitants and three-fifths of every other description, and that, in order to ascertain the alterations in the direct taxation which might be required from time to time, a census should be taken. The word 'wealth' was struck out of the clause on motion of Mr. Randolph; and the whole proposition, proportionate representation to direct taxation, and both to the white and three-fifths of the colored in habitants, and requiring a census, was adopted.

In the course of the debates, and after the motion of Mr. Ellsworth that the first census be taken in three years after the meeting of congress had been adopted, Mr. Madison records: 'Mr. King asked what was the precise meaning of 'direct taxation.' No one answered.' But Mr. Gerry immediately moved to amend by the insertion of the clause that 'from the first meeting of the legislature of the United States until a census shall be taken, all moneys for supplying the public treasury by direct taxation shall be raised from the several states according to the number ****683** of their representatives respectively in the first branch.' This left for the time the matter of collection to the states. Mr. Langdon objected that this would bear unreasonably hard against New Hampshire, and Mr. Martin said that direct taxation should not be used but in cases of absolute necessity, and then the states would be the best judges of the mode. 5 Elliot, Deb. 451, 453.

Thus was accomplished one of the great compromises of the constitution, resting on the doctrine that the right of representation ought to be conceded to every community on which a tax is to be imposed, but crystallizing it in such form as to allay jealousies in respect of the future balance of power; to reconcile conflicting views in respect of the enumeration of slaves; and to remove the objection that, in adjusting a system of representation between the states, regard should be had to their relative wealth, since those who were to be most heavily ***564** taxed ought to have a proportionate influence in the goverment.

The compromise, in embracing the power of direct taxation, consisted not simply in including part of the slaves in the enumeration of population, but in providing that, as between state and state, such taxation should be proportioned to representation. The establishment of the same rule for the apportionment of taxes as for regulating the proportion of representatives, observed Mr. Madison in No. 54 of the Federalist, was by no means founded on the same principle, for, as to the former, it had reference to the proportion of wealth, and, although in respect of that it was in ordinary cases a very unfit measure, it 'had too recently obtained the general sanction of America not to have found a ready preference with the convention,' while the opposite interests of the states, balancing each other, would produce impartiality in enumeration. By prescribing

this rule, Hamilton wrote (Federalist, No. 36) that the door was shut 'to partiality or oppression,' and 'the abuse of this power of taxation to have been provided against with guarded circumspection'; and obviously the operation of direct taxation on every state tended to prevent resort to that mode of supply except under pressure of necessity, and to promote prudence and economy in expenditure.

We repeat that the right of the federal government to directly assess and collect its own taxes, at least until after requisitions upon the states had been made and failed, was one of the chief points of conflict; and Massachusetts, in ratifying, recommended the adoption of an amendment in these words: 'That congress do not lay direct taxes but when the moneys arising from the impost and excise are insufficient for the public exigencies, nor then until congress shall have first made a requisition upon the states to assess, levy, and pay their respective proportions of such requisition, agreeably to the census fixed in the said constitution, in such way and manner as the legislatures of the states shall think best.' 1 Elliot, Deb. 322. And in this South Carolina, New Hampshire, and Rhode Island concurred. Id. 325, 326, 329, 336.

***565** Luther Martin, in his well known communication to the legislature of Maryland in January, 1788, expressed his views thus: 'By the power to lay and collect taxes they may proceed to direct taxation on every individual, either by a capitation tax on their heads, or an assessment on their property. * * * Many of the members, and myself in the number, thought that states were much better judges of the circumstances of their citizens, and what sum of money could be collected from them by direct taxation, and of the manner in which it could be raised with the greatest ease and convenience to their citizens, than the general government could be; and that the general government ought not to have the power of laying direct taxes in any case but in that of the delinquency of a state.' 1 Elliot, Deb. 344, 368, 369.

Ellsworth and Sherman wrote the governor of Connecticut, September 26, 1787, that it was probable 'that the principal branch of revenue will be duties on imports. What may be necessary to be raised by direct taxation is to be apportioned on the several states, according to the number of their inhabitants; and although congress may raise the money by their own authority, if necessary, yet that authority need not be exercised if each state will furnish its quota.' 1 Elliot, Deb. 492.

And Ellsworth, in the Connecticut convention, in discussing the power of congress to lay taxes, pointed out that all sources of revenue, excepting the impost, still lay open to the states, and insisted that it was 'necessary that the power of the general legislature should extend to all the objects of taxation, that government should be able to command all the resources of the country, because no man can tell what our exigencies may be. Wars have now become rather wars of the purse than of the sword. Government must therefore be able to command the whole power of the purse. * * * Direct taxation can go but little way towards raising a revenue. To raise money in this way, people must be provident; they must constantly be laying up money to answer the demands of the collector. But you cannot make people thus provident. If you would do anything to the purpose, you must come in when they are spending, and take a part with them. * * * ***566** All nations have seen the necessity and propriety of raising a revenue by indirect taxation, by duties upon articles of consumption. * * * In England the whole public revenue is about twelve millions sterling per annum. The land tax amounts to about two millions; the window and some other taxes, to about two millions more. The other eight millions are raised upon articles ****684** of consumption. * * * This constitution defines the extent of the powers of the general government. If the general legislature should at any time overleap their limits, the judicial department is a constitutional check. If the United States go beyond their powers, if they make a law which the constitution does not authorize, it is void; and the judicial power, the national judges, who, to secure their impartiality, are to be

made independent, will declare it to be void.' 2 Elliot, Deb. 191, 192, 196.

In the convention of Massachusetts by which the constitution was ratified, the second section of article 1 being under consideration, Mr. King said: 'It is a principle of this constitution that representation and taxation should go hand in hand. * * * By this rule are representation and taxation to be apportioned. And it was adopted, because it was the language of all America. According to the Confederation, ratified in 1781, the sums for the general welfare and defense should be apportioned according to the surveyed lands, and improvements thereon, in the several states; but that it hath never been in the power of congress to follow that rule, the returns from the several states being so very imperfect.' 2 Elliot, Deb. 36.

Theophilus Parsons observed: 'Congress have only a concurrent right with each state in laying direct taxes, not an exclusive right; and the right of each state to direct taxation is equally as extensive and perfect as the right of congress.' 2 Elliot, Deb. 93. And John Adams, Dawes, Sumner, King, and Sedgwick all agreed that a direct tax would be the last source of revenue resorted to by congress.

In the New York convention, Chancellor Livingston pointed out that, when the imposts diminished and the expenses of the government increased, 'they must have recourse to direct *567 taxes; that is, taxes on land and specific duties.' 2 Elliot, Deb. 341. And Mr. Jay, in reference to an amendment that direct taxes should not be imposed until requisition had been made and proved fruitless, argued that the amendment would involve great difficulties, and that it ought to be considered that direct taxes were of two kinds,—general and specific. Id. 380, 381.

In Virginia, Mr. John Marshall said: 'The objects of direct taxes are well understood. They are but few. What are they? Lands, slaves, stock of all kinds, and a few other articles of domestic property. * * * They will have the benefit of the knowledge and experience of the state legislature. They will see in what manner the legislature of Virginia collects its taxes. * * * Cannot congress regulate the taxes so as to be equal on all parts of the community? Where is the absurdity of having thirteen revenues? Will they clash with or injure each other? If not, why cannot congress make thirteen distinct laws, and impose the taxes on the general objects of taxation in each state, so as that all persons of the society shall pay equally, as they ought? 3 Elliot, Deb. 229, 235. At that time, in Virginia, lands were taxed, and specific taxes assessed on certain specified objects. These objects were stated by Sec. Wolcott to be taxes on lands, houses in towns, slaves, stud horses, jackasses, other horses and mules, billiard tables, four-wheeled riding carriages, phaetons, stage wagons, and riding carriages with two wheels; and it was undoubtedly to these objects that the future chief justice referred.

Mr. Randolph said: 'But in this new constitution there is a more just and equitable rule fixed,—a limitation beyond which they cannot go. Representatives and taxes go hand in hand. According to the one will the other be regulated. The number of representatives is determined by the number of inhabitants. They have nothing to do but to lay taxes accordingly.' 3 Elliot, Deb. 121.

Mr. George Nicholas said: 'The proportion of taxes is fixed by the number of inhabitants, and not regulated by the extent of territory or fertility of soil. * * * Each state ***568** will know, from its population, its proportion of any general tax. As it was justly observed by the gentleman over the way [Mr. Randolph], they cannot possibly exceed that proportion. They are limited and restrained expressly to it. The state legislatures have no check of this kind. Their power is uncontrolled.' 3 Elliot, Deb. 243, 244.

Mr. Madison remarked that 'they will be limited to fix the proportion of each state, and they must raise it in the most convenient and satisfactory manner to the public.' 3 Elliot, Deb. 255.

From these references—and they might be extended indefinitely—it is clear that the rule to govern each of the great classes into which taxes were divided was prescribed in view of the commonly accepted distinction between them and of the taxes directly levied under the systems of the states; and that the difference between direct and indirect taxation was fully appreciated is supported by the congressional debates after the government was organized.

In the debates in the house of representatives preceding the passage of the act of congress to lay 'duties upon carriages for the conveyance of persons,' approved June 5, 1794 (1 Stat. 373, c. 45), Mr. Sedgwick said that 'a capitation tax, and taxes on land and on property and income generally, were direct charges, as well in the immediate as ultimate sources of contribution. He had considered those, and those only, as direct taxes in their operation and effects. On the other hand, a tax imposed on a specific article of personal property, and particularly of objects of luxury, as in the case under consideration, he had never supposed had been considered a direct tax, within the meaning of the constitution.'

Mr. Dexter observed that his colleague 'had stated the meaning of direct taxes to be a **685 capitation tax, or a general tax on all the taxable property of the citizens; and that a gentleman from Virginia [Mr. Nicholas] thought the meaning was that all taxes are direct which are paid by the citizen without being recompensed by the consumer; but that, where the tax was only advanced and repaid by the consumer, the tax was indirect. He thought that both opinions were just, *569 and not inconsistent, though the gentlemen had differed about them. He thought that a general tax on all taxable property was a direct tax, because it was paid without being recompensed by the consumer.' Ann. 3d Cong. 644, 646.

At a subsequent day of the debate, Mr. Madison objected to the tax on carriages as 'an unconstitutional tax'; but Fisher Ames declared that he had satisfied himself that it was not a direct tax, as 'the duty falls not on the possession, but on the use.' Ann. 730.

Mr. Madison wrote to Jefferson on May 11, 1794: 'And the tax on carriages succeeded, in spite of the constitution, by a majority of twenty, the advocates for the principle being re-enforced by the adversaries to luxuries.' 'Some of the motives which they decoyed to their support ought to premonish them of the danger. By breaking down the barriers of the constitution, and giving sanction to the idea of sumptuary regulations, wealth may find a precarious defense in the shield of justice. If luxury, as such, is to be taxed, the greatest of all luxuries, says Paine, is a great estate. Even on the present occasion, it has been found prudent to yield to a tax on transfers of stock in the funds and in the banks.' 2 Mad. Writings, 14.

But Albert Gallatin, in his Sketch of the Finances of the United States, published in November, 1796, said: 'The most generally received opinion, however, is that, by direct taxes in the constitution, those are meant which are raised on the capital or revenue of the peopel; by indirect, such as are raised on their expense. As that opinion is in itself rational, and conformable to the decision which has taken place on the subject of the carriage tax, and as it appears important, for the sake of preventing future controversies, which may be not more fatal to the revenue than to the tranquillity of the Union, that a fixed interpretation should be generally adopted, it will not be improper to corroborate it by quoting the author from whom the idea seems to have been borrowed.' He then quotes from Smith's Wealth of Nations, and continues: 'The remarkable coincidence of the clause of the constitution with this passage in using the word 'capitation' as a generic *570 expression, including the different species of direct taxes,—an acceptation of the word peculiar, it is believed, to Dr. Smith,—leaves little doubt that the framers of the one had the other in view at the time, and that they, as well as he, by direct taxes, meant those paid directly from the falling immediately on the revenue; and by indirect,

those which are paid indirectly out of the revenue by falling immediately upon the expense.' 3 Gall. Writings (Adams' Ed.) 74, 75.

The act provided in its first section 'that there shall be levied, collected, and paid upon all carriages for the conveyance of persons, which shall be kept by or for any person for his or her own use, or to be let out to hire or for the conveyance of passengers, the several duties and rates following'; and then followed a fixed yearly rate on every coach, chariot, phaeton, and coachee, every four-wheel and every two-wheel top carriage, and upon every other two-wheel carriage varying according to the vehicle.

In Hylton v. U. S. (decided in March, 1796) 3 Dall. 171, this court held the act to be constitutional, because not laying a direct tax. Chief Justice Ellsworth and Mr. Justice Cushing took no part in the decision, and Mr. Justice Wilson gave no reasons.

Mr. Justice Chase said that he was inclined to think (but of this he did not 'give a judicial opinion') that 'the direct taxes contemplated by the constitution are only two, to wit, a capitation or poll tax, simply, without regard to property, profession, or any other circumstance, and a tax on land'; and that he doubted 'whether a tax, by a general assessment of personal property, within the United States, is included within the term 'direct tax." But he thought that 'an annual tax on carriages for the conveyance of persons may be considered as within the power granted to congress to lay duties. The term 'duty' is the most comprehensive next to the general term 'tax'; and practically in Great Britain (whence we take our general ideas of taxes, duties, imposts, excises, customs, etc.), embraces taxes on stamps, tolls for passage, etc., and is not confined to taxes on importation only. It seems to me that a tax on expense is an indirect ***571** tax; and I think an annual tax on a carriage for the conveyance of persons is of that kind, because a carriage is a consumable commodity, and such annual tax on it is on the expense of the owner.'

Mr. Justice Paterson said that 'the constitution declares that a capitation tax is a direct tax; and, both in theory and practice, a tax on land is deemed to be a direct tax. * * * It is not necessary to determine whether a tax on the product of land be a direct or indirect tax. Perhaps, the immediate product of land, in its original and crude state, ought to be considered as the land itself; it makes part of it; or else the provision made against taxing exports would be easily eluded. Land, independently of its produce, is of no value. * * * Whether direct taxes, in the sense of the constitution, comprehend any other tax than a capitation tax, and taxes on land, is a questionable point. * * * But as it is not before the court, it would be improper to give any decisive opinion upon it.' And he concluded: 'All taxes on expenses or consumption are indirect taxes ****686** A tax on carriages is of this kind, and, of course, is not a direct tax.' This conclusion he fortified by reading extracts from Adam Smith on the taxation of consumable commodities.

Mr. Justice Iredell said: 'There is no necessity or propriety in determining what is or is not a direct or indirect tax in all cases. Some difficulties may occur which we do not at present foresee. Perhaps a direct tax, in the sense of the constitution, can mean nothing but a tax on something inseparably annexed to the soil; something capable of apportionment under all such circumstances. A land or a poll tax may be considered of this description. * * * In regard to other articles, there may possibly be considerable doubt. It is sufficient, on the present occasion, for the court to be satisfied that this is not a direct tax contemplated by the constitution, in order to affirm the present judgment.'

It will be perceived that each of the justices, while suggesting doubt whether anything but a capitation or a land tax was a direct tax within the meaning of the constitution, distinctly avoided expressing an opinion upon that question or ***572** laying down a comprehensive definition, but confined his opinion to the case before the court.

The general line of observation was obviously

influenced by Mr. Hamilton's brief for the government, in which he said: 'The following are presumed to be the only direct taxes: Capitation or poll taxes, taxes on lands and buildings, general assessments, whether on the whole property of individuals, or on their whole real or personal estate. All else must, of necessity, be considered as indirect taxes.' 7 Hamilton's Works (Lodge's Ed.) 332.

Mr. Hamilton also argued: 'If the meaning of the word 'excise' is to be sought in a British statute, it will be found to include the duty on carriages, which is there considered as an 'excise.' * * * An argument results from this, though not perhaps a conclusive one, yet, where so important a distinction in the constitution is to be realized, it is fair to seek the meaning of terms in the statutory language of that country from which our jurisprudence is derived.' 7 Hamilton's Works (Lodge's Ed.) 333.

If the question had related to an income tax, the reference would have been fatal, as such taxes have been always classed by the law of Great Britain as direct taxes.

The above act was to be enforced for two years, but before it expired was repealed, as was the similar act of May 28, 1796, c. 37, which expired August 31, 1801 (1 Stat. 478, 482).

By the act of July 14, 1798, when a war with France was supposed to be impending, a direct tax of two millions of dollars was apportioned to tbe states respectively, in the manner prescribed, which tax was to be collected by officers of the United States, and assessed upon 'dwelling houses, lands, and slaves,' according to the valuations and enumerations to be made pursuant to the act of July 9, 1798, entitled 'An act to provide for the valuation of lands and dwelling houses and the enumeration of slaves within the United States.' 1 Stat. 597, c. 75; Id. 580, c. 70. Under these acts, every dwelling house was assessed according to a prescribed value, and the sum of 50 cents upon every slave enumerated, and the residue of the sum apportioned was directed to be assessed upon the lands within each state according to the valuation *573 made pursuant to the prior act, and at such rate per centum as would be sufficient to produce said remainder. By the act of August 2, 1813, a direct tax of three millions of dollars was laid and apportioned to the states respectively, and reference had to the prior act of July 22, 1813, which provided that, whenever a direct tax should be laid by the authority of the United States, the same should be assessed and laid 'on the value of all lands, lots of ground with their improvements, dwelling houses, and slaves, which several articles subject to taxation shall be enumerated and valued by the respective assessors at the rate each of them is worth in money.' 3 Stat. 53, c. 37; Id. 22, c. 16. The act of January 9, 1815, laid a direct tax of six millions of dollars, which was apportioned, assessed, and laid as in the prior act on all lands, lots of grounds with their improvements, dwelling houses, and slaves. These acts are attributable to the war of 1812.

The act of August 6, 1861 (12 Stat. 294, c. 45), imposed a tax of twenty millions of dollars, which was apportioned and to be levied wholly on real estate, and also levied taxes on incomes, whether derived from property or profession, trade or vocation (12 Stat. 309). And this was followed by the acts of July 1, 1862 (12 Stat. 473, c. 119); March 3, 1863 (12 Stat. 718, 723, c. 74); June 30, 1864 (13 Stat. 281, c. 173); March 3, 1865 (13 Stat. 479, c. 78); March 10, 1866 (14 Stat. 4, c. 15); July 13, 1866 (14 Stat. 137, c. 184); March 2, 1867 (14 Stat. 477, c. 169); and July 14, 1870 (16 Stat. 256, c. 255). The differences between the latter acts and that of August 15, 1894, call for no remark in this connection. These acts grew out of the war of the Rebellion, and were, to use the language of Mr. Justice Miller, 'part of the system of taxing incomes, earnings, and profits adopted during the late war, and abandoned as soon after that war was ended as it could be done safely.' Railroad Co. v. Collector, 100 U. S. 595, 598.

From the foregoing it is apparent (1) that the distinction between direct and indirect taxation was

well understood by the framers of the constitution and those who adopted it; (2) that, under the state system of taxation, all taxes on ***574** real estate or personal property or the rents or income thereof were regarded as direct taxes; (3) that the rules of apportionment and of uniformity were adopted in view of that distinction and those systems; (4) that whether the tax on carriages was direct ****687** or indirect was disputed, but the tax was sustained as a tax on the use and an excise; (5) that the original expectation was that the power of direct taxation would be exercised only in extraordinary exigencies; and down to August 15, 1894, this expectation has been realized. The act of that date was passed in a time of profound peace, and if we assume that no special exigency called for unusual legislation, and that resort to this mode of taxation is to become an ordinary and usual means of supply, that fact furnishes an additional reason for circumspection and care in disposing of the case.

We proceed, then, to examine certain decisions of this court under the acts of 1861 and following years, in which it is claimed that this court had heretofore adjudicated that taxes like those under consideration are not direct taxes, and subject to the rule of apportionment, and that we are bound to accept the rulings thus asserted to have been made as conclusive in the premises. Is this contention well founded as respects the question now under examination? Doubtless the doctrine of stare decisis is a salutary one, and to be adhered to on all proper occasions, but it only arises in respect of decisions directly upon the points in issue.

The language of Chief Justice Marshall in Cohens v. Virginia, 6 Wheat. 264, 399, may profitably again be quoted: 'It is a maxim not to be disregarded that general expressions, in every opinion, are to be taken in connection with the case in which those expressions are used. If they go beyond the case, they may be respected, but ought not to control the judgment in a subsequent suit when the very point is presented for decision. The reason of the maxim is obvious. The question actually before the court is investigated with care, and considered in its full extent. Other principles which may serve to illustrate it are considered in their relation to the case decided, but their possible bearing on all other cases is seldom completely investigated.'

***575** So in Carroll v. Carroll's Lessee, 16 How. 275, 286, where a statute of the state of Maryland came under review, Mr. Justice Curtis said: 'If the construction put by the court of a state upon one of its statutes was not a matter in judgment, if it might have been decided either way without affecting any right brought into question, then, according to the principles of the common law, an opinion on such a question is not a decision. To make it so, there must have been an application of the judicial mind to the precise question necessary to be determined to fix the rights of the parties, and decide to whom the property in contestation belongs. And therefore this court, and other courts organized under the common law, has never held itself bound by any part of an opinion, in any case, which was not needful to the ascertainment of the right or title in question between the parties.'

Nor is the language of Mr. Chief Justice Taney inapposite, as expressed in The Genesee Chief, 12 How. 443, wherein it was held that the lakes, and navigable waters connecting them, are within the scope of admiralty and maritime jurisdiction as known and understood in the United States when the constitution was adopted, and the preceding case of The Thomas Jefferson, 10 Wheat. 428, was overruled. The chief justice said: 'It was under the influence of these precedents and this usage that the case of The Thomas Jefferson, 10 Wheat. 428, was decided in this court, and the jurisdiction of the courts of admiralty of the United States declared to be limited to the ebb and flow of the tide. The Orleans v. Phoebus, 11 Pet. 175, afterwards followed this case, merely as a point decided. It is the decision in the case of The Thomas Jefferson which mainly embarrasses the court in the present inquiry. We are sensible of the great weight to which it is entitled. But at the same time we are convinced that

if we follow it we follow an erroneous decision into which the court fell, when the great importance of the question as it now presents itself could not be foreseen, and the subject did not therefore receive that deliberate consideration which at this time would have been given to it by the eminent men who presided here when that case was decided. *576 For the decision was made in 1825, when the commerce on the rivers of the West and on the Lakes was in its infancy, and of little importance, and but little regarded, compared with that of the present day. Moreover, the nature of the questions concerning the extent of the admiralty jurisdiction, which have arisen in this court, were not calculated to call its attention particularly to the one we are now considering.'

Manifestly, as this court is clothed with the power and intrusted with the duty to maintain the fundamental law of the constitution, the discharge of that duty requires it not to extend any decision upon a constitutional question if it is convinced that error in principle might supervene.

Let us examine the cases referred to in the light of these observations.

In Insurance Co. v. Soule, 7 Wall. 433, the validity of a tax which was described as 'upon the business of an insurance company,' was sustained on the ground that it was 'a duty or excise,' and came within the decision in Hylton's Case. The arguments for the insurance company were elaborate, and took a wide range, but the decision rested on narrow ground, and turned on the distinction between an excise duty and a tax strictly so termed, regarding the former a charge for a privilege, or on the transaction of business, without any necessary reference to the amount of property belonging to those on whom the charge might fall, although it might be increased or diminished by the extent to which the privilege was exercised or **688 the business done. This was in accordance with Society v. Coite, 6 Wall. 594, Provident Inst. v. Massachusetts, Id. 611, and Hamilton Co. v. Massachusetts, Id. 632, in which cases there was a difference of opinion on the question whether the tax under consideration was a tax on the property, and not upon the franchise or privilege. And see Van Allen v. Assessors, 3 Wall. 573; Home Ins. Co. v. New York, 134 U. S. 594, 10 Sup. Ct. 593; Pullman's Palace Car Co. v. Pennsylvania, 141 U. S. 18, 11 Sup. Ct. 876.

In Bank v. Fenno, 8 Wall. 533, a tax was laid on the circulation of state banks or national banks paying out the notes of individuals or state banks, and it was *577 held that it might well be classed under the head of duties, and as falling within the same category as Soule's Case, 7 Wall. 433. It was declared to be of the same nature as excise taxation on freight receipts, bills of lading, and passenger tickets issued by a railroad company. Referring to the discussions in the convention which framed the constitution, Mr. Chief Justice Chase observed that what was said there 'doubtless shows uncertainty as to the true meaning of the term 'direct tax,' but it indicates also an understanding that direct taxes were such as may be levied by capitation and on land and appurtenances, or perhaps by valuation and assessment of personal property upon general lists; for these were the subjects from which the states at that time usually raised their principal supplies.' And in respect of the opinions in Hylton's Case the chief justice said: 'It may further be taken as established upon the testimony of Paterson that the words 'direct taxes,' as used in the constitution, comprehended only capitation taxes and taxes on land, and perhaps taxes on personal property by general valuation and assessment of the various descriptions possessed within the several states.'

In National Bank v. U. S., 101 U. S. 1, involving the constitutionality of section 3413 of the Revised Statutes, enacting that 'every national banking association, state bank, or banker, or association, shall pay a tax of ten per centum on the amount of notes of any town, city, or municipal corporation, paid out by them,' Bank v. Fenno was cited with approval to the point that congress, having undertaken to provide a currency for the whole

country, might, to secure the benefit of it to the people, restrain, by suitable enactments, the circulation as money of any notes not issued under its authority; and Mr. Chief Justice Waite, speaking for the court, said, 'The tax thus laid is not on the obligation, but on its use in a particular way.'

Scholey v. Rew, 23 Wall. 331, was the case of a succession tax, which the court held to be 'plainly an excise tax or duty' 'upon the devolution of the estate, or the right to become beneficially entitled to the same or the income thereof in ***578** possession or expectancy.' It was like the succession tax of a state, held constitutional in Mager v. Grima, 8 How. 490; and the distinction between the power of a state and the power of the United States to regulate the succession of property was not referred to, and does not appear to have been in the mind of the court. The opinion stated that the act of parliament from which the particular provision under consideration was borrowed had received substantially the same construction, and cases under that act hold that a succession duty is not a tax upon income or upon property, but on the actual benefit derived by the individual, determined as prescribed. In re Elwes, 3 Hurl. & N. 719; Attorney General v. Earl of Sefton, 2 Hurl. & C. 362, 3 Hurl. & C. 1023, and 11 H. L. Cas. 257.

In Railroad Co. v. Collector, 100 U. S. 595, the validity of a tax collected of a corporation upon the interest paid by it upon its bonds was held to be 'essentially an excise on the business of the class of corporations mentioned in the statute.' And Mr. Justice Miller, in delivering the opinion, said: 'As the sum involved in this suit is small, and the law under which the tax in question was collected has long since been repealed, the case is of little consequence as regards any principle involved in it as a rule of future action.'

All these cases are distinguishable from that in hand, and this brings us to consider that of Springer v. U. S., 102 U. S. 586, chiefly relied on and urged upon us as decisive.

That was an action of ejectment, brought on a tax deed issued to the United States on sale of defendant's real estate for income taxes. The defendant contended that the deed was void, because the tax was a direct tax, not levied in accordance with the constitution. Unless the tax were wholly invalid, the defense failed.

The statement of the case in the report shows that Springer returned a certain amount as his net income for the particular year, but does not give the details of what his income, gains, and profits consisted in.

The original record discloses that the income was not ***579** derived in any degree from real estate, but was in part professional as attorney at law, and the rest interest on United States bonds. It would seem probable that the court did not feel called upon to advert to the distinction between the latter and the former source of income, as the validity of the tax as to either would sustain the action.

The opinion thus concludes: 'Our conclusions are that direct taxes, within the meaning of the constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate; and that the tax of which the plaintiff in error complains is within the category of an excise or duty.'

While this language is broad enough to cover the interest as well as the professional earnings, the case would have been more significant as a precedent if the distinction had ****689** been brought out in the report and commented on in arriving at judgment, for a tax on professional receipts might be treated as an excise or duty, and therefore indirect, when a tax on the income of personalty might be held to be direct.

Be this as it may, it is conceded in all these cases, from that of Hylton to that of Springer, that taxes on land are direct taxes, and in none of them is it determined that taxes on rents or income derived from land are not taxes on land.

We admit that it may not unreasonably be said that logically, if taxes on the rents, issues, and profits of real estate are equivalent to taxes on real estate, and are therefore direct taxes, taxes on the income of personal property as such are equivalent to taxes on such property, and therefore direct taxes. But we are considering the rule stare decisis, and we must decline to hold ourselves bound to extend the scope of decisions,—none of which discussed the question whether a tax on the income from personalty is equivalent to a tax on that personalty, but all of which held real estate liable to direct taxation only,—so as to sustain a tax on the income of realty on the ground of being an excise or duty.

As no capitation or other direct tax was to be laid otherwise than in proportion to the population, some other direct tax than a capitation tax (and, it might well enough be argued, some other tax of the same kind as a capitation tax) must be ***580** referred to, and it has always been considered that a tax upon real estate eo nomine, or upon its owners in respect thereof, is a direct tax, within the meaning of the constitution. But is there any distinction between the real estate itself or its owners in respect of it and the rents or income of the real estate coming to the owners as the natural and ordinary incident of their ownership?

If the constitution had provided that congress should not levy any tax upon the real estate of any citizen of any state, could it be contended that congress could put an annual tax for five or any other number of years upon the rent or income of the real estate? And if, as the constitution now reads, no unapportioned tax can be imposed upon real estate, can congress without apportionment nevertheless impose taxes upon such real estate under the guise of an annual tax upon its rents or income?

As, according to the feudal law, the whole beneficial interest in the land consisted in the right to take the rents and profits, the general rule has always been, in the language of Coke, that 'if a man seised of land in fee by his deed granteth to another the profits of those lands, to have and to hold to him and his heirs, and maketh livery secundum formam chartae, the whole land itself doth pass. For what is the land but the profits thereof?' Co. Litt. 45. And that a devise of the rents and profits or of the income of lands passes the land itself both at law and in equity. 1 Jarm. Wills (5th Ed.) *798, and cases cited.

The requirement of the constitution is that no direct tax shall be laid otherwise than by apportionment. The prohibition is not against direct taxes on land, from which the implication is sought to be drawn that indirect taxes on land would be constitutional, but it is against all direct taxes; and it is admitted that a tax on real estate is a direct tax. Unless, therefore, a tax upon rents or income issuing out of lands is intrinsically so different from a tax on the land itself that it belongs to a wholly different class of taxes, such taxes must be regarded as falling within the same category as a tax on real estate eo nomine. The name of the tax is unimportant. ***581** The real question is, is there any basis upon which to rest the contention that real estate belongs to one of the two great classes of taxes, and the rent or income which is the incident of its ownership belongs to the other? We are unable to perceive any ground for the alleged distinction. An annual tax upon the annual value or annual user of real estate appears to us the same in substance as an annual tax on the real estate, which would be paid out of the rent or income. This law taxes the income received from land and the growth or produce of the land. Mr. Justice Paterson observed in Hylton's Case, 'land, independently of its produce, is of no value,' and certainly had no thought that direct taxes were confined to unproductive land.

If it be true that by varying the form the substance may be changed, it is not easy to see that anything would remain of the limitations of the constitution, or of the rule of taxation and representation, so carefully recognized and guarded in favor of the citizens of each state. But constitutional provisions cannot be thus evaded. It is the sub-

stance, and not the form, which controls, as has indeed been established by repeated decisions of this court. Thus in Brown v. Maryland, 12 Wheat. 419, 444, it was held that the tax on the occupation of an importer was the same as a tax on imports, and therefore void. And Chief Justice Marshall said: 'It is impossible to conceal from ourselves that this is varying the form without varying the substance. It is treating a prohibition which is general as if it were confined to a particular mode of doing the forbidden thing. All must perceive that a tax on the sale of an article imported only for sale is a tax on the article itself.'

In Weston v. City Council, 2 Pet. 449, it was held that a tax on the income of United States securities was a tax on the securities themselves, and equally inadmissible. The ordinance of the city of Charleston involved in that case was exceedingly obscure; but the opinions of Mr. Justice Thompson and ****690** Mr. Justice Johnson, who dissented, make it clear that the levy was upon the interest of the bonds and not upon the bonds, and they held that it was an income tax, and as ***582** such sustainable; but the majority of the court, Chief Justice Marshall delivering the opinion, overruled that contention.

So in Dobbins v. Commissioners, 16 Pet. 435, it was decided that the income from an official position could not be taxed if the office itself was exempt.

In Almy v. California, 24 How. 169, it was held that a duty on a bill of lading was the same thing as a duty on the article which it represented; in Railroad Co v. Jackson, 7 Wall. 262, that a tax upon the interest payable on bonds was a tax not upon the debtor, but upon the security; and in Cook v. Pennsylvania, 97 U. S. 566, that a tax upon the amount of sales of goods by an auctioneer was a tax upon the goods sold.

In Philadelphia & S. S. S. Co. v. Pennsylvania, 122 U. S. 326, 7 Sup. Ct. 1118, and Leloup v. Port of Mobile, 127 U. S. 640, 8 Sup. Ct. 1380, it was held that a tax on income received from interstate commerce was a tax upon the commerce itself, and therefore unauthorized. And so, although it is thoroughly settled that where by way of duties laid on the transportation of the subjects of interstate commerce, and on the receipts derived therefrom, or on the occupation or business of carrying it on, a tax is levied by a state on interstate commerce, such taxation amounts to a regulation of such commerce, and cannot be sustained, yet the property in a state belonging to a corporation, whether foreign or domestic, engaged in foreign or domestic commerce, may be taxed; and when the tax is substantially a mere tax on property, and not one imposed on the privilege of doing interstate commerce, the exaction may be sustained. 'The substance, and not the shadow, determines the validity of the exercise of the power.' Telegraph Co. v. Adams, 155 U. S. 688, 15 Sup. Ct. 268.

Nothing can be clearer than that what the constitution intended to guard against was the exercise by the general government of the power of directly taxing persons and property within any state through a majority made up from the other states. It is true that the effect of requiring direct taxes to be apportioned among the states in proportion to their population is necessarily that the amount of taxes on the individual ***583** taxpayer in a state having the taxable subject-matter to a larger extent in proportion to its population than another state has, would be less than in such other state; but this inequality must be held to have been contemplated, and was manifestly designed to operate to restrain the exercise of the power of direct taxation to extraordinary emergencies, and to prevent an attack upon accumulated property by mere force of numbers.

It is not doubted that property owners ought to contribute in just measure to the expenses of the government. As to the states and their municipalities, this is reached largely through the imposition of direct taxes. As to the federal government, it is attained in part through excises and indirect taxes

upon luxuries and consumption generally, to which direct taxation may be added to the extent the rule of apportionment allows. And through one mode or the other the entire wealth of the country, real and personal, may be made, as it should be, to contribute to the common defense and general welfare.

But the acceptance of the rule of apportionment was one of the compromises which made the adoption of the constitution possible, and secured the creation of that dual form of government, so elastic and so strong, which has thus far survived in unabated vigor. If, by calling a tax indirect when it is essentially direct, the rule of protection could be frittered away, one of the great landmarks defining the boundary between the nation and the states of which it is composed, would have disappeared, and with it one of the bulwarks of private rights and private property.

We are of opinion that the law in question, so far as it levies a tax on the rents or income of real estate, is in violation of the constitution, and is invalid.

Another question is directly presented by the record as to the validity of the tax levied by the act upon the income derived from municipal bonds. The averment in the bill is that the defendant company owns two millions of the municipal bonds of the city of New York, from which it derives an annual income of $60,000, and that the directors of the company intend to return and pay the taxes on the income so derived.

The constitution contemplates the independent exercise by ***584** the nation and the state, severally, of their constitutional powers.

As the states cannot tax the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution, so it has been held that the United States have no power under the constitution to tax either the instrumentalities or the property of a state.

A municipal corporation is the representative of the state, and one of the instrumentalities of the state government. It was long ago determined that the property and revenues of municipal corporations are not subjects of federal taxation. Collector v. Day, 11 Wall. 113; U. S. v. Railroad Co., 17 Wall. 322, 332. In Collector v. Day it was adjudged that congress had no power, even by an act taxing all incomes, to levy a tax upon the salaries of judicial officers of a state, for reasons similar to those on which it had been held in Dobbins v. Commissioners, 16 Pet. 435, that a state could not tax the salaries ****691** of officers of the United States. Mr. Justice Nelson, in delivering judgment, said: 'The general government and the states, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former, in its appropriate sphere, is supreme; but the states, within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the states.'

This is quoted in Van Brocklin v. Tennessee, 117 U. S. 151, 178, 6 Sup. Ct. 670, and the opinion continues: 'Applying the same principles, this court in U. S. v. Baltimore & O. R. Co., 17 Wall. 322, held that a municipal corporation within a state could not be taxed by the United States on the dividends or interest of stock or bonds held by it in a railroad or canal company, because the municipal corporation was a representative of the state, created by the state to exercise a limited portion of its powers of government, and therefore its revenues, like those of the state itself, were not taxable by the United States. The revenues thus adjudged to be exempt from federal taxation***585** were not themselves appropriated to any specific public use, nor derived from property held by the state or by the municipal corporation for any specific public use, but were part of the general income of that corporation, held for the public use in no other sense than all property and income belonging to it in its muni-

cipal character must be so held. The reasons for exempting all the property and income of a state, or of a municipal corporation, which is a political division of the state, from federal taxation, equally require the exemption of all the property and income of the national government from state taxation.'

In Morcantile Bank v. City of New York, 121 U. S. 138, 162, 7 Sup. Ct. 826, this court said: 'Bonds issued by the state of New York, or under its authority, by its public municipal bodies, are means for carrying on the work of the government, and are not taxable, even by the United States, and it is not a part of the policy of the government which issues them to subject them to taxation for its own purposes.'

The question in Bonaparte v. Tax Court, 104 U. S. 592, was whether the registered public debt of one state, exempt from taxation by that state, or actually taxed there, was taxable by another state, when owned by a citizen of the latter, and it was held that there was no provision of the constitution of the United States which prohibited such taxation. The states had not covenanted that this could not be done, whereas, under the fundamental law, as to the power to borrow money, neither the United States, on the one hand, nor the states on the other, can interfere with that power as possessed by each, and an essential element of the sovereignty of each.

The law under consideration provides 'that nothing herein contained shall apply to states, counties or municipalities.' It is contended that, although the property or revenues of the states or their instrumentalities cannot be taxed, nevertheless the income derived from state, county, and municipal securities can be taxed. But we think the same want of power to tax the property or revenues of the states or their instrumentalities exists in relation to a tax on the income from their securities, and for the same reason; and that reason ***586** is given by Chief Justice Marshall, in Weston v. City Council, 2 Pet. 449, 468, where he said: 'The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burthen on the operations of government. It may be carried to an extent which shall arrest them entirely. * * * The tax on government stock is thought by this court to be a tax on the contract, a tax on the power a to borrow money on the credit of the United States, and consequently to be repugnant to the constitution.' Applying this language to these municipal securities, it is obvious that taxation on the interest therefrom would operate on the power to borrow before it is exercised, and would have a sensible influence on the contract, and that the tax in question is a tax on the power of the states and their instrumentalities to borrow money, and consequently repugnant to the constitution.

Upon each of the other questions argued at the bar, to wit: (1) Whether the void provisions as to rents and income from real estate invalidated the whole act; (2) whether, as to the income from personal property, as such, the act is unconstitutional, as laying direct taxes; (3) whether any part of the tax, if not considered as a direct tax, is invalid for want of uniformity on either of the grounds suggested,—the justices who heard the argument are equally divided, and therefore no opinion is expressed.

The result is that the decree of the circuit court is reversed and the cause remanded, with directions to enter a decree in favor of the complainant in respect only of the voluntary payment of the tax on the rents and income of the real estate of the defendant company, and of that which it holds in trust, and on the income from the municipal bonds owned or so held by it.

Mr. Justice FIELD.

I also desire to place my opinion on record upon some of the important questions discussed in relation to the direct and indirect taxes proposed by the income tax law of 1894.

*587 Several suits have been instituted in state **692 and federal courts, both at law and in equity, to test the validity of the provisions of the law, the determination of which will necessitate careful and extended consideration.

The subject of taxation in the new government which was to be established created great interest in the convention which framed the constitution, and was the cause of much difference of opinion among its members, and earnest contention between the states. The great source of weakness of the confederation was its inability to levy taxes of any kind for the support of its government. To raise revenue it was obliged to make requisitions upon the states, which were respected or disregarded at their pleasure. Great embarrassments followed the consequent inability to obtain the necessary funds to carry on the government. One of the principal objects of the proposed new government was to obviate this defect of the confederacy, by conferring authority upon the new government, by which taxes could be directly laid whenever desired. Great difficulty in accomplishing this object was found to exist. The states bordering on the ocean were unwilling to give up their right to lay duties upon imports, which were their chief source of revenue. The other states, on the other hand, were unwilling to make any agreement for the levying of taxes directly upon real and personal property, the smaller states fearing that they would be overborne by unequal burdens forced upon them by the action of the larger states. In this condition of things, great embarrassment was felt by the members of the convention. It was feared at times that the effort to form a new government would fail. But happily a compromise was effected by an agreement that direct taxes should be laid by congress by apportioning them among the states according to their representation. In return for this concession by some of the states, the other states bordering on navigable waters consented to relinquish to the new government the control of duties, imposts, and excises, and the regulation of commerce, with the condition that the duties, imposts, and excises should be uniform throughout the United States. So that, on the one *588 hand, anything like oppression or undue advantage of any one state over the others would be prevented by the apportionment of the direct taxes among the states according to their representation, and, on the other hand, anything like oppression or hardship in the levying of duties, imposts, and excises would be avoided by the provision that they should be uniform throughout the United States. This compromise was essential to the continued union and harmony of the states. It protected every state from being controlled in its taxation by the superior numbers of one or more other states.

The constitution, accordingly, when completed, divided the taxes which might be levied under the authority of congress into those which were direct and those which were indirect. Direct taxes, in a general and large sense, may be described as taxes derived immediately from the person, or from real or personal property, without any recourse therefrom to other sources for reimbursement. In a more restricted sense, they have sometimes been confined to taxes on real property, including the rents and income derived therefrom. Such taxes are conceded to be direct taxes, however taxes on other property are designated, and they are to be apportioned among the states of the Union according to their respective numbers. The second section of article 1 of the constitution declares that representatives and direct taxes shall be thus apportioned. It had been a favorite doctrine in England and in the colonies, before the adoption of the constitution, that taxation and representation should go together. The constitution prescribes such apportionment among the several states according to their respective numbers, to be determined by adding to the whole number of free persons, including those bound to service for a term of years, and excluding Indians not taxed, three-fifths of all other persons.

Some decisions of this court have qualified or thrown doubts upon the exact meaning of the words 'direct taxes.' Thus, in Springer v. U. S., 102 U. S. 586, it was held that a tax upon gains, profits, and

income was an excise or duty, and not a direct tax, within the meaning of the constitution, and *589 that its imposition was not, therefore, unconstitutional. And in Insurance Co. v. Soule, 7 Wall. 433, it was held that an income tax or duty upon the amounts insured, renewed, or continued by insurance companies, upon the gross amounts of premiums received by them and upon assessments made by them, and upon dividends and undistributed sums, was not a direct tax, but a duty or excise.

In the discussions on the subject of direct taxes in the British parliament, an income tax has been generally designated as a direct tax, differing in that respect from the decision of this court in Springer v. U. S. But, whether the latter can be accepted as correct or otherwise, it does not affect the tax upon real property and its rents and income as a direct tax. Such a tax is, by universal consent, recognized to be a direct tax.

As stated, the rents and income of real property are included in the designation of direct taxes, as part of the real property. Such has been the law in England for centuries, and in this country from the early settlement of the colonies; and it is strange that any member of the legal profession should at this day question a doctrine which has always been thus accepted by common-law lawyers. It is so declared in approved treatises upon real property and in accepted authorities on particular branches of real estate law, and has been so announced in decisions in the English courts and our own courts without number. Thus, in Washburn on Real Property, it is said that 'a devise of the rents **693 and profits of land, or the income of land, is equivalent to a devise of the land itself, and will be for life or in fee, according to the limitation expressed in the devise.' Volume 2, p. 695, § 30.

In Jarman on Wills it is laid down that 'a devise of the rents and profits or of the income of land passes the land itself, both at law and in equity; a rule, it is said, founded on the feudal law, according to which the whole beneficial interest in the land consisted in the right to take the rents and profits. And since the act 1 Vict. c. 26, such a devise carries the fee simple; but before that act it carried no more than an estate for life, unless words of inheritance were *590 added.' Mr. Jarman cites numerous authorities in support of his statement. South v. Alleine, 1 Salk. 228; Goldin v. Lakeman, 2 Barn. & Adol. 42; Johnson v. Arnold, 1 Ves. Sr. 171; Baines v. Dixon, Id. 42; Mannox v. Greener, L. R. 14 Eq. 456; Blann v. Bell, 2 De Gex, M. & G. 781; Plenty v. West, 6 C. B. 201.

Coke upon Littleton says: 'If a man seised of lands in fee by his deed granteth to another the profits of those lands, to have and to hold to him and his heires, and maketh livery secundum formam chartae, the whole land itselfe, doth passe; for what is the land but the profits thereof?' Lib. 1, p. 4b., c. 1, § 1.

In Goldin v. Lakeman, Lord Tenterden, Chief Justice of the court of the king's bench, to the same effect, said, 'It is an established rule that a devise of the rents and profits is a devise of the land.' And, in Johnson v. Arnold, Lord Chancellor Hardwicke reiterated profits of lands is a devise of the lands themselves' profits of lands is a devise of the lands themselves'

The same rule is announced in this country,—the court of errors of New York, in Patterson v. Ellis, 11 Wend. 259, 298, holding that the 'devise of the interest or of the rents and profits is a devise of the thing itself, out of which that interest or those rents and profits may issue;' and the supreme court of Massachusetts, in Reed v. Reed, 9 Mass. 372, 374, that 'a devise of the income of lands is the same, in its effect, as a devise of the lands.' The same view of the law was expressed in Anderson v. Greble, 1 Ashm. 136, 138; King, the president of the court, stating, 'I take it to be a well-settled rule of law that by a devise of the rent, profits, and income of land, the land itself passes.' Similar adjudications might be repeated almost indefinitely. One may have the reports of the English courts examined for several centuries without finding a single decision or even a dictum of thier

judges in conflict with them. And what answer do we receive to these adjudications? Those rejecting them furnish no proof that the framers of the constitution did not follow them, as the great body of the people of the country then did. An incident which occurred in this court and room 20 ***591** years ago may have become a precedent. To a powerful argument then being made by a distinguished counsel, on a public question, one of the judges exclaimed that there was a conclusive answer to his position, and that was that the court was of a different opinion. Those who decline to recognize the adjudications cited may likewise consider that they have a conclusive answer to them in the fact that they also are of a different opinion. I do not think so. The law, as expounded for centuries, cannot be set aside or disregarded because some of the judges are now of a different opinion from those who, a century ago, followed it, in framing our constitution.

Hamilton, speaking on the subject, asks, 'What, in fact, is property but a fiction, without the beneficial use of it?' and adds, 'In many cases, indeed, the income or annuity is the property itself.' 3 Hamilton, Works (Putnam's Ed.) p. 34.

It must be conceded that whatever affects any element that gives an article its value, in the eye of the law, affects the article itself.

In Brown v. Maryland, 12 Wheat. 419, it was held that a tax on the occupation of an importer is the same as a tax on his imports, and as such was invalid. It was contended that the state might tax occupations and that this was nothing more; but the court said, by Chief Justice Marshall (page 444): 'It is impossible to conceal from ourselves that this is varying the form without varying the substance. It is treating a prohibition which is general as if it were confined to a particular mode of doing the forbidden thing. All must perceive that a tax on the sale of an article imported only for sale is a tax on the article itself.'

In Weston v. Council, 2 Pet. 449, it was held that a tax upon stock issued for loans to the United States was a tax upon the loans themselves, and equally invalid. In Dobbins v. Commissioner, 16 Pet. 435, it was held that the salary of an officer of the United States could not be taxed, if the office was itself exempt. In Almy v. California, 24 How. 169, it was held that a duty on a bill of lading was the same thing as a duty on the article transported. In Cook v. Pennsylvania, 97 U. S. 566, it was held that a tax upon the amount ***592** of sales of goods made by an auctioneer was a tax upon the goods sold. In Philadelphia & S. S. S. Co. v. Pennsylvania, 122 U. S. 326, 7 Sup. Ct. 1118, and Leloup v. Port of Mobile, 127 U. S. 640, 648, 8 Sup. Ct. 1380, it was held that a tax upon the income received from interstate commerce was a tax upon the commerce itself, and equally unauthorized. The same doctrine was held in People v. Commissioners of Taxes, etc., 90 N. Y. 63; State Freight Tax Case, 15 Wall. 232, 274; Welton v. Missouri. 91 U. S. 275, 278; and in Fargo v. Michigan, 121 U. S. 230, 7 Sup. Ct. 857.

The law, so far as it imposes a tax upon land by taxation of the rents and income ****694** thereof, must therefore fail, as it does not follow the rule of apportionment. The constitution is imperative in its directions on this subject, and admits of no departure from them.

But the law is not invalid merely in its disregard of the rule of apportionment of the direct tax levied. There is another and an equally cogent objection to it. In taxing incomes other than rents and profits of real estate it disregards the rule of uniformity which is prescribed in such cases by the constitution. The eighth section of the first article of the constitution declares that 'the congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States.' Excises are a species of tax consisting generally of duties laid upon the manufacture, sale, or consumption of commodities within the country, or upon certain

callings or occupations, often taking the form of exactions for licenses to pursue them. The taxes created by the law under consideration, as applied to savings banks, insurance companies, whether of fire, life, or marine, to building or other associations, or to the conduct of any other kind of business, are excise taxes, and fall within the requirement, so far as they are laid by congress, that they must be uniform throughout the United States.

The uniformity thus required is the uniformity throughout the United States of the duty, impost, and excise levied; that is, the tax levied cannot be one sum upon an article at one ***593** place, and a different sum upon the same article at another place. The duty received must be the same at all places throughout the United States, proportioned to the quantity of the article disposed of, or the extent of the business done. If, for instance, one kind of wine or grain or produce has a certain duty laid upon it, proportioned to its quantity, in New York, it must have a like duty, proportioned to its quantity, when imported at Charleston or San Francisco; or if a tax be laid upon a certain kind of business, proportioned to its extent, at one place, it must be a like tax on the same kind of business, proportioned to its extent, at another place. In that sense, the duty must be uniform throughout the United States.

It is contended by the government that the constitution only requires an uniformity geographical in its character. That position would be satisfied if the same duty were laid in all the states, however variant it might be in different places of the same state. But it could not be sustained in the latter case without defeating the equality, which is an essential element of the uniformity required, so far as the same is practicable.

In U. S. v. Singer, 15 Wall. 111, 121, a tax was imposed upon a distiller, in the nature of an excise, and the question arose whether in its imposition upon different distillers the uniformity of the tax was preserved, and the court said: 'The law is not in our judgment subject to any constitutional objection. The tax imposed upon the distiller is in the nature of an excise, and the only limitation upon the power of congress in the imposition of taxes of this character is that they shall be 'uniform throughout the United States.' The tax here is uniform in its operation; that is, it is assessed equally upon all manufacturers of spirits, wherever they are. The law does not establish one rule for one distiller and a different rule for another, but the same rule for all alike.'

In the Head Money Cases, 112 U. S. 580, 594, 5 Sup. Ct. 247, a tax was imposed upon the owners of steam vessels for each passenger landed at New York from a foreign port, and it was objected that the tax was not levied by any rule of uniformity, but the court, by Justice Miller, replied: 'The tax is uniform when ***594** it operates with the same force and effect in every place where the subject of it is found. The tax in this case, which, as far as it can be called a tax, is an excise duty on the business of bringing passengers from foreign countries into this, by ocean navigation, is uniform, and operates precisely alike in every port of the United States where such passengers can be landed.' In the decision in that case, in the circuit court (18 Fed. 135, 139), Mr. Justice Blatchford, in addition to pointing out that 'the act was not passed in the exercise of the power of laying taxes,' but was a regulation of commerce, used the following language: 'Aside from this, the tax applies uniformly to all steam and sail vessels coming to all ports in the United States, from all foreign ports, with all alien passengers. The tax being a license tax on the business, the rule of uniformity is sufficiently observed if the tax extends to all persons of the class selected by congress; that is, to all owners of such vessels. Congress has the exclusive power of selecting the class. It has regulated that particular branch of commerce which concerns the bringing of alien passengers,' and that taxes shall be levied upon such property as shall be prescribed by law. The object of this provision was to prevent unjust discriminations. It prevents property from being classified, and taxed as classed, by different rules. All kinds of property must be taxed uniformly or be entirely ex-

empt. The uniformity must be coextensive with the territory to which the tax applies.

Mr. Justice Miller, in his lectures on the constitution, 1889–1890 (pages 240, 241), said of taxes levied by congress: 'The tax must be uniform on the particular article; and it is uniform, within the meaning of the constitutional requirement, if it is made to bear the same percentage over all the United States. That is manifestly the meaning of this word, as used in this clause. The framers ****695** of the constitution could not have meant to say that the government, in raising its revenues, should not be allowed to discriminate between the articles which it should tax.' In discussing generally the requirement of uniformity found in state constitutions, he said: 'The difficulties in the way of this construction have, however, been very largely obviated by the meaning of the word ***595** 'uniform,' which has been adopted, holding that the uniformity must refer to articles of the same class; that is, different articles may be taxed at different amounts, provided the rate is uniform on the same class everywhere, with all people, and at all times.'

One of the learned counsel puts it very clearly when he says that the correct meaning of the provisions requiring duties, imposts, and excises to be 'uniform throughout the United States' is that the law imposing them should 'have an equal and uniform application in every part of the Union.'

If there were any doubt as to the intention of the states to make the grant of the right to impose indirect taxes subject to the condition that such taxes shall be in all respects uniform and impartial, that doubt, as said by counsel, should be resolved in the interest of justice, in favor of the taxpayer.'

Exemptions from the operation of a tax always create inequalities. Those not exempted must, in the end, bear an additional burden or pay more than their share. A law containing arbitrary exemptions can in no just sense be termed 'uniform.' In my judgment, congress has rightfully no power, at the expense of others, owning property of the like character, to sustain private trading corporations, such as building and loan associations, savings banks, and mutual life, fire, marine, and accident insurance companies, formed under the laws of the various states, which advance no national purpose or public interest, and exist solely for the pecuniary profit of their members.

Where property is exempt from taxation, the exemption, as has been justly stated, must be supported by some consideration that the public, and not private, interests will be advanced by it. Private corporations and private enterprises cannot be aided under the pretense that it is the exercise of the discretion of the legislature to exempt them. Association v. Topeka, 20 Wall. 655; Parkersburg v. Brown, 106 U. S. 487, 1 Sup. Ct. 442; Barbour v. Board, 82 Ky. 645, 654, 655; City of Lexington v. McQuillan's Heirs, 9 Dana, 513, 516, 517; and Sutton's Heirs v. City of Louisville, 5 Dana, 28–31.

Cooley, in his treatise on Taxation (2d Ed. 215), justly ***596** observes that 'it is difficult to conceive of a justifiable exemption law which should select single individuals or corporations, or single articles of property, and, taking them out of the class to which they belong, make them the subject of capricious legislative favor. Such favoritism could make no pretense to equality; it would lack the semblance of legitimate tax legislation.'

The income tax law under consideration is marked by discriminating features which affect the whole law. It discriminates between those who receive an income of $4,000 and those who do not. It thus vitiates, in my judgment, by this arbitrary discrimination, the whole legislation. Hamilton says in one of his papers (the Continentalist): 'The genius of liberty reprobates everything arbitrary or discretionary in taxation. It exacts that every man, by a definite and general rule, should know what proportion of his property the state demands; whatever liberty we may boast of in theory, it cannot exist in fact while [arbitrary] assessments continue.' 1 Hamilton's Works (Ed. 1885) 270. The legislation, in the discrimination it makes, is class legislation.

Whenever a distinction is made in the burdens a law imposes or in the benefits it confers on any citizens by reason of their birth, or wealth, or religion, it is class legislation, and leads inevitably to oppression and abuses, and to general unrest and disturbance in society. It was hoped and believed that the great amendments to the constitution which followed the late Civil War had rendered such legislation impossible for all future time. But the objectionable legislation reappears in the act under consideration. It is the same in essential character as that of the English income statute of 1691, which taxed Protestants at a certain rate, Catholics, as a class, at double the rate of Protestants, and Jews at another and separate rate. Under wise and constitutional legislation, every citizen should contribute his proportion, however small the sum, to the support of the government, and it is no kindness to urge any of our citizens to escape from that obligation. If he contributes the smallest mite of his earnings to that purpose, he will have a greater regard for the government and more self-respect ***597** for himself, feeling that, though he is poor in fact, he is not a pauper of his government. And it is to be hoped that, whatever woes and embarrassments may betide our people, they may never lose their manliness and self-respect. Those qualities preserved, they will ultimately triumph over all reverses of fortune.

There is nothing in the nature of the corporations or associations exempted in the present act, or in their method of doing business, which can be claimed to be of a public or benevolent nature. They differ in no essential characteristic in their business from 'all other corporations, companies, or associations doing business for profit in the United States.' Section 32, Law of 1894.

A few words as to some of them, the extent of their capital and business, and of the exceptions made to their taxation:

(1) As to Mutual Savings Banks. Under income tax laws prior to 1870, these institutions were specifically taxed. Under the new law, ****696** certain institutions of this class are exempt, provided the shareholders do not participate in the profits, and interest and dividends are only paid to the depositors. No limit is fixed to the property and income thus exempted,—it may be $100,000 or $100,000,000. One of the counsel engaged in this case read to us during the argument from the report of the comptroller of the currency, sent by the president to congress, December 3, 1894, a statement to the effect that the total number of mutual savings banks exempted were 646, and the total number of stock savings banks were 378, and showed that they did the same character of business and took in the money of depositors for the purpose of making it bear interest, with profit upon it in the same way; and yet the 646 are exempt, and the 378 are taxed. He also showed that the total deposits in savings banks were $1,748,000,000.

(2) As to Mutual Insurance Corporations. These companies were taxed under previous income tax laws. They do business somewhat differently from other companies; but they conduct a strictly private business, in which the public has no interest, and have been often held not to be benevolent or charitable organizations.

***598** The sole condition for exempting them under the present law is declared to be that they make loans to or divide their profits among their members or depositors or policy holders. Every corporation is carried on, however, for the benefit of its members, whether stockholders, or depositors, or policy holders. If it is carried on for the benefit of its shareholders, every dollar of income is taxed; if it is carried on for the benefit of its policy holders or depositors, who are but another class of shareholders, it is wholly exempted. In the state of New York the act exempts the income from over $1,000,000,000 of property of these companies. The leading mutual life insurance company has property exceeding $204,000,000 in value, the income of which is wholly exempted. The insertion of the exemption is stated by counsel to have saved that institution fully $200,000 a year over other in-

surance companies and associations, having similar property and carrying on the same business, simply because such other companies or associations divide their profits among their shareholders instead of their policy holders.

(3) As to Building and Loan Associations. The property of these institutions is exempted from taxation to the extent of millions. They are in no sense benevolent or charitable institutions, and are conducted solely for the pecuniary profit of their members. Their assets exceed the capital stock of the national banks of the country. One, in Dayton, Ohio, has a capital of $10,000,000, and Pennsylvania has $65,000,000 invested in these associations. The census report submitted to congress by the president, May 1, 1894, shows that their property in the United States amounts to over $628,000,000. Why should these institutions and their immense accumulations of property singled out for the special favor of congress, and be freed from their just, equal, and proportionate share of taxation, when others engaged under different names, in similar business, are subjected to taxation by this law? The aggregate amount of the saving to these associations, by reason of their exemption, is over $600,000 a year.

If this statement of the exemptions of corporations under the law of congress, taken from the carefully prepared briefs of counsel *599 and from reports to congress, will not satisfy parties interested in this case that the act in question disregards, in almost every line and provision, the rule of uniformity required by the constitution, then 'neither will they be persuaded, though one rose from the dead.' That there should be any question or any doubt on the subject surpasses my comprehension. Take the case of mutual savings banks and stock savings banks. They do the same character of business, and in the same way use the money of depositors, loaning it at interest for profit, yet 646 of them, under the law before us, are exempt from taxation on their income, and 378 are taxed upon it. How the tax on the income of one kind of these banks can be said to be laid upon any principle of uniformity, when the other is exempt from all taxation, I repeat, surpasses my comprehension.

But there are other considerations against the law which are equally decisive. They relate to the uniformity and equality required in all taxation, national and state; to the invalidity of taxation by the United States of the income of the bonds and securities of the states and of their municipal bodies; and the invalidity of the taxation of the salaries of the judges of the United States courts.

As stated by counsel: 'There is no such thing in the theory of our national government as unlimited power of taxation in congress. There are limitations, as he justly observes, of its powers arising out of the essential nature of all free governments; there are reservations of individual rights, without which society could not exist, and which are respected by every government. The right of taxation is subject to these limitations.' Citizens' Savings Loan Ass'n v. Topeka, 20 Wall. 655, and Parkersburg v. Brown, 106 U. S. 487, 1 Sup. Ct. 442.

The inherent and fundamental nature and character of a tax is that of a contribution to the support of the government, levied upon the principle of equal and uniform apportionment among the persons taxed, and any other exaction does not come within the legal definition of a 'tax.'

This inherent limitation upon the taxing power forbids the imposition of taxes which are unequal in their operation upon *600 similar kinds of property, and necessarily strikes down the gross and arbitrary distinctions in the income law as passed by congress. The **697 law, as we have seen, distinguishes in the taxation between corporations by exempting the property of some of them from taxation, and levying the tax on the property of others, when the corporations do not materially differ from one another in the character of their business or in the protection required by the government. Trifling differences in their modes of business, but not in their results, are made the ground and occasion of the greatest possible differences in the amount of

taxes levied upon their incomes, showing that the action of the legislative power upon them has been arbitrary and capricious, and sometimes merely fanciful.

There was another position taken in this case which is not the least surprising to me of the many advanced by the upholders of the law, and that is that if this court shall declare that the exemptions and exceptions from taxation, extended to the various corporations mentioned, fire, life, and marine insurance companies, and to mutual savings banks, building, and loan associations, violate the requirement of uniformity, and are therefore void, the tax as to such corporations can be enforced, and that the law will stand as though the exemptions had never been inserted. This position does not, in my judgment, rest upon any solid foundation of law or principle. The abrogation or repeal of an unconstitutional or illegal provision does not operate to create and give force to any enactment or part of an enactment which congress has not sanctioned and promulgated. Seeming support of this singular position is attributed to the decision of this court in Huntington v. Worthen, 120 U. S. 97, 7 Sup. Ct. 469. But the examination of that case will show that it does not give the slightest sanction to such a doctrine. There the constitution of Arkansas had provided that all property subject to taxation should be taxed according to its value, to be ascertained in such manner as the general assembly should direct, making the same equal and uniform throughout the state, and certain public property was declared by statute to be exempt from taxation, which statute was subsequently held to be unconstitutional. The court decided that the unconstitutional*601 part of the enactment, which was separable from the remainder, could be omitted and the remainder enforced; a doctrine undoubtedly sound, and which has never, that I am aware of, been questioned. But that is entirely different from the position here taken, that exempted things can be taxed by striking out their exemption.

The law of 1894 says there shall be assessed, levied, and collected, 'except as herein otherwise provided,' 2 per centum of the amount, etc. If the exceptions are stricken out, there is nothing to be assessed and collected except what congress has otherwise affirmatively ordered. Nothing less can have the force of law. This court is impotent to pass any law on the subject. It has no legislative power. I am unable, therefore, to see how we can, by declaring an exemption or exception invalid, thereby give effect to provisions as though they were never exempted. The court by declaring the exemptions invalid cannot, by any conceivable ingenuity, give operative force as enacting clauses to the exempting provisions. That result is not within the power of man.

The law is also invalid in its provisions authorizing the taxation of the bonds and securities of the states and of their municipal bodies. It is objected that the cases pending before us do not allege any threatened attempt to tax the bonds or securities of the state, but only of municipal bodies of the states. The law applies to both kinds of bonds and securities, those of the states as well as those of municipal bodies, and the law of congress we are examining, being of a public nature, affecting the whole community, having been brought before us and assailed as unconstitutional in some of its provisions, we are at liberty, and I think it is our duty, to refer to other unconstitutional features brought to our notice in examining the law, though the particular points of their objection may not have been mentioned by counsel. These bonds and securities are as important to the performance of the duties of the state as like bonds and securities of the United States are important to the performance of their duties, and are as exempt from the taxation of the United States as the former are exempt from the taxation of the states. As stated by Judge *602 Cooley in his work on the Principles of Constitutional Law: 'The power to tax, whether by the United States or by the states, is to be construed in the light of and limited by the fact that the states and the Union are inseparable, and that the constitution contemplates the perpetual maintenance of each with all its constitution-

al powers, unembarrassed and unimpaired by any action of the other. The taxing power of the federal government does not therefore extend to the means or agencies through or by the employment of which the states perform their essential functions; since, if these were within its reach, they might be embarrassed, and perhaps wholly paralyzed, by the burdens it should impose. 'That the power to tax involves the power to destroy; that the power to destroy may defeat and render useless the power to create; that there is a plain repugnance in conferring on one government a power to control the constitutional measures of another, which other, in respect to those very measures, is declared to be supreme over that which exerts the control,—are propositions not to be denied.' It is true that taxation does not necessarily and unavoidably destroy, and that to carry it to the excess of destruction would be an abuse not to be anticipated; ****698** but the very power would take from the states a portion of their intended liberty of independent action within the sphere of their powers, and would constitute to the state a perpetual danger of embarrassment and possible annihilation. The constitution contemplates no such shackles upon state powers, and by implication forbids them.'

The internal revenue act of June 30, 1864, in section 122, provided that railroad and certain other companies specified, indebted for money for which bonds had been issued, upon which interest was stipulated to be paid, should be subject to pay a tax of 5 per cent. on the amount of all such interest, to be paid by the corporations, and by them deducted from the interest payable to the holders of such bonds; and the question arose in U. S. v. Baltimore & O. R. Co., 17 Wall. 322, whether the tax imposed could be thus collected from the revenues of a city owning such bonds. This court answered the question as follows: 'There is no dispute about the general***603** rules of the law applicable to this subject. The power of taxation by the federal government upon the subjects and in the manner prescribed by the act we are considering is undoubted. There are, however, certain departments which are excepted from the general power. The right of the states to administer their own affairs through their legislative, executive, and judicial departments, in their own manner, through their own agencies, is conceded by the uniform decisions of this court, and by the practice of the federal government from its organization. This carries with it an exemption of those agencies and instruments from the taxing power of the federal government. If they may be taxed lightly, they may be taxed heavily; if justly, oppressively. Their operation may be impeded and may be destroyed if any interference is permitted. Hence, the beginning of such taxation is not allowed on the one side, is not claimed on the other.'

And, again: 'A municipal corporation like the city of Baltimore is a representative not only of the state, but it is a portion of its governmental power. It is one of its creatures, made for a specific purpose, to exercise within a limited sphere the powers of the state. The state may withdraw these local powers of government at pleasure, and may, through its legislature or other appointed channels, govern the local territory as it governs the state at large. It may enlarge or contract its powers or destroy its existence. As a portion of the state, in the exercise of a limited portion of the powers of the state, its revenues, like those of the state, are not subject to taxation.'

In Collector v. Day, 11 Wall. 113, 124, the court, speaking by Mr. Justice Nelson, said: 'The general government and the states, although both exist within the same territorial limits, are separate and distinct sovereignties, acting separately and independently of each other, within their respective spheres. The former, in its appropriate sphere, is supreme; but the states, within the limits of their powers not granted, or, in the language of the tenth amendment, 'reserved,' are as independent of the general government as that government within its sphere is independent of the states.'

***604** According to the census reports, the bonds and securities of the states amount to the sum of $1,243,268,000, on which the income or interest

exceeds the sum of $65,000,000 per annum, and the annual tax of 2 per cent. upon this income or interest would be $1,300,000.

The law of congress is also invalid in that it authorizes a tax upon the salaries of the judges of the courts of the United States, against the declaration of the constitution that their compensation shall not be diminished during their continuance in office. The law declares that a tax of 2 per cent. shall be assessed, levied, and collected, and paid annually upon the gains, profits, and income received in the preceding calendar year by every citizen of the United States, whether said gains, profits, or income be derived from any kind of property, rents, interest, dividends, or salaries, or from any profession, trade, employment, or vocation carried on within the United States or elsewhere, or from any source whatever. The annual salary of a justice of the supreme court of the United States is $10,000, and this act levies a tax of 2 per cent. on $6,000 of this amount, and imposes a penalty upon those who do not make the payment or return the amount for taxation.

The same objection, as presented to a consideration of the objection to the taxation of the bonds and securities of the states, as not being specially taken in the cases before us, is urged here to a consideration of the objection community, and attacked for its unconstitutionality of the judges of the courts of the United States. The answer given to that objection may be also given to the present one. The law of congress, being of a public nature, affecting the interests of the whole community, and attacked for jits unconstitutionality in certain particulars, may be considered with reference to other unconstitutional provisions called to our attention upon examining the law, though not specifically noticed in the objections taken in the records or briefs of counsel that the constitution may not be violated from the carelessness or oversight of counsel in any particular. See O'Neil v. Vermont, 144 U. S. 359, 12 Sup. Ct. 693.

Besides, there is a duty which this court owes to the 100 ***605** other United States judges who have small salaries, and who, having their compensation reduced by the tax, may be seriously affected by the law.

The constitution of the United States provides ****699** in the first section of article 3 that 'the judicial power of the United States shall be vested in one supreme court, and in such inferior courts as the congress may from time to time ordain and establish. The judges, both of the supreme and inferior courts, shall hold their offices during good behavior, and shall, at stated times, receive for their services a compensation, which shall not be diminished during their continuance in office.' The act of congress under discussion imposes, as said, a tax on $6,000 of this compensation, and therefore diminishes each year the compensation provided for every justice. How a similar law of congress was regarded 30 years ago may be shown by the following incident, in which the justices of this court were assessed at 3 per cent. upon their salaries. Against this Chief Justice Taney protested in a letter to Mr. Chase, then secretary of the treasury, appealing to the above article in the constitution, and adding: 'If it [his salary] can be diminished to that extent by the means of a tax, it may, in the same way, be reduced from time to time, at the pleasure of the legislature.' He explained in his letter the object of the constitutional inhibition thus:

'The judiciary is one of the three great departments of the government created and established by the constitution. Its duties and powers are specifically set forth, and are of a character that require it to be perfectly independent of the other departments. And in order to place it beyond the reach, and above even the suspicion, of any such influence, the power to reduce their compensation is expressly withheld from congress, and excepted from their powers of legislation.

'Language could not be more plain than that used in the constitution. It is, moreover, one of its most important and essential provisions. For the articles which limit the powers of the legislative

and executive branches of the government, and those which provide safeguards for the protection of the citizen in his person and property, would be of little value *606 without a judiciary to uphold and maintain them which was free from every influence, direct or indirect, that might by possibility, in times of political excitement, warp their judgment.

'Upon these grounds, I regard an act of congress retaining in the treasury a portion of the compensation of the judges as unconstitutional and void.'

This letter of Chief Justice Taney was addressed to Mr. Chase, then secretary of the treasury, and afterwards the successor of Mr. Taney as chief justice. It was dated February 16, 1863; but as no notice was taken of it, on the 10th of March following, at the request of the chief justice, the court ordered that his letter to the secretary of the treasury be entered on the records of the court, and it was so entered. And in the memoir of the chief justice it is stated that the letter was, by this order, preserved 'to testify to future ages that in war, no less than in peace, Chief Justice Taney strove to protect the constitution from violation.'

Subsequently, in 1869, and during the administration of President Grant, when Mr. Boutwell was secretary of the treasury, and Mr. Hoar, of Massachusetts, was attorney general, there were in several of the statutes of the United States, for the assessment and collection of internal revenue, provisions for taxing the salaries of all civil officers of the United States, which included, in their literal application, the salaries of the president and of the judges of the United States. The question arose whether the law which imposed such a tax upon them was constitutional. The opinion of the attorney general thereon was requested by the secretary of the treasury. The attorney general, in reply, gave an elaborate opinion advising the secretary of the treasury that no income tax could be lawfully assessed and collected upon the salaries of those officers who were in office at the time the statute imposing the tax was passed, holding on this subject the views expressed by Chief Justice Taney. His opinion is published in volume 13 of the Opinions of the Attorney General, at page 161. I am informed that it has been followed*607 ever since without question by the department supervising or directing the collection of the public revenue.

Here I close my opinion. I could not say less in view of questions of such gravity that go down to the very foundation of the government. If the provisions of the constitution can be set aside by an act of congress, where is the course of usurpation to end? The present assault upon capital is but the beginning. It will be but the stepping-stone to others, larger and more sweeping, till our political contests will become a war of the poor against the rich,—a war constantly growing in intensity and bitterness. 'If the court sanctions the power of discriminating taxation, and nullifies the uniformity mandate of the constitution,' as said by one who has been all his life a student of our institutions, 'it will mark the hour when the sure decadence of our present government will commence.' If the purely arbitrary limitation of four thousand dollars in the present law can be sustained, none having less than that amount of income being assessed or taxed for the support of the government, the limitation of future congresses may be fixed at a much larger sum, at five or ten or twenty thousand dollars, parties possessing an income of that amount alone being bound to bear the burdens of government; or the limitation may be designated at such an amount as a board of 'walking delegates' may deem necessary. There is no safety in allowing the limitation to be adjusted except in strict compliance with the mandates of the constitution, which require its taxation, if imposed by direct taxes, **700 to be apportioned among the states according to their representation, and, if imposed by indirect taxes, to be uniform in operation and, so far as practicable, in proportion to their property, equal upon all citizens. Unless the rule of the constitution governs, a majority may fix the limitation at such rate as will not include any of their own number.

I am of opinion that the whole law of 1894 should be declared void, and without any binding force,—that part which relates to the tax on the rents, profits, or income from real estate, that is, so much as constitutes part of the direct tax, because not imposed by the rule of apportionment according *608 to the representation of the states, as prescribed by the constitution; and that part which imposes a tax upon the bonds and securities of the several states, and upon the bonds and securities of their municipal bodies, and upon on the salaries of judges of the courts of the United States, as being beyond the power of congress; and that part which lays duties, imposts, and excises, as void in not providing for the uniformity required by the constitution in such cases.

Mr. Justice WHITE (dissenting).

My brief judicial experience has convinced me that the custom of filing long dissenting opinions is one 'more honored in the breach than in the observance.' The only purpose which an elaborate dissent can accomplish, if any, is to weaken the effect of the opinion of the majority, and thus engender want of confidence in the conclusions of courts of last resort. This consideration would impel me to content myself with simply recording my dissent in the present case, were it not for the fact that I consider that the result of the opinion just announced is to overthrow a long and consistent line of decisions, and to deny to the legislative department of the government the possession of a power conceded to it by universal consensus for 100 years, and which has been recognized by repeated adjudications of this court. The issues presented are as follows:

Complainant, as a stockholder in a corporation, avers that the latter will voluntarily pay the income tax, levied under the recent act of congress; that such tax is unconstitutional; and that its voluntary payment will seriously affect his interest by defeating his right to test the validity of the exaction, and also lead to a multiplicity of suits against the corporation. The prayer of the bill is as follows: First, that it may be decreed that the provisions known as 'The Income Tax Law,' incorporated in the act of congress passed August 15, 1894, are unconstitutional, null, and void; second, that the defendant be restrained from voluntarily complying with the provisions of that act by making its returns and statements, *609 and paying the tax. The bill, therefore, presents two substantial questions for decision: The right of the plaintiff to relief in the form in which he claims it, and his right to relief on the merits.

The decisions of this court hold that the collection of a tax levied by the government of the United States will not be restrained by its courts. Cheatham v. U. S., 92 U. S. 85; Snyder v. Marks, 109 U. S. 189, 3 Sup. Ct. 157. See, also, Elliott v. Swartwout, 10 Pet. 137; City of Philadelphia v. Collector, 5 Wall. 720; Hornthal v. Collector, 9 Wall. 560. The same authorities have established the rule that the proper course, in a case of illegal taxation, is to pay the tax under protest or with notice of suit, and then bring an action against the officer who collected it. The statute law of the United States, in express terms, gives a party who has paid a tax under protest the right to sue for its recovery. Rev. St. § 3226.

The act of 1867 forbids the maintenance of any suit 'for the purpose of restraining the assessment or collection of any tax.' The provisions of this act are now found in Rev. St. § 3224.

The complainant is seeking to do the very thing which, according to the statute and the decisions above referred to, may not be done. If the corporator cannot have the collection of the tax enjoined, it seems obvious that he cannot have the corporation enjoined from paying it, and thus do by indirection what he cannot do directly.

It is said that such relief as is here sought has been frequently allowed. The cases relied on are Dodge v. Woolsey, 18 How. 331, and Hawes v. Oakland, 104 U. S. 450. Neither of these authorities, I submit, is in point. In Dodge v. Woolsey, the main question at issue was the validity of a state tax, and that case did not involve the act of congress to which I have referred. Hawes v. Oakland

was a controversy between a stockholder and a corporation, and had no reference whatever to taxation.

The complainant's attempt to establish a right to relief upon the ground that this is not a suit to enjoin the tax, but ***610** one to enjoin the corporation from paying it, involves the fallacy already pointed out,—that is, that a party can exercise a right indirectly which he cannot assert directly,—that he can compel his agent, through process of this court, to violate an act of congress.

The rule which forbids the granting of an injunction to restrain the collection of a tax is founded on broad reasons of public policy, and should not be ignored. In Cheatham v. U. S., supra, which involved the vaildity of an income tax levied under an act of congress prior to the one here in issue, this court, through Mr. Justice Miller, said:

'If there existed in the courts, state or national, any general power of impeding or controlling the collection of taxes, or relieving the hardship incident to taxation, the very existence of the government might be ****701** placed in the power of a hostile judiciary. Dows v. City of Chicago, 11 Wall. 108. While a free course of remonstrance and appeal is allowed within the departments before the money is finally exacted, the general government has wisely made the payment of the tax claimed, whether of customs or of internal revenue, a condition precedent to a resort to the courts by the party against whom the tax is assessed. In the internal revenue branch it has further prescribed that no such suit shall be brought until the remedy by appeal has been tried; and, if brought after this, it must be within six months after the decision on the appeal. We regard this as a condition on which alone the government consents to litigate the lawfulness of the original tax. It is not a hard condition. Few governments have conceded such a right on any condition. If the compliance with this condition requires the party aggrieved to pay the money, he must do it.'

Again, in State Railroad Tax Cases, 92 U. S. 575, the court said:

'That there might be no misunderstanding of the universality of this principle, it was expressly enacted, in 1867, that 'no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.' Rev. St. § 3224. And, though this was intended to apply alone to taxes levied by the United States, it shows the sense ***611** of congress of the evils to be feared in courts of justice could, in any case, interfere with the process of collecting the taxes on which the government depends for its continued existence. It is a wise policy. It is founded in the simple philosophy derived from the experience of ages, that the payment of taxes has to be enforced by summary and stringent means against a reluctant and often adverse sentiment; and, to do this successfully, other instrumentalities and other modes of procedure are necessary than those which belong to courts of justice. See Cheatham v. Norvell, decided at this term; Nichols v. U. S., 7 Wall. 122; Dows v. City of Chicago, 11 Wall. 108.'

The contention that a right to equitable relief arises from the fact that the corporator is without remedy, unless such relief be granted him, is, I think, without foundation. This court has repeatedly said that the illegality of a tax is not ground for the issuance of an injunction against its collection, if there be an adequate remedy at law open to the payer (Dows v. City of Chicago, 11 Wall. 108; Hannewinkle v. Georgetown, 15 Wall. 547; Board v. McComb, 92 U. S. 531; State Railroad Tax Cases, 92 U. S. 575; Union Pacific Ry. Co. v. Cheyenne, 113 U. S. 516, 5 Sup. Ct. 601; Milwaukee v. Koeffler, 116 U. S. 219, 6 Sup. Ct. 372; Express Co. v. Seibert, 142 U. S. 339, 12 Sup. Ct. 250), as in the case where the state statute, by which the tax is imposed, allows a suit for its recovery after payment under protest (Shelton v. Platt, 139 U. S. 591, 11 Sup. Ct. 646; Allen v. Car Co., 139 U. S. 658, 11 Sup. Ct. 682).

The decision here is that this court will allow, on the theory of equitable right, a remedy expressly

forbidden by the statutes of the United States, though it has denied the existence of such a remedy in the case of a tax levied by a state.

Will it be said that, although a stockholder cannot have a corporation enjoined from paying a state tax where the state statute gives him the right to sue for its recovery, yet when the United States not only gives him such right, but, in addition, forbids the issue of an injunction to prevent the payment of federal taxes, the court will allow to the stockholder ***612** a remedy against the United States tax which it refuses against the state tax?

The assertion that this is only a suit to prevent the voluntary payment of the tax suggests that the court may, by an order operating directly upon the defendant corporation, accomplish a result which the statute manifestly intended should not be accomplished by suit in any court. A final judgment forbidding the corporation from paying the tax will have the effect to prevent its collection, for it could not be that the court would permit a tax to be collected from a corporation which it had enjoined from paying. I take it to be beyond dispute that the collection of the tax in question cannot be restrained by any proceeding or suit, whatever its form, directly against the officer charged with the duty of collecting such tax. Can the statute be evaded, in a suit between a corporation and a stockholder, by a judgment forbidding the former from paying the tax, the collection of which cannot be restrained by suit in any court? Suppose, notwithstanding the final judgment just rendered, the collector proceeds to collect from the defendant corporation the taxes which the court declares, in this suit, cannot be legally assessed upon it. If that final judgment is sufficient in law to justify resistance against such collection, then we have a case in which a suit has been maintained to restrain the collection of taxes. If such judgment does not conclude the collector, who was not a party to the suit in which it was rendered, then it is of no value to the plaintiff. In other words, no form of expression can conceal the fact that the real object of this suit is to prevent the collection of taxes imposed by congress, notwithstanding the express statutory requirement that 'no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.' Either the decision of the constitutional question is necessary or it is not. If it is necessary, then the court, by way of granting equitable relief, does the very thing which the act of congress forbids. If it is unnecessary, then the court decides the act of congress here asserted unconstitutional, without being obliged ****702** to do so by the requirements of the case before it.

***613** This brings me to the consideration of the merits of the cause.

The constitutional provisions respecting federal taxation are four in number, and are as follows:

'(1) Representatives and direct taxes shall be apportioned among the several states, which may be included within this Union, according to their respective numbers, which shall be determined by adding to the whole number of free persons, including those bound to service for a term of years and excluding Indians not taxed, three-fifths of all other persons.' Article 1, § 2, cl. 3. The fourteenth amendment modified this provision, so that the whole number of persons in each state should be counted, 'Indians not taxes' excluded.

'(2) The congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States.' Article 1, § 8, cl. 1.

'(3) No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken.' Article 1, § 9, cl. 4.

'(4) No tax or duty shall be laid on articles exported from any state.' Article 1, § 9, cl. 5.

It has been suggested that, as the above provi-

sions ordain the apportionment of direct taxes, and authorize congress to 'lay and collect taxes, duties, imposts, and excises,' therefore there is a class of taxes which are neither direct, and are not duties, imposts, and excises, and are exempt from the rule of apportionment on the one hand, or of uniformity on the other. The soundness of this suggestion need not be discussed, as the words, 'duties, imposts, and excises,' in conjunction with the reference to direct taxes, adequately convey all power of taxation to the federal government.

It is not necessary to pursue this branch of the argument, since it is unquestioned that the provisions of the constitution vest in the United States plenary powers of taxation; that is, all the powers which belong to a government as such except ***614** that of taxing exports. The court in this case so says, and quotes approvingly the language of this court, speaking through Mr. Chief Justice Chase, in License Tax Cases, 5 Wall. 462, as follows:

'It is true that the power of congress to tax is a very extensive power. It is given in the constitution with only one exception and only two qualifications. Congress cannot tax exports, and it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject and may be exercised at discretion.'

In deciding, then, the question of whether the income tax violates the constitution, we have to determine, not the existence of a power in congress, but whether an admittedly unlimited power to tax (the income tax not being a tax on exports) has been used according to the restrictions, as to methods for its exercise, found in the constitution. Not power, it must be borne in mind, but the manner of its use, it the only issue presented in this case. The limitations in regard to the mode of direct taxation imposed by the constitution are that capitation and other direct taxes shall be apportioned among the states according to their respective numbers, while duties, imposts, and excises must be uniform throughout the United States. The meaning of the word 'uniform' in the constitution need not be examined, as the court is divided upon that a subject, and no expression of opinion thereon is conveyed or intended to be conveyed in this dissent.

In considering whether we are to regard an income tax as 'direct' or otherwise, it will, in my opinion, serve no useful purpose, at this late period of our political history, to seek to ascertain the meaning of the word 'direct' in the constitution by resorting to the theoretical opinions on taxation found in the writings of some economists prior to the adoption of the constitution or since. These economists teach that the question of whether a tax is direct or indirect depends not upon whether it is directly levied upon a person, but upon whether, when so levied, it may be ultimately shifted from the person ***615** in question to the consumer, thus becoming, while direct in the method of its application, indirect in its final results, because it reaches the person who really pays it only indirectly. I say it will serve no useful purpose to examine these writers, because, whatever may have been the value of their opinions as to the economic sense of the word 'direct,' they cannot now afford any criterion for determining its meaning in the constitution, inasmuch as an authoritative and conclusive construction has been given to that term, as there used, by an interpretation adopted shortly after the formation of the constitution by the legislative department of the government, and approved by the executive; by the adoption of that interpretation from that time to the present without question, and its exemplification and enforcement in many legislative enactments, and its acceptance by the authoritative text writers on the constitution; by the sanction of that interpretation, in a decision of this court rendered shortly after the constitution was adopted; and finally by the repeated reiteration and affirmance of that interpretation, so that it has become imbedded in our jurisprudence, and therefore may be considered almost a part of the written constitution itself.

Instead, therefore, of following counsel in their

references to economic writers and their **703 discussion of the motives and thoughts which may or may not have been present in the minds of some of the framers of the constitution, as if the question before us were one of first impression, I shall confine myself to a demonstration of the truth of the propositions just laid down.

In 1794 (1 Stat. 373, c. 45) congress levied, without reference to apportionment, a tax on carriages 'for the conveyance of persons.' The act provided 'that there shall be levied, collected, and paid upon all carriages for the conveyance of persons which shall be kept by, or for any person for his or her own use, or to be let out to hire, or for the conveying of passengers, the several duties and rates following'; and then came a yearly tax on every 'coach, chariot, phaeton, and coachee, every four-wheeled and every *616 two-wheeled top carriage, and upon every other two-wheeled carriage,' varying in amount according to the vehicle.

The debates which took place at the passage of that act are meagerly preserved. It may, however, be inferred from them that some considered that whether a tax was 'direct' or not in the sense of the constitution depended upon whether it was levied on the object or on its use. The carriage tax was defended by a few on the ground that it was a tax on consumption. Mr. Madison opposed it as unconstitutional, evidently upon the conception that the word 'direct' in the constitution was to be considered as having the same meaning as that which had been attached to it by some economic writers. His view was not sustained, and the act passed by a large majority,—49 to 22. It received the approval of Washington. The congress which passed this law numbered among its members many who sat in the convention which framed the constitution. It is moreover safe to say that each member of that congress, even although he had not been in the convention, had, in some way, either directly or indirectly, been an influential actor in the events which led up to the birth of that instrument. It is impossible to make an analysis of this act which will not show that its provisions constitute a rejection of the economic construction of the word 'direct,' and this result equally follows, whether the tax be treated as laid on the carriage itself or on its use by the owner. If viewed in one light, then the imposition of the tax on the owner of the carriage, because of his ownership, necessarily constituted a direct tax under the rule as laid down by economists. So, also, the imposition of a burden of taxation on the owner for the use by him of his own carriage made the tax direct according to the same rule. The tax having been imposed without apportionment, it follows that those who voted for its enactment must have give to the word 'direct,' in the constitution, a different significance from that which is affixed to it by the economists referred to.

The validity of this carriage tax act was considered by this court in Hylton v. U. S., 3 Dall. 171. Chief Justice Ellsworth and Mr. Justice Cushing took no part in *617 the decision. Mr. Justice Wilson stated that he had, in the circuit court of Virginia, expressed his opinion in favor of the constitutionality of the tax. Mr. Justice Chase, Mr. Justice Paterson, and Mr. Justice Iredell each expressed the reasons for his conclusions. The tax, though laid, as I have said, on the carriage, was held not to be a direct tax under the constitution. Two of the judges who sat in that case (Mr. Justice Paterson and Mr. Justice Wilson) had been distinguished members of the constitutional convention. Excepts from tne observations of the justices are given in the opinion of the court. Mr. Justice Paterson, in addition to the language there quoted, spoke as follows (the italics being mine):

' *I never entertained a doubt that the principal—I will not say the only—objects that the framers of the constitution contemplated as falling within the rule of apportionment were a capitation tax and a tax on land.* Local considerations and the particular circumstances and relative situation of the states naturally lead to this view of the subject. The provision was made in favor of the Southern states. They possessed a large number of slaves. They had ex-

tensive tracts of territory, thinly settled, and not very productive. A majority of the states had but few slaves, and several of them a limited territory, well settled, and in a high state of cultivation. The Southern states, if no provision had been introduced in the constitution, would have been wholly at the mercy of the other states Congress, in such case, might tax slaves at discretion or arbitrarily, and land in every part on the Union after the same rate or measure,—so much a head in the first instance, and so much an acre in the second. To guard them against imposition in these particulars was the reason of introducing the clause in the constitution which directs that representatives and direct taxes shall be apportioned among the states according to their respective numbers.'

It is evident that Mr. Justice Chase coincided with these views of Mr. Justice Paterson, though he was perhaps not quite so firmly settled in his convictions, for he said:

'I am inclined to think—but of this I do not give a judicial ***618** opinion—that the direct taxes contemplated by the constitution are only two, to wit, a capitation or poll tax simply, without regard to property, profession, or any other circumstances, and the tax on land. I doubt whether a tax by a general assessment of personal property within the United States is included within the term 'direct tax."

Mr. Justice Iredell certainly entertained similar views, since he said:

'Some difficulties may occur which we do not at present foresee. Perhaps a direct tax in the sense of the constitution can mean ****704** nothing but a tax on something inseparably annexed to the soil; something capable of apportionment under all such circumstances. A land of a poll tax may be considered of this description. * * * In regard to other articles there may possibly be considerable doubt.'

These opinions strongly indicate that the real convictions of the justices were that only capitation taxes and taxes on land were direct within the meaning of the constitution, but they doubted whether some other objects of a kindred nature might not be embraced in that word. Mr. Justice Paterson had no doubt whatever of the limitation, and Justice Iredell's doubt seems to refer only to things which were inseparably connected with the soil, and which might therefore be considered, in a certain sense, as real estate.

That case, however, established that a tax levied without apportionment on an object of personal property was not a 'direct tax' within the meaning of the constitution. There can be no doubt that the enactment of this tax and its interpretation by the court, as well as the suggestion, in the opinions delivered, that nothing was a 'direct tax,' within the meaning of the constitution, but a capitation tax and a tax on land, were all directly in conflict with the views of those who claimed at the time that the word 'direct' in the constitution was to be interpreted according to the views of economists. This is conclusively shown by Mr. Madison's language. He asserts not only that the act had been passed contrary to the constitution, but that the decision of the court was likewise in violation of that instrument. Ever since the announcement***619** of the decision in that case, the legislative department of the government has accepted the opinions of the justices, as well as the decision itself, as conclusive in regard to the meaning of the word 'direct'; and it has acted upon that assumption in many instances, and always with executive indorsement. All the acts passed levying direct taxes confined them practically to a direct levy on land. True, in some of these acts a tax on slaves was included, but this inclusion, as has been said by this court, was probably based upon the theory that these were in some respects taxable along with the land, and therefore their inclusion indicated no departure by congress from the meaning of the word 'direct' necessarily resulting from the decision in the Hylton Case, and which, moreover, had been expressly elucidated and suggested as being practically limited to capitation taxes and taxes on real estate by the justices who

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157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759, 3 A.F .T.R. 2557
(Cite as: 157 U.S. 429, 15 S.Ct. 673)

expressed opinions in that case.

These acts imposing direct taxes having been confined in their operation exclusively to real estate and slaves, the subject-matters indicated as the proper objects of direct taxation in the Hylton Case are the strongest possible evidence that this suggestion was accepted as conclusive, and had become a settled rule of law. Some of these acts were passed at times of great public necessity, when revenue was urgently required. The fact that no other subjects were selected for the purposes of direct taxation, except those which the judges in the Hylton Case had suggested as appropriate therefor, seems to me to lead to a conclusion which is absolutely irresistible,—that the meaning thus affixed to the word 'direct' at the very formation of the government was considered as having been as irrevocably determined as if it had been written in the constitution in express terms. As I have already observed, every authoritative writer who has discussed the constitution from that date down to this has treated this judicial and legislative ascertainment of the meaning of the word 'direct' in the constitution as giving it a constitutional significance, without reference to the theoretical distinction between 'direct' and 'indirect,' made by some economists prior to the constitution or since. This doctrine*620 has become a part of the hornbook of American constitutional interpretation, has been taught as elementary in all the law schools, and has never since then been anywhere authoritatively questioned. Of course, the text-books may conflict in some particulars, or indulge in reasoning not always consistent, but as to the effect of the decision in the Hylton Case and the meaning of the word 'direct,' in the constitution, resulting therefrom, they are a unit. I quote briefly from them.

Chancellor Kent, in his Commentaries, thus states the principle:

'The construction of the powers of congress relative to taxation was brought before the supreme court, in 1796, in the case of Hylton v. U. S. By the act of June 5, 1794, congress laid a duty upon carriages for the conveyance of persons, and the question was whether this was a 'direct tax,' within the meaning of the constitution. If it was not a direct tax, it was admitted to be rightly laid, under that part of the constitution which declares that all duties, imposts, and excises shall be uniform throughout the United States; but, if it was a direct tax, it was not constitutionally laid, for it must then be laid according to the census, under that part of the constitution which declares that direct taxes shall be apportioned among the several states according to numbers. The circuit court in Virginia was divided in opinion on the question, but on appeal to the supreme court it was decided that the tax on carriages was not a direct tax, within the letter or meaning of the constitution, and was therefore constitutionally laid.

'The question was deemed of very great importance, and was elaborately argued. It was held that a general power was given great was held that a general power was given to kind or nature, without any restraint. They had plenary power over every species of taxable property, except exports. But there were two rules prescribed for their government,—the rule of uniformity, and the rule of apportionment. Three kinds of taxes, viz. **705 duties, imposts, and excises, were to be laid by the first rule; and capitation and other direct taxes, by the second rule. If there were any other species of taxes, as the *621 court seemed to suppose there might be, that were not direct, and not included within the words 'duties, imposts, or excises,' they were to be laid by the rule of uniformity or not, as congress should think proper and reasonable.

'The constitution contemplated no taxes as direct taxes but such as congress could lay in proportion to the census; and the rule of apportionment could not reasonably apply to a tax on carriages, nor could the tax on carriages be laid by that rule without very great inequality and injustice. If two states, equal in census, were each to pay 8,000 dollars by a tax on carriages, and in one state there were 100 carriages and in another 1,000, the tax on

each carriage would be ten times as much in one state as in the other. While A. in the one state, would pay for his carriage eight dollars, B., in the other state, would pay for his carriage eighty dollars. In this way it was shown by the court that the notion that a tax on carriages was a 'direct tax,' within the purview of the constitution, and to be apportioned sccording to the census, would lead to the grossest abuse and oppression. This argument was conclusive against the construction set up, and the tax on carriages was considered as included within the power to lay duties; and the better opinion seemed to be that the direct taxes contemplated by the constitution were only two, viz. a capitation or poll tax and a tax on land.' Kent. Comm. pp. 254–256.

Story, speaking on the same subject, says:

'Taxes on lands, houses, and other permanent real estate, or on parts or appurtenances thereof, have always been deemed of the same character; that is, direct taxes. It has been seriously doubted if, in the sense of the constitution, any taxes are direct taxes except those on polls or on lands. Mr. Justice Chase, in Hylton v. U. S., 3 Dall. 171, said: 'I am inclined to think that the direct taxes contemplated by the constitution are only two, viz., a capitation or poll tax simply, without regard to property, profession, or other circumstances, and a tax on land. I doubt whether a tax by a general assessment of personal property within the United States is included within the term 'direct tax." Mr. Justice Paterson in the same case said: 'It is not necessary to determine ***622** whether a tax on the produce of land be a direct or an indirect tax. Perhaps the immediate product of land, in its original and crude state, ought to be considered as a part of the land itself. When the produce is converted into a manufacture it assumes a new shape, etc. Whether 'direct taxes,' in the sense of the constitution, comprehend any other tax than a capitation tax, or a tax on land, is a questionable point, etc. I never entertained a doubt that the principal—I will not say the only—objects that the framers of the constitution contemplated, as falling within the rule of apportionment, were a capitation tax and a tax on land.' And he proceeded to state that the rule of apportionment, both as regards representatives and as regards direct taxes, was adopted to guard the Southern states against undue impositions and oppressions in the taxing of slaves. Mr. Justice Iredell in the same case said: 'Perhaps a direct tax, in the sense of the constitution, can mean nothing but a tax on something inseparably annexed to the soil; something capable of apportionment under all such circumstances. A land or poll tax may be considered of this description. The latter is to be considered so, particularly under the present constitution, on account of the slaves in the Southern states, who give a ratio in the representation in the proportion of three to five. Either of these is capable of an apportionment. In regard to other articles, there may possibly to considerable doubt.' The reasoning of the Federalists seems to lead to the same result.' Story, Const. § 952.

Cooley, in his work on Constitutional Limitations (page 595), thus tersely states the rule:

'Direct taxes, when laid by congress, must be apportioned among the several states according to the representative population. The term 'direct taxes,' as employed in the constitution, has a technical meaning, and embraces capitation and land taxes only.'

Miller on the Constitution (section 282a) thus puts it:

'Under the provisions already quoted, the question then came up as to what is a 'direct tax,' and also upon what property it is to be levied, as distinguished from any other tax. In regard to this it is sufficient to say that it is believed that no other than a capitation tax of so much per head and a land tax is a 'direct tax,' ***623** within the meaning of the constitution of the United States. All other taxes, except imposts, are properly called 'excise taxes.' 'Direct taxes,' within the meaning of the constitution, are only capitation taxes, as expressed in that instrument, and taxes on real estate.'

In Pomeroy's Constitutional Law (section 281) we read as follows:

'It becomes necessary, therefore, to inquire a little more particularly what are direct and what indurect taxes. Few cases on the general question of taxation have arisen and been decided by the supreme court, for the simple reason that, until the past few years, the United States has generally been able to obtain all needful revenue from the single source of duties upon imports. There can be no doubt, however, that all the taxes provided for in the internal revenue acts now and what indirect taxes. Few cases on the

'This subject came before the supreme court of the United States in a very early case,—Hylton v. U. S. In the year 1794, ****706** congress laid a tax of ten dollars on all carriages, and the rate was thus made uniform. The validity of the statute was disputed. It was claimed that the tax was direct, and should have been apportioned among the states. The court decided that this tax was not direct. The reasons given for the decision are unanswerable, and would seem to cover all the provisions of the present internal revenue laws.'

Hare, in his treatise on American Constitutional Law (pages 249, 250), is to the like affect:

'Agreeably to section 9 of article 1, paragraph 4, 'no capitation or other direct tax shall be laid except in proportion to the census or enumeration hereinbefore directed to be taken'; while section 3 of the same article requires that representation and direct taxes shall be apportioned among the several states * * * according to their respective numbers. 'Direct taxes,' in the sense of the constitution, are poll taxes and taxes on land.'

Burroughs on Taxation (page 502) takes the same view:

'Direct Taxes. The kinds of taxation authorized are both direct and indirect. The construction given to the expression 'direct taxes' is that it included only a tax on land and a poll ***624** tax, and this is in accord with the views of writers upon political economy.'

Ordroneaux, in his Constitutional Legislation (page 225), says:

'Congress having been given the power 'to lay and collect taxes, duties, imposts, and excises,' the above three provisions are limitations upon the exercise of this authority:

'(1) By distinguishing between direct and indirect taxes as to their mode of assessment;

'(2) By establishing a permanent freedom of trade between the states; and

'(3) By prohibiting any discrimination in favor of particular states, through revenue laws establishing a preference between their ports and those of others.

'These provisions should be read together, because they are at the foundation of our system of national taxation.

'The two rules prescribed for the government of congress in laying taxes are those of apportionment for direct taxes and uniformity for indirect. In the first class are to be found capitation or poll taxes and taxes on land; in the second, duties, imposts, and excises.

'The provision relating to capitation taxes was made in favor of the Southern states, and for the protection of slave property. While they possessed a large number of persons of this class, they also had extensive tracts of sparsely settled and unproductive lands. At the same time an opposite condition, both as to land territory and population, existed in a majority of the other states. Were congress permitted to tax slaves and land in all parts of the country at a uniform rate, the Southern slave states must have been placed at a great disadvantage. Hence, and to guard against this inequality of circumstances, there was introduced into the constitu-

tion the further provision that 'representatives and direct taxes shall be apportioned among the states according to their respective numbers.' This changed the basis of direct taxation from a strictly monetary standard, which could not, equitably, be made uniform throughout the country, to one resting upon population as the measure of representation. But for this congress might have taxed slaves arbitrarily, and ***625** at its pleasure, as so much property, and land uniformly throughout the Union, regardless of differences in productiveness. It is not strange, therefore, that it Hylton v. U. S. the court said that: 'The rule of apportionment is radically wrong, and cannot be supported by and solid reasoning. It ought not, therefore, to be extended by construction. Apportionment is an operation on states, and involves valuations and assessments which are arbitrary, and should not be resorted to but in case of necessity.'

'Direct taxes being now well settled in their meaning, a tax on carriages left for the use of the owner is not a capitation tax; nor a tax on the business of an insurance company; nor a tax on a bank's circulation; nor a tax on income; nor a succession tax. The foregoing are not, properly speaking, direct taxes within the meaning of the constitution, but excise taxes or duties.'

Black, writing on Constitutional Law, says:

'But the chief difficulty has arisen in determining what is the difference between direct taxes and such as are indirect. In general usage, and according to the terminology of political economy, a direct tax is one which is levied upon the person who is to pay it, or upon his land or personalty, or his business or income, as the case may be. An indirect tax is one assessed upon the manufacturer or dealer in the particular commodity, and paid by him, but which really falls upon the consumer, since it is added to the market price of the commodity which he must pay. But the course of judicial decision has determined that the term 'direct,' as here applied to taxes, is to be taken in a more restricted sense. The supreme court has ruled that only land taxes and capitation taxes are 'direct,' and no others. In 1794 congress levied a tax of ten dollars on all carriages kept for use, and it was held that this was not a direct tax. And so also an income tax is not to be considered direct. Neither is a tax on the circulation of state banks, nor a succession tax, imposed upon every 'devolution of title to real estate.'' Op. cit. p. 162.

Not only have the other departments of the government accepted the significance attached to the word 'direct' in the ***626** Hylton Case by their actions as to direct taxes, but they have also relied on it as conclusive in their ****707** dealings with indirect taxes by levying them solely upon objects which the judges in that case declared were not objects of direct taxation. Thus the affirmance by the federal legislature and executive of the doctrine established as a result of the Hylton Case has been twofold.

From 1861 to 1870 many laws levying taxes on income were enacted, as follows: Act Aug. 1861 (12 Stat. 309, 311); Act July, 1862 (12 Stat. 473, 475); Act March, 1863 (12 Stat. 718, 723); Act June, 1864 (13 Stat. 281, 285); Act March, 1865 (13 Stat. 479, 481); Act March, 1866 (14 Stat. 4, 5); Act July, 1866 (14 Stat. 137–140); Act March, 1867 (14 Stat. 477–480); Act July, 1870 (16 Stat. 256–261).

The statutes above referred to cover all income and every conceivable source of revenue from which it could result,—rentals from real estate, products of personal property, the profits of business or professions.

The validity of these laws has been tested before this court. The first case on the subject was that of Insurance Co. v. Soule, 7 Wall. 443. The controversy in that case arose under the ninth section of the act of July 13, 1866 (14 Stat. 137, 140), which imposed a tax on 'all dividends in scrip and money, thereafter declared due, wherever and whenever ths same shall be payable, to stockholders, policy holders, or depositors or parties whatso-

ever, including non-residents whether citizens or aliens, as part of the earnings, incomes or gains of any bank, trust company, savings institution, and of any fire, marine, life, or inland insurance company, either stock or mutual, under whatever name or style known or called in the United States or territories, whether specially incorporated or existing under general laws, and on all undistributed sum or sums made or added during the year to their surplus or contingent funds.'

It will be seen that the tax imposed was levied on the income of insurance companies as a unit, including every possible ***627** source of revenue, whether from personal or real property, from business gains or otherwise. The case was presented here on a certificate of division of opinion below. One of the questions propounded was 'whether the taxes paid by the plaintiff and sought to be recovered in this action are not direct taxes, within the meaning of the constitution of the United States.' The issue, therefore, necessarily brought before this court was whether an act imposing an income tax on every possible source of revenue was valid or invalid. The case was carefully, ably, elaborately, and learnedly argued. The brief on behalf of the company, filed by Mr. Wills, was supported by another, signed by Mr. W. O. Bartlett, which covered every aspect of the contention. It rested the weight of its argument against the statute on the fact that it included the rents of real estate among the sources of income taxed, and therefore put a direct tax upon the land. Able as have been the arguments at bar in the present case, an examination of those then presented will disclose the fact that every view here urged was there pressed upon the court with the greatest ability, and after exhaustive research, equaled, but not surpassed, by the eloquence and learning which has accompanied the presentation of this case. Indeed, it may be said that the principal authorities cited and relied on now can be found in the arguments which were then submitted. It may be added that the case on behalf of the government was presented by Attorney General Evarts.

The court answered all the contentions by deciding the generic question of the validity of the tax, thus passing necessarily upon every issue raised, as the whole necessarily includes every one of its parts. I quote the reasoning applicable to the matter now in hand:

'The sixth question is: 'Whether the taxes paid by the plaintiff, and sought to be recovered back in this action, are not direct taxes, within the meaning of the constitution of the United States.' In considering this subject it is proper to advert to the several provisions of the constitution relating to taxation by congress. 'Representatives and direct taxes shall be apportioned among the several states which shall be included***628** in this Union according to their respective numbers,' etc. 'Congress shall have power to lay and collect taxes, duties, imposts, and excises, to pay the debts and provide for the common defence and general welfare of the United States; but all duties, imposts, and excises shall be uniform throughout the United States.' 'No capitation or other direct tax shall be laid, unless in proportion to the census or enumeration hereinbefore directed to be taken.' 'No tax or duty shall be laid on articles exported from any state.'

'These clauses contain the entire grant of the taxing power by the organic law, with the limitations which that instrument imposes.

'The national government, though supreme within its own sphere, is one of limited jurisdiction and specific functions. It has no faculties but such as the constitution has given it, either expressly or incidentally by necessary intendment. Whenever any act done under its authority is challenged, the proper sanction must be found in its charter, or the act is ultra vires and void. This test must be applied in the examination of the question before us. If the tax to which it refers is a 'direct tax,' it is clear that it has not been laid in conformity to the requirements of the constitution. It is therefore necessary to asscertain to which of the categories named in the eighth section of the first article it belongs.

'What are direct taxes was elaborately argued and considered by this court in Hylton v. U. S., decided in the year 1796. One of the members of the court (Justice Wilson) had been a distinguished member of the convention ****708** which framed the constitution. It was unanimously held by the four justices who heard the argument that a tax upon carriages kept by the owner for his own use was not a direct tax. Justice Chase said: 'I am inclined to think—but of this I do not give a judicial opinion—that the direct taxes contemplated by the constitution are only two, to wit, a capitation or poll tax simply, without regard to property, profession, or any other circumstances, and a tax on land.' Paterson, J., followed in the same line of remark. He said: 'I never entertained a doubt that the principal (I will not say ***629** the only) object the framers of the constitution contemplated as falling within the rule of apportionment was a capitation tax or a tax on land. * * * The constitution declares that a capitation tax is a direct tax, and both in theory and practice a tax on land is deemed to be a direct tax. In this way the terms 'direct taxes' 'capitation and other direct tax' are satisfied.'

'The views expressed in this case are adopted by Chancellor Kent and Justice Story in their examination of the subject. 'Duties' are defined by Tomlin to be things due and recoverable by law. The term, in its widest signification, is hardly less comprehensive than 'taxes.' It is applied, in its most restricted meaning, to customs; and in that sense is nearly the synonym of 'imposts.'

"Impost' is a duty on imported goods and merchandise. In a larger sense, it is any tax or imposition. Cowell says it is distinguished from 'custom,' 'because custom is rather the profit which the prince makes on goods shipped out.' Mr. Madison considered the terms 'duties' and 'imposts' in these clauses as synonymous. Judge Tucker thought 'they were probably intended to comprehend every species of tax or contribution not included under the ordinary terms 'taxes' and 'excises."

"Excise' is defined to be an inland imposition, sometimes upon the consumption of the commodity, and sometimes upon the retail sale; sometimes upon the manufacturer, and sometimes upon the vendor.

'The taxing power is given in the most comprehensive terms. The only limitations imposed are that direct taxes, including the capitation tax, shall be apportioned; that duties, imposts, and excises shall be uniform; and that no duties shall be imposed upon articles exported from any state. With these exceptions, the exercise of the power is, in all respects, unfettered.

'If a tax upon carriages, kept for his own use by the owner, is not a direct tax, we can see no ground upon which a tax upon the business of an insurance company can be held to belong to that class of revenue charges.

'It has been held that congress may require direct taxes to ***630** be laid and collected in the territories as well as in the states.

'The consequences which would follow the apportionment of the tax in question among the states and territories of the Union in the manner prescribed by the constitution must not be overlooked. They are very obvious. Where such corporations are numerous and rich, it might be light; where none exist, it could not be collected; where they are few and poor, it would fall upon them with such weight as to involve annihilation. It cannot be supposed that the framers of the constitution intended that any tax should be apportioned, the collection of which on that principle would be attended with such results. The consequences are fatal to the proposition.

'To the question under consideration it must be answered that the tax to which it relates is not a direct tax, but a duty or excise; that it was obligatory on the plaintiff to pay it.

'The other questions certified up are deemed to be sufficiently answered by the answers given to

the first and sixth questions.'

This opinion, it seems to me, closes the door to discussion in regard to the meaning of the word 'direct' in the constitution, and renders unnecessary a resort to the conflicting opinions of the framers, or to the theories of the economists. It adopts that construction of the word which confines it to capitation taxes and a tax on land, and necessarily rejects the contention that that word was to be construed in accordance with the economic theory of shifting a tax from the shoulders of the person upon whom it was immediately levied to those of some other person. This decision moreover, is of great importance, because it is an authoritative reaffirmance of the Hylton Case, and an approval of the suggestions there made by the justices, and constitutes another sanction given by this court to the interpretation of the constitution adopted by the legislative, executive, and judicial departments of the government, and thereafter continuously acted upon.

Not long thereafter, in Bank v. Fenno, & Wall. 533, the question of the application of the word 'direct' was again submitted to this court. The issue there was whether a tax on the circulation of state banks was 'direct,' within ***631** the meaning of the constitution. It was ably argued by the most distinguished counsel, Reverdy Johnson and Caleb Cushing representing the bank, and Attorney General Hoar, the United States. The brief of Mr. Cushing again presented nearly every point now urged upon our consideration. It cited copiously from the opinions of Adam Smith and others. The constitutionality of the tax was maintained by the government on the ground that the meaning of the word direct' in the constitution, as interpreted by the Hylton Case, as enforced by the continuous legislative construction, and as sanctioned by the consensus of opinion already referred to, was finally settled. Those who assailed the tax there urged, as is done here, that the Hylton Case was not conclusive, because the only question decided was the particular matter ****709** at issue, and insisted that the suggestions of the judges were mere dicta, and not to be followed. They said that Hylton v. U. S. adjudged one point alone, which was that a tax on a carriage was not a direct tax, and that from the utterances of the judges in the case it was obvious that the general question of what was a direct tax was but crudely considered. Thus the argument there presented to this court the very view of the Hylton Case, which has been reiterated in the argument here, and which is sustained now. What did this court say then, speaking through Chief Justice Chase, as to these arguments? I take very fully from its opinion:

'Much diversity of opinion has always prevailed upon the question, what are direct taxes? Attempts to answer it by reference to the definitions of political economists have been frequently made, but without satisfactory results. The enumeration of the different kinds of taxes which congress was authorized to impose was probably made with very little reference to their speculations. The great work of Adam Smith, the first comprehensive treatise on political economy in the English language, had then been recently published; but in this work, though there are passages which refer to the characteristic difference between direct and indirect taxation, there is nothing which affords any valuable light on the use of the words 'direct taxes,' in the constitution.

***632** 'We are obliged, therefore, to resort to historical evidence, and to seek the meaning of the words in the use and in the opinion of those whose relations to the government, and means of knowledge, warranted them in speaking with authority.

'And, considered in this light, the meaning and application of the rule, as to direct taxes, appears to us quite clear.

'It is, as we think, distinctly shown in every act of congress on the subject.

'In each of these acts a gross sum was laid upon the United States, and the total amount was apportioned to the several states according to their

respective numbers of inhabitants, as ascertained by the last preceding census. Having been apportioned, provision was made for the imposition of the tax upon the subjects specified in the act, fixing its total sum.

'In 1798, when the first direct tax was imposed, the total amount was fixed at two millions of dollars; in 1813, the amount of the second direct tax was fixed at three millions; in 1815, the amount of the third at six millions, and it was made an annual tax; in 1816, the provision making the tax annual was repealed by the repeal of the first section of the act of 1815, and the total amount was fixed for that year at three millions of dollars. No other direct tax was imposed until 1861, when a direct tax of twenty millions of dollars was laid, and made annual; but the provision making it annual was suspended, and no tax, except that first laid, was ever apportioned. In each instance the total sum was apportioned among the states by the constitutional rule, and was assessed at prescribed rates on the subjects of the tax. The subjects, in 1798, 1813, 1815, 1816, were lands, improvements, dwelling houses, and slaves; and in 1861, lands, improvements, and dwelling houses only. Under the act of 1798, slaves were assessed at fifty cents on each; under the other acts, according to valuation by assessors.

'This review shows that personal property, contracts, occupations, and the like, have never been regarded by congress as proper subjects of direct tax. It has been supposed that slaves must be considered as an exception to this observation. But the exception is rather apparent than real. As persons, slaves ***633** were proper subjects of a capitation tax, which is described in the constitution as a direct tax; as property, they were, by the laws of some, if not most, of the states, classed as real property, descendible to heirs. Under the first view, they would be subject to the tax of 1798, as a capitation tax; under the latter, they would be subject to the taxation of the other years, as realty. That the latter view was that taken by the framers of the acts, after 1798, becomes highly probable, when it is considered that, in the states where slaves were held, much of the value which would otherwise have attached to land passed into the slaves. If, indeed, the land only had been valued without the slaves, the land would have been subject to much heavier proportional imposition in those states than in states where there were no slaves; for the proportion of tax imposed on each state was determined by population, without reference to the subjects on which it was to be assessed.

'The fact, then, that slaves were valued, under the acts referred to, for from showing, as some have supposed, that congress regarded personal property as a proper object of direct taxation, under the constitution, shows only that congress, after 1798, regarded slaves, for the purposes of taxation, as realty.

'It may be rightly affirmed, therefore, that, in the practical construction of the constitution by congress, direct taxes have been limited to taxes on land and appurtenances, and taxes on polls, or capitation taxes.

'And this construction is entitled to great consideration, especially in the absence of anything adverse to it in the discussions of the convention which framed, and of the conventions which ratified, the constitution. * * *

'This view received the sanction of this bourt two years before the enactment of the first law imposing direct taxes eo nomine.'

The court then reviews the Hylton Case, repudiates the attack made upon it, reaffirms the construction placed on it by the legislative, executive, and judicial departments, and Company Case, to which I have referred. ****710** expressly adheres to the ruling in the insurance Company Case, to whichI have referred. Summing up, it said:

***634** 'It follows necessarily that the power to tax without apportionment extends to all other objects. Taxes on other objects are included under the

heads of taxes not direct, duties, imposts, and excises, and must be laid and collected by the rule of uniformity. The tax under consideration is a tax on bank circulation, and may very well be classed under the head of duties. Certainly it is not, in the sense of the constitution, a direct tax. It may be said to come within the same category of taxation as the tax on incomes of insurance companies, which this court, at the last term, in the case of Insurance Co. v. Soule, held not to be a direct tax.'

This case was, so far as the question of direct taxation is concerned, decided by an undivided court; for, although Mr. Justice Nelson dissented from the opinion, it was not on the ground that the tax was a direct tax, but on another question.

Some years after this decision the matter again came here for adjudication, in the case of Scholey v. Rew, 23 Wall. 331. The issue there involved was the validity of a tax placed by a United States statute on the right to take real estate by inheritance. The collection of the tax was resisted on the ground that it was direct. The brief expressly urged this contention, and said the tax in question was a tax on land, if ever there was one. It discussed the Hylton Case, referred to the language used by the various judges, and sought to place upon it the construction which we are now urged to give it, and which has been so often rejected by this court.

This court again by its unanimous judgment answered all these contentions. I quote its language:

'Support to the first objection is attempted to be drawn from that clause of the constitution which provides that direct taxes shall be apportioned among the several states which may be included within the Union, according to their respective numbers, and also from the clause which provides that no capitation or other direct tax shall be laid, unless in proportion to the census or amended enumeration; but it is clear that the tax or duty levied by the act under consideration is not a direct tax, within the meaning of either of those ***635** provisions. Instead of that, it is plainly an excise tax or duty, authorized by section 8 of article 1, whih vests the power in congress to lay and collect taxes, duties, imposts, and excises, to pay the debts, and provide for the common defense and general welfare. * * *

'Indirect taxes, such as duties of impost and excises, and every other description of the same, must be uniform; and direct taxes must be laid in proportion to the census or enumeration, as remodeled in the fourteenth amendment. Taxes on lands, houses, and other permanent real estate have always been deemed to be direct taxes, and capitation taxes, by the express words of the constitution, are within the same category; but it never has been decided that any other legal exactions for the support of the federal government fall within the condition that, unless laid in proportion to numbers, that the assessment is invalid.

'Whether direct taxes, in the sense of the constitution, comprehend any other tax than a capitation tax and a tax on land, is a question not absolutely decided, nor is it necessary to determine it in the present case, as it is expressly decided that the term does not include the tax on income, which cannot be distinguished in principle from a succession tax, such as the one involved in the present controversy.'

What language could more clearly and forcibly reaffirm the previous rulings of the court upon this subject? What stronger indorsement could be given to the construction of the constitution which had been given in the Hylton Case, and which had been adopted and adhered to by all branches of the government almost from the hour of its establishment? It is worthy of note that the court here treated the decision in the Hylton Case as conveying the view that the only direct taxes were 'taxes on land and appurtenances.' In so doing it necessarily again adopted the suggestion of the justices there made, thus making them the adjudged conclusions of this court. It is too late now to destroy the force of the opinions in that case by qualifying them as mere dicta, when they have again and again been ex-

pressly approved by this court.

If there were left a doubt as to what this established construction*636 is, it seems to be entirely removed by the case of Springer v. U. S., 102 U. S. 586. Springer was assessed for an income tax on his professional earnings and on the interest on United States bonds. He declined to pay. His real estate was sold in consequence. The suit involved the validity of the tax, as a basis for the sale. Again every question now presented was urged upon this court. The brief of the plaintiff in error, Springer, made the most copious references to the economic writers, continental and English. It cited the opinions of the framers of the constitution. It contained extracts from the journals of the convention, and marshaled the authorities in extensive and impressive array. It reiterated the argument against the validity of an income tax which included rentals. It is also asserted that the Hylton Case was not authority, because the expressions of the judges, in regard to anything except the carriage tax, were mere dicta.

The court adhered to the ruling announced in the previous cases, and held that the tax was not direct, within the meaning of the constitution. It reexamined and answered everything advanced here, and said, in summing up the case:

'Our conclusions are that direct taxes, within the meaning of the constitution, are only capitation taxes, as expressed in that instrument, **711 and taxes on real estate; and that the tax of which the plaintiff in error complained is within the category of an excise or duty.'

The facts, then, are briefly these: At the very birth of the government a contention arose as to the meaning of the word 'direct.' That controversy was determined by the legislative and executive departments of the government. Their action came to this court for review, and it was approved. Every judge of this court who expressed an opinion made use of language which clearly showed that he thought the word 'direct,' in the constitution, applied only to capitation taxes and taxes directly on land. Thereafter the construction thus given was accepted everywhere as definitive. The matter came again and again to this court, and in every case the original ruling was adhered to. The suggestions made in the Hylton Case were adopted here, and *637 in the last case here decided, reviewing all the others, this court said that direct taxes, within the meaning of the constitution, were only taxes on land, and capitation taxes. And now, after a hundred years, after long-continued action by other departments of the government, and after repeated adjudications of this court, this interpretation is overthrown, and the congress is declared not to have a power of taxation which may at some time, as it has in the past, prove necessary to the very existence of the government. By what process of reasoning is this to be done? By resort to theories, in order to construe the word 'direct' in its economic sense, instead of in accordance with its meaning in the constitution, when the very result of the history which I have thus briefly recounted is to show that the economic construction of the word was repudiated by the framers themselves, and has been time and time again rejected by this court; by a resort to the language of the framers and a review of their opinions, although the facts plainly show that they themselves settled the question which the court now virtually unsettles. In view of all that has taken place, and of the many decisions of this court, the matter at issue here ought to be regarded as closed forever.

The injustice and harm which must always result from overthrowing a long and settled practice sanctioned by the decisions of this court could not be better illustrated than by the example which this case affords. Under the income-tax laws which prevailed in the past for many years, and which covered every conceivable source of income,—rentals from real estate,—and everything else, vast sums were collected from the people of the United States. The decision here rendered announces that those sums were wrongfully taken, and thereby, it seems to me, creates a claim, in equity and good conscience, against the govern-

ment for an enormous amount of money. Thus, from the change of view by this court, it happens that an act of congress, passed for the purpose of raising revenue, in strict conformity with the practice of the government from the earliest time, and in accordance with the oft-repeated decisions of this court, furnishes the ***638** occasion for creating a claim against the government for hundreds of millions of dollars. I say, creating a claim, because, if the government be in good conscience bound to refund that which has been taken from the citizen in violation of the constitution, although the technical right may have disappeared by lapse of time, or because the decisions of this court have misled the citizen to his grievous injury, the equity endures, and will present itself to the conscience of the government. This consequence shows how necessary it is that the court should not overthrow its past decisions. A distinguished writer aptly points out the wrong which must result to society from a shifting judicial interpretation. He says:

'If rules and maxims of law were to ebb and flow with the taste of the judge, or to assume that shape which, in his fancy, best becomes the times; if the decisions of one case were not to be ruled by or depend at all upon former determinations in other cases of a like nature,—I should be glad to know what person would venture to purchase an estate without first having the judgment of a court of justice respecting the identical title under which he means to purchase. No reliance could be had upon precedents. Former resolutions upon titles of the same kind could afford him no assurance at all. Nay, even a decision of a court of justice upon the very identical title would be nothing more than a precarious, temporary security. The practice upon which it was founded might, in the course of a few years, become antiquated. The same title might be again drawn into dispute. The taste and fashion of the times might be improved, and on that ground a future judge might hold himself at liberty, if not consider it his duty, to pay as little regard to the maxims and decisions of his predecessor as that predecessor did to the maxims and decisions of those who went before him.' Fearne, Rem. (London Ed. 1801) p. 264.

The disastrous consequences to flow from disregarding settled decisions, thus cogently described, must evidently become greatly magnified in a case like the present, when the opinion of the court affects fundamental principles of the government by denying an essential power of taxation ***639** long conceded to exist, and often exerted by congress. If it was necessary that the previous decisions of this court should be repudiated, the power to amend the constitution existed, and should have been availed of. Since the Hylton Case was decided, the constitution has been repeatedly amended. The construction which confined the word 'direct' to capitation and land taxes was not changed by these amendments, and it should not now be reversed by what seems to me to be a judicial amendment of the constitution.

The finding of the court in this case that the inclusion of rentals from real estate in an income tax makes it direct, to that extent, is, in my judgment, conclusively denied by the ****712** authorities to which I have referred, and which establish the validity of an income tax in itself. Hence, I submit, the decisions necessarily reverses the settled rule which it seemingly adopts in part. Can there be serious doubt that the question of the validity of an income tax, in which the rentals of real estate are included, is covered by the decisions which say that an income tax is generically indirect, and that, therefore, it is valid without apportionment? I mean, of course could there be any such doubt, were it not for the present opinion of the court? Before undertaking to answer this question I deem it necessary to consider some arguments advanced or suggestions made.

(1) The opinions of Turgot and Smith and other economists are cited, and it is said their views were known to the framers of the constitution, and we are then referred to the opinions of the framers themselves. The object of the collocation of these two sources of authority is to show that there was a

concurrence between them as to the meaning of the word 'direct.' But, in order to reach this conclusion, we are compelled to overlook the fact that this court has always held, as appears from the preceding cases, that the opinions of the economists threw little or no light on the interpretation of the word 'direct,' as found in the constitution. And the whole effect of the decisions of this court is to establish the proposition that the word has a different significance in the constitution from that which Smith and Turgot have given to it when used in a general economic sense. Indeed, it seems to me ***640** that the conclusion deduced from this line of thought itself demonstrates its own unsoundness. What is that conclusion? That the framers well understood the meaning of 'direct.'

Now, it seems evident that the framers, who well understood the meaning of this word, have themselves declared in the most positive way that it shall not be here construed in the sense of Smith and Turgot. The congress which passed the carriage tax act was composed largely of men who had participated in framing the constitution. That act was approved by Washington, who had presided over the deliberations of the convention. Certainly, Washington himself, and the majority of the framers, if they well understood the sense in which the word 'direct' was used, would have declined to adopt and approve a taxing act which clearly violated the provisions of the constitution, if the word 'direct,' as therein used, had the meaning which must be attached to it if read by the light of the theories of Turgot and Adam Smith. As has already been noted, all the judges who expressed opinions in the Hylton Case suggested that 'direct,' in the constitutional sense, referred only to taxes on land and capitation taxes. Could they have possible made this suggestion if the word had been used as Smith and Turgot used it? It is immaterial whether the suggestions of the judges were dicta or not. They could not certainly have made this intimation, if they understood the meaning of the word 'direct' as being that which it must have imported if construed according to the writers mentioned. Take the language of Mr. Justice Paterson, 'I never entertained a doubt that the principal, I will not say the only, objects that the framers of the constitution contemplated as falling within the rule of apportionment were a capitation tax and a tax on land.' He had borne a conspicuous part in the convention. Can we say that he understood the meaning of the framers, and yet, after the lapse of a hundred years, fritter away that language, uttered by him from this bench in the first great case in which this court was called upon to interpret the meaning of the word 'direct'? It cannot be said that his language was used carelessly, or without a knowledge of its great import. The debate upon the passage ***641** of the carriage tax act had manifested divergence of opinion as to the meaning of the word 'direct.' The magnitude of the issue is shown by all contemporaneous authority to have been deeply felt, and its far-reaching consequence was appreciated. Those controversies came here for settlement, and were then determined with a full knowledge of the importance of the issues. They should not be now reopened.

The argument, then, it seems to me, reduces itself to this: That the framers well knew the meaning of the word 'direct'; that, so well understanding it, they practically interpreted it in such a way as to plainly indicate that it had a sense contrary to that now given to it, in the view adopted by the court. Although they thus comprehended the meaning of the word and interpreted it at an early day, their interpretation is now to be overthrown by resorting to the economists whose construction was repudiated by them. It is thus demonstrable that the conclusion deduced from the premise that the framers well understood the meaning of the word 'direct' involves a fallacy; in other words, that it draws a faulty conclusion, even if the predicate upon which the conclusion is rested be fully admitted. But I do not admit the premise. The views of the framers, cited in the argument, conclusively show that they did not well understand, but were in great doubt as to, the meaning of the word 'direct.' The use of the word was the result of a compromise. It was accepted as

the solution of a difficulty which threatened to frustrate the hopes of those who looked upon the formation of a new government as absolutely necessary to escape the condition of weakness which the articles of confederation had shown. Those who accepted the compromise viewed the word in different lights, and expected different results to flow from its adoption. This was the natural result of the struggle which was terminated by the adoption of the provision as to representation ****713** and direct taxes. That warfare of opinion had been engendered by the existence of slavery in some of the states, and was the consequence of the conflict of interest thus brought about. In reaching a settlement, the minds of those who acted on it were naturally concerned in the main with the cause of the ***642** contention, and not with the other things which had been previously settled by the convention. Thus, while there was, in all probability, clearness of vision as to the meaning of the word 'direct,' in relation to its bearing on slave property, there was inattention in regard to other things, and there were therefore diverse opinions as to its proper signification. That such was the case in regard to many other clauses of the constitution has been shown to be the case by those great controversies of the past, which have been peacefully settled by the adjudications of this court. While this difference undoubtedly existed as to the effect to be given the word 'direct,' the consensus of the majority of the framers as to its meaning was shown by the passage of the carriage tax act. That consensus found adequate expression in the opinions of the justices in the Hylton Case, and in the decree of this court there rendered. The passage of that act, those opinions, and that decree, settled the proposition that the word applied only to capitation taxes and taxes on land.

Nor does the fact that there was difference in the minds of the framers as to the meaning of the word 'direct' weaken the binding force of the interpretation placed upon that word from the beginning; for, if such difference existed, it is certainly sound to hold that a contemporaneous solution of a doubtful question, which has been often confirmed by this court, should not now be reversed. The framers of the constitution, the members of the earliest congress, the illustrious man first called to the office of chief executive, the jurists who first sat in this court, two of whom had borne a great part in the labors of the convention, all of whom dealt with this doubtful question, surely occupied a higher vantage ground for its correct solution than do those of our day. Here, then, is the dilemma: If the framers understood the meaning of the word 'direct' in the constitution, the practical effect which they gave to it should remain undisturbed; if they were in doubt as to the meaning, the interpretation long since authoritatively affixed to it should be upheld.

(2) Nor do I think any light is thrown upon the question of whether the tax here under consideration is direct or indirect***643** by referring to the principle of 'taxation without representation,' and the great struggle of our forefathers for its enforcement. It cannot be said that the congress which passed this act was not the representative body fixed by the constitution. Nor can it be contended that the struggle for the enforcement of the principle involved the contention that representation should be in exact proportion to the wealth taxed. If the argument be used in order to draw the inference that because, in this instance, the indirect tax imposed will operate differently through various sections of the country, therefore that tax should be treated as direct, it seems to me it is unsound. The right to tax, and not the effects which may follow from its lawful exercise, is the only judicial question which this court is called upon to consider. If an indirect tax, which the constitution has not subjected to the rule of apportionment, is to be held to be a direct tax, because it will bear upon aggregations of property in different sections of the country according to the extent of such aggregations, then the power is denied to congress to do that which the constitution authorizes because the exercise of a lawful power is supposed to work out a result which, in the opinion of the court, was not contemplated by the fathers. If this be sound, then every

question which has been determined in our past history is now still open for judicial reconstruction. The justness of tariff legislation has turned upon the assertion on the one hand, denied on the other, that it operated unequally on the inhabitants of different sections of the country. Those who opposed such legislation have always contended that its necessary effect was not only to put the whole burden upon the section, but also to directly enrich certain of our citizens at the expense of the rest, and thus build up great fortunes, to the benefit of the few and the detriment of the many. Whether this economic contention be true or untrue is not the question. Of course, I intimate no view on the subject. Will it be said that if, to-morrow, the personnel of this court should be changed, it could deny the power to enact tariff legislation which has been admitted to exist in congress from the beginning, upon the ground that such legislation beneficially affects one section or set of people ***644** to the detriment of others, within the spirit of the constitution, and therefore constitutes a direct tax?

(3) Nor, in my judgment, does any force result from the argument that the framers expected direct taxes to be rarely resorted to, and, as the present tax was imposed without public necessity, it should be declared void.

It seems to me that this statement begs the whole question, for it assumes that the act now before us levies a direct tax, whereas the question whether the tax is direct or not is the very issue involved in this case. If congress now deems it advisable to resort to certain forms of indirect taxation which have been frequently, though not continuously, availed of in the past, I cannot see that its so doing affords any reason for converting an indirect into a direct tax in order to nullify the legislative will. The policy of any particular method of taxation, or the presence of an exigency which requires its adoption, is a purely legislative question. ****714** It seems to me that it violates the elementary distinction between the two departments of the government to allow an opinion of this court upon the necessity or expediency of a tax to affect or control our determination of the existence of the power to impose it.

But I pass from these considerations to approach the question whether the inclusion of rentals from real estate in an income tax renders such a tax to that extent 'direct' under the constitution, because it constitutes the imposition of a direct tax on the land itself.

Does the inclusion of the rentals from real estate in the sum going to make up the aggregate income from which (in order to arrive at taxable income) is to be deducted insurance, repairs, losses in business, and $4,000 exemption, make the tax on income so ascertained a direct tax on such real estate?

In answering this question, we must necessarily accept the interpretation of the word 'direct' authoritatively given by the history of the government and the decisions of this court just cited. To adopt that interpretation for the general purposes of an income tax, and then repudiate it because of one of the elements of which it is composed, would violate every ***645** elementary rule of construction. So, also, to seemingly accept that interpretation, and then resort to the framers and the economists in order to limit its application and give it a different significance, is equivalent to its destruction, and amounts to repudiating it without directly doing so. Under the settled interpretation of the word, we ascertain whether a tax be 'direct' or not by considering whether it is a tax on land or a capitation tax. And the tax on land, to be within the provision for apportionment, must be direct. Therefore we have two things to take into account: Is it a tax on land, and is it direct thereon, or so immediately on the land as to be equivalent to a direct levy upon it? To say that any burden on land, even though indirect, must be apportioned, is not only to incorporate a new provision in the constitution, but is also to obliterate all the decisions to which I have referred, by construing them as holding that, although the constitution forbids only a direct tax on land

without apportionment, it must be so interpreted as to bring an indirect tax on land within its inhibition.

It is said that a tax on the rentals is a tax on the land, as if the act here under consideration imposed an immediate tax on the rentals. This statement, I submit, is a misconception of the issue. The point involved is whether a tax on net income, when such income is made up by aggregating all sources of revenue and deducting repairs, insurance, losses in business, exemptions, etc., becomes, to the extent to which real-estate revenues may have entered into the gross income, a direct tax on the land itself. In other words, does that which reaches an income, and thereby reaches rentals indirectly, and reaches the land by a double indirection, amount to a direct levy on the land itself? It seems to me the question, when thus accurately stated, furnishes its own negative response, Indeed, I do not see how the issue can be stated precisely and logically without making it apparent on its face that the inclusion of rental from real property in income is nothing more than an indirect tax upon the land.

It must be borne in mind that we are not dealing with the want of power in congress to assess real estate at all. On ***646** the contrary, as I have shown at the outset, congress has plenary power to reach real estate, both directly and indirectly. If it taxes real estate directly, the constitution commands that such direct imposition shall be apportioned. But because an excise or other indirect tax, imposed without apportionment, has an indirect effect upon real estate, no violation of the constitution is committed, because the constitution has left congress untrammeled by any rule of apportionment as to indirect taxes,—imposts, duties, and excises. The opinions in the Hylton Case, so often approved and reiterated, the unanimous views of the text writers, all show that a tax on land, to be direct, must be an assessment of the land itself, either by quantity or valuation. Here there is no such assessment. It is well also to bear in mind, in considering whether the tax is direct on the land, the fact that if land yields no rental it contributes nothing to the income. If it is vacant, the law does not force the owner to add the rental value to his taxable income. And so it is if he occupies it himself.

The citation made by counsel from Coke on Littleton, upon which so much stress is laid, seems to me to have no relevancy. The fact that where one delivers or agrees to give or transfer land, with all the fruits and revenues, it will be presumed to be a conveyance of the land, in no way supports the proposition that an indirect tax on the rental of land is a direct burden on the land itself. $Nor can I see the application of Brown v. Maryland; Western v. Peters; Dobbins v. Commissioners; Almy v. California; Cook v. Pennsylvania; Railroad Co. v. Jackson; Philadelphia & S. S. S. Co. v. Pennsylvania; Leloup v. Mobile; Telegraph Co. v. Adams. All these cases involved the question whether, under the constitution, if no power existed to tax at all, either directly or indirectly, an indirect tax would be unconstitutional. These cases would be apposite to this is congress had no power to tax real estate. Were such the case, it might be that the imposition of an excise by congress which reached real estate indirectly would ***647** necessarily violate the constitution, because, as it had no power in the premises, every attempt to tax, directly or indirectly, would be null. Here, on the contrary, it is not denied that the power to ****715** tax exists in congress, but the question is, is the tax direct or indirect, in the constitutional sense?

But it is unnecessary to follow the argument further; for, if I understand the opinions of this court already referred to, they absolutely settle the proposition that an inclusion of the rentals of real estate in an income tax does not violate the constitution. At the risk of repetition, I propose to go over the cases again for the purpose of Demonstrating this. In doing so, let it be understood at the outset that I do not question the authority of Cohens v. Virginia or Carroll v. Carroll's Lessee or any other of the cases referred to in argument of counsel. These great opinions hold that an adjudication need not be extended beyond the principles which it de-

15 S.Ct. 673
157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759, 3 A.F .T.R. 2557
(Cite as: 157 U.S. 429, 15 S.Ct. 673)

cides. While conceding this, it is submitted that, if decided cases do directly, affirmatively, and necessarily, in principle, adjudicate the very question here involved, then, under the very text of the opinions referred to by the court, they should conclude this question. In the first case, that of Hylton, is there any possibility, by the subtlest ingenuity, to reconcile the decision here announced with what was there established?

In the second case (Insurance Co. v. Soule) the levy was upon the company, its premiums, its dividends, and net gains from all sources. The case was certified to this court, and the statement made by the judges in explanation of the question which they propounded says:

'The amount of said premiums, dividends, and net gains were truly stated in said lists or returns.' Original Record, p. 27.

It will be thus seen that the issue there presented was not whether an income tax on business gains was valid, but whether an income tax on gains from business and all other net gains was constitutional. Under this state of facts, the question put to the court was——

'Whether the taxes paid by the plaintiff, and sought to be recovered back, in this action, are not direct taxes within the meaning of the constitution of the United States.'

***648** This tax covered revenue of every possible nature, and it therefore appears self-evident that the court could not have upheld the statute without deciding that the income derived from realty, as well as that derived from every other source, might be taxed without apportionment. It is obvious that, if the court had considered that any particular subject-matter which the statute reached was not constitutionally included, it would have been obliged, by every rule of safe judicial conduct, to qualify its answer as to this particular subject.

It is impossible for me to conceive that the court did not embrace in its ruling the constitutionality of an income tax which included rentals from real estate, since, without passing upon that question, it could not have decided the issue presented. And another reason why it is logically impossible that this question of the validity of the inclusion of the rental of real estate in an income tax could have been overlooked by the court is found in the fact, to which I have already adverted, that this was one of the principal points urged upon its attention, and the argument covered all the ground which has been occupied here,—indeed, the very citation from Coke upon Littleton, now urged as conclusive, was there made also in the brief of counsel. And although the return of income, involved in that case, was made 'in block,' the very fact that the burden of the argument was that to include rentals from real estate, in income subject to taxation, made such tax pro tanto direct, seems to me to indicate that such rentals had entered into the return made by the corporation.

Again, in the case of Scholey v. Rew, the tax in question was laid directly on the right to take real estate by inheritance,—a right which the United States had no power to control. The case could not have been decided, in any point of view, without holding a tax upon that right was not direct, and that, therefore, it could be levied without apportionment. It is manifest that the court could not have overlooked the question whether this was a direct tax on the land or not, because in the argument of counsel it was said, if there was any tax in the world that was a tax on real estate which was ***649** direct, that was the one. The court said it was not, and sustained the law. I repeat that the tax there was put directly upon the right to inherit, which congress had no power to regulate or control. The case was therefore greatly stronger than that here presented, for congress has a right to tax real estate directly with apportionment. That decision cannot be explained away by saying that the court overlooked the fact that congress had no power to tax the devolution of real estate, and treated it as a tax on such devolution. Will it be said, of the distin-

guished men who then adorned this bench, that, although the argument was pressed upon them that this tax was levied directly on the real estate, they ignored the elementary principle that the control of the inheritance of realty is a state and not a federal function? But, even if the case proceeded upon the theory that the tax was on the devolution of the real estate, and was therefore not direct, is it not absolutely decisive of this controversy? If to put a burden of taxation on the right to take real estate by inheritance reaches realty only by indirection, how can it be said that a tax on the income, the result of all sources of revenue, including rentals, after deducting losses and expenses, which thus reaches the rentals indirectly, and the real estate indirectly through the rentals, is a direct tax on the real estate itself?

So, it is manifest in the Springer Case that the same question was necessarily decided. It seems obvious that the court intended in that case to decide the whole question, including ****716** the right to tax rental from real estate without apportionment. It was elaborately and carefully argued there that as the law included the rentals of land in the income taxed, and such inclusion was unconstitutional, this, therefore, destroyed that part of the law which imposed the tax on the revenues of personal property. Will it be said, in view of the fact that in this very case four of the judges of this court think that the inclusion of the rentals from real estate in an income tax renders the whole law invalid, that the question of the inclusion of the rentals was of no moment there, because the return there did not contain a mention of such rentals? Were ***650** the great judges who then composed this court so neglectful that they did not see the importance of a question which is now considered by some of its members so vital that the result in their opinion is to annul the whole law, more especially when that question was pressed upon the court in argument with all possible vigor and earnestness? But I think that the opinion in the Springer Case clearly shows that the court did consider this question of importance, that it did intend to pass upon it, and that it deemed that it had decided all the questions affecting the validity of an income tax in passing upon the main issue, which included the others as the greater includes the less.

I can discover no principle upon which these cases can be considered as any less conclusive of the right to include rentals of land in the concrete result, income, than they are as to the right to levy a general income tax. Certainly, the decisions which hold that an income tax as such is not direct, decide on principle that to include the rentals of real estate in an income tax does not make it direct. If embracing rentals in income makes a tax on income to that extent a 'direct' tax on the land, then the same word, in the same sentence of the constitution, has two wholly distinct constitutional meanings, and signifies one thing when applied to an income tax generally, and a different thing when applied to the portion of such a tax made up in part of rentals. That is to say, the word means one thing when applied to the greater, and another when applied to the lesser, tax.

My inability to agree with the court in the conclusions which it has just expressed causes me much regret. Great as is my respect for any view by it announced, I cannot resist the conviction that its opinion and decree in this case virtually annul its previous decisions in regard to the powers of congress on the subject of taxation, and are therefore fraught with danger to the court, to each and every citizen, and to the republic. The conservation and orderly development of our institutions rest on our acceptance of the results of the past, and their use as lights to guide our steps in the future. Teach the lesson that settled principles may be overthrown ***651** at any time, and confusion and turmoil must ultimately result. In the discharge of its function of interpreting the constitution this court exercises an august power. It sits removed from the contentions of political parties and the animosities of factions. It seems to me that the accomplishment of its lofty mission can only be secured by the stability of its teachings and the sanctity which surrounds them. If

the permanency of its conclusions is to depend upon the personal opinions of those who, from time to time, may make up its membership, it will inevitably become a theater of political strife, and its action will be without coherence or consistency. There is no great principle of our constitutional law, such as the nature and extent of the commerce power, or the currency power, or other powers of the federal government, which has not been ultimately defined by the adjudications of this court after long and earnest struggle. If we are to go back to the original sources of our political system, or are to appeal to the writings of the economists in order to unsettle all these great principles, everything is lost, and nothing saved to the people. The rights of every individual are guarantied by the safeguards which have been thrown around them by our adjudications. If these are to be assailed and overthrown, as is the settled law of income taxation by this opinion, as I understand it, the rights of property, so far as the federal constitution is concerned, are of little worth. My strong convictions forbid that I take part in a conclusion which seems to me so full of peril to the country. I am unwilling to do so, without reference to the question of what my personal opinion upon the subject might be if the question were a new one, and was thus unaffected by the action of the framers, the history of the government, and the long line of decisions by this court. The wisdom of our forefathers in adopting a written constitution has often been impeached upon the theory that the interpretation of a written instrument did not afford as complete protection to liberty as would be enjoyed under a constitution made up of the traditions of a free people. Writing, it has been said, does not insure greater stability than tradition does, while it *652 destroys flexibility. The answer has always been that by the foresight of the fathers the construction of our written constitution was ultimately confided to this body, which, from the nature of its judicial structure, could always be relied upon to act with perfect freedom from the influence of faction, and to preserve the benefits of consistent interpretation. The fundamental conception of a judicial body is that of one hedged about by precedents which are binding on the court without regard to the personality of its members. Break down this belief in judicial continuity, and let it be felt that on great constitutional questions this court is to depart from the settled conclusions of its predecessors, and to determine them all according to the mere opinion of those who **717 temporarily fill its bench, and our constitution will, in my judgment, be bereft of value, and become a most dangerous instrument to the rights and liberties of the people.

In regard to the right to include in an income tax the interest upon the bonds of municipal corporations, I think the decisions of this court, holding that the federal government is without power to tax the agencies of the state government, embrace such bonds, and that this settled line of authority is conclusive upon my judgment here. It determines the question that, where there is no power to tax for any purpose whatever, no direct or indirect tax can be imposed. The authorities cited in the opinion are decisive of this question. They are relevant to one case, and not to the other, because, in the one case, there is full power in the federal government to tax, the only controversy being whether the tax imposed is direct or indirect; while in the other there is no power whatever in the federal government, and therefore the levy, whether direct or indirect, is beyond the taxing power.

Mr. Justice HARLAN authorizes me to say that he concurs in the views herein expressed.Mr. Justice HARLAN, dissenting.

I concur so entirely in the general views expressed by Mr. Justice WHITE in reference to the questions disposed of by the *653 opinion and judgment of the majority, that I will do no more than indicate, without argument, the conclusions reached by me after much consideration. Those conclusions are:

1. Giving due effect to the statutory provision that 'no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court' (Rev. St. § 3224), the decree

below dismissing the bill should be affirmed. As the Farmers' Loan & Trust Company could not itself maintain a suit to restrain either the assessment or collection of the tax imposed by the act of congress, the maintenance of a suit by a stockholder to restrain that corporation and its directors from voluntarily paying such tax would tend to defeat the manifest object of the statute, and be an evasion of its provisions. Congress intended to forbid the issuing of any process that would interfere in any wise with the prompt collection of the taxes imposed. The present suits are mere devices to strike down a general revenue law by decrees, to which neither the government nor any officer of the United States could be rightfully made parties of record.

2. Upon principle, and under the doctrines announced by this court in numerous cases, a duty upon the gains, profits, and income derived from the rents of land is not a 'direct' tax on such land within the meaning of the constitutional provisions requiring capitation or other direct taxes to be apportioned among the several states according to their respective numbers, determined in the mode prescribed by that instrument. Such a duty may be imposed by congress without apportioning the same among the states according to population.

3. While property, and the gains, profits, and income derived from property, belonging to private corporations and individuals, are subjects of taxation for the purpose of paying the debts and providing for the common defense and the general welfare of the United States, the instrumentalities employed by the states in execution of their powers are not subjects of taxation by the general government, any more than the instrumentalities of the United States are the subjects of taxation by the states; and any tax imposed directly upon interest derived from bonds issued by a municipal corporation ***654** for public purposes, under the authority of the state whose instrumentality it is, is a burden upon the exercise of the powers of that corporation which only the state creating it may impose. In such a case it is immaterial to inquire whether the tax is, in its nature or by its operation, a direct or an indirect tax; for the instrumentalities of the states—among which, as is well settled, are municipal corporations, exercising powers and holding property for the benefit of the public—are not subjects of national taxation in any form or for any purpose, while the property of private corporations and of individuals is subject to taxation by the general government for national purposes. So it has been frequently adjudged, and the question is no longer an open one in this court.

Upon the several questions about which the members of this court are equally divided in opinion, I deem it appropriate to withhold any expression of my views, because the opinion of the chief justice is silent in regard to those questions.

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EXHIBIT 4

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108 S.Ct. 1355
485 U.S. 505, 108 S.Ct. 1355, 99 L.Ed.2d 592, 61 A.F.T.R.2d 88-995, 56 USLW 4311, 88-1 USTC P 9284
(Cite as: 485 U.S. 505, 108 S.Ct. 1355)

Supreme Court of the United States
State of SOUTH CAROLINA, Plaintiff
v.
James A. BAKER, III, Secretary of the Treasury of the United States.

No. 94, Orig.
Argued Dec. 7, 1987.
Decided April 20, 1988.
Rehearing Denied June 13, 1988.
See 486 U.S. 1062, 108 S.Ct. 2837.

State invoked Supreme Court's original jurisdiction to challenge constitutionality of Internal Revenue Code provision denying federal income tax exemption for interest earned on unregistered long-term state and local government bonds. On state's exceptions to findings of special master in favor of Secretary of Treasury, the Supreme Court, Justice Brennan, held that: (1) statute does not violate Tenth Amendment, and (2) state bond interest is not immune from nondiscriminatory federal tax.

Exceptions overruled; judgment entered for defendant.

Justice Stevens concurred and filed opinion.

Justice Scalia, concurred in part and in judgment and filed opinion.

Chief Justice Rehnquist concurred in judgment and filed opinion.

Justice O'Connor dissented and filed opinion.

Justice Kennedy took no part in consideration or decision of case.

West Headnotes

[1] Internal Revenue 220 ⚿3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and Statutory Provisions. Most Cited Cases

States 360 ⚿4.16(2)

360 States
360I Political Status and Relations
360I(A) In General
360k4.16 Powers of United States and Infringement on State Powers
360k4.16(2) k. Federal Laws Invading State Powers. Most Cited Cases
(Formerly 360k4.17)

Tax code provision denying federal income tax exemption for unregistered state and local government bonds does not violate Tenth Amendment, even if treated as directly regulating states by prohibiting outright issuance of bearer bonds, absent evidence that states were deprived of right to participate in national political process; allegation that code provision was passed by "uninformed Congress relying on incomplete information" was insufficient to state Tenth Amendment claim. U.S.C.A. Const.Amend. 10; 26 U.S.C.A. § 103 (j)(1).

[2] Internal Revenue 220 ⚿3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and Statutory Provisions. Most Cited Cases

Tax code provision denying exemption to unregistered long-term state and local government bonds does not unconstitutionally require states to authorize bond registration and administer registration scheme; provision regulates state activities, rather than seeking to control or influence manner in which state regulates private parties. U.S.C.A. Const.Amend. 10; 26 U.S.C.A. § 103(j)(1).

[3] Internal Revenue 220 ⚿3003

220 Internal Revenue
220I Nature and Extent of Taxing Power in General
220I(A) In General
220k3003 k. Power to Tax and Regulate in General. Most Cited Cases

Taxation 371 ⚿2006

371 Taxation
371I In General
371k2004 Power of State
371k2006 k. United States Entities, Property, and Securities. Most Cited Cases
(Formerly 371k7, 371k5)

Taxation 371 ⚿3410

371 Taxation
371VIII Income Taxes
371VIII(A) In General
371k3404 Power to Impose
371k3410 k. Income from Bonds or Other Securities or Obligations of United States. Most Cited Cases
(Formerly 371k938)

States can never tax United States directly but can tax any private parties with whom it does business, even though financial burden falls on United States, as long as tax does not discriminate against United States or those with whom it deals; rule with respect to state tax immunity is essentially the same, except that at least some nondiscriminatory federal taxes can be collected directly from states even though parallel state tax could not be collected directly from federal government.

[4] Internal Revenue 220 ⚿3132.20

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3132 Interest Received
220k3132.20 k. Imputed or Unstated Interest. Most Cited Cases

State bond interest is not immune from nondiscriminatory federal tax; overruling *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759. U.S.C.A. Const.Amend. 16.

[5] Internal Revenue 220 ⚿3111

220 Internal Revenue
220V Income Taxes
220V(D) Incomes Taxable in General
220k3111 k. Constitutional and Statutory Provisions. Most Cited Cases

Taxation 371 ⚿2001

371 Taxation
371I In General
371k2001 k. Nature of Taxes. Most Cited Cases
(Formerly 371k1)

Internal Revenue Code provision imposing federal income tax liability on interest from unregistered bonds does not unconstitutionally tax or discriminate against states; any increased administrative costs incurred by states in implementing registration system are not "taxes" within meaning of tax immunity doctrine, and provision requires all publicly offered long-term bonds to be issued in registered form, whether issued by state or local governments, federal government, or private corporations. U.S.C.A. Const.Amend. 10; Tax Equity and Fiscal Responsibility Act of 1982, § 310, 96 Stat. 324.

****1356** Syllabus [FN*]

FN* The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U.S. 321, 337, 26 S.Ct. 282, 287, 50 L.Ed. 499.

***505** Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 removes ****1357** the federal income tax exemption for interest earned on publicly offered long-term bonds

(hereinafter referred to as bonds) issued by state and local governments (hereinafter referred to collectively as States) unless those bonds are issued in registered (as opposed to bearer) form. South Carolina invoked this Court's original jurisdiction, contending that § 310(b)(1) is constitutionally invalid under the Tenth Amendment and the doctrine of intergovernmental tax immunity. A Special Master was appointed. After conducting hearings and taking evidence, he concluded that § 310(b)(1) is constitutional and recommended entering judgment for the defendant. South Carolina and the National Governors' Association (NGA), as an intervenor, filed exceptions to various factual findings of the Master and to his legal conclusions concerning their constitutional challenges.

Held:

1. Section 310(b)(1) does not violate the Tenth Amendment or constitutional principles of federalism by effectively compelling States to issue bonds in registered form. Pp. 1360-1362.

(a) The Tenth Amendment limits on Congress' authority to regulate state activities are structural, not substantive-that is, the States must find their protection from congressional regulation through the national political process, not through judicially defined spheres of unregulable state activity. In this case, South Carolina has not even alleged that it was deprived of any right to participate in the national political process or that it was singled out in a way that left it politically isolated and powerless. The allegations South Carolina does make-that Congress was uninformed and chose an ineffective remedy-do not amount to an allegation that the political process operated in a defective manner. Pp. 1361.

(b) NGA's contention that § 310 is invalid because it commandeers the state legislative and administrative process by coercing States into enacting legislation authorizing bond registration and into administering the registration scheme finds no support in the claim left open by *FERC v. Mississippi,* 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532 (1982). Section 310 regulates state activities; it does not, as did the statute in *FERC,* seek to control or influence the ***506** manner in which States regulate private parties. That a State wishing to engage in certain activity must take administrative and sometimes legislative action to comply with federal standards regulating that activity is a commonplace that presents no constitutional defect. Moreover, under NGA's theory, any State could immunize its activities from federal regulation by simply codifying the manner in which it engages in those activities. Pp. 1361-1362.

2. Section 310(b)(1) does not violate the doctrine of intergovernmental tax immunity by taxing the interest earned on unregistered state bonds. Section 310(b)(1) is inconsistent with this Court's holding in *Pollock v. Farmers' Loan & Trust Co.,* 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895), that state bond interest was immune from a nondiscriminatory federal tax, but that decision has been effectively overruled by subsequent case law. Under the intergovernmental tax immunity jurisprudence prevailing at *Pollock* 's time, neither the Federal nor the State Governments could tax income that an individual directly derived from *any* contract with the other government. This general rule was based on the rationale that any tax on income a party received under a contract with the government was a tax on the contract and thus a tax "on" the government because it burdened the government's power to enter into the contract. That rationale has been repudiated by modern intergovernmental tax immunity case law, and the government contract immunities have been, one by one, overruled. The owners of state bonds have no constitutional entitlement not to pay taxes on income they earn from the bonds, and States have no constitutional ****1358** entitlement to issue bonds paying lower interest rates than other issuers. The nondiscriminatory tax under § 310 is imposed on and collected from bondholders, not States, and any increased administrative costs incurred by States in implementing the registration system are not "taxes" within the mean-

ing of the tax immunity doctrine. Moreover, the provisions of § 310 seek to assure that *all* publicly offered long-term bonds are issued in registered form, whether issued by state or local governments, the Federal Government, or private corporations. Pp. 1362.

Exceptions to Special Master's Report overruled, and judgment entered for defendant.

BRENNAN, J., delivered the opinion of the Court, in which WHITE, MARSHALL, BLACKMUN, and STEVENS, JJ., joined, and in which SCALIA, J., joined except for Part II. STEVENS, J., filed a concurring opinion, *post,* p. ----. SCALIA, J., filed an opinion concurring in part and concurring in the judgment, *post,* p. ----. REHNQUIST, C.J., filed an opinion concurring in the judgment, *post,* p. ----. O'CONNOR, J., filed a dissenting opinion, *post,* p. ----. KENNEDY, J., took no part in the consideration or decision of the case.

***507** *John P. Linton* argued the cause for plaintiff. With him on the brief were *Charlton deSaussure, Jr., T. Travis Medlock,* Attorney General of South Carolina, *Frank K. Sloan,* Chief Deputy Attorney General, and *Grady L. Patterson III.*

Lewis B. Kaden argued the cause for plaintiff-in-intervention National Governors' Association. With him on the briefs were *James D. Liss, Barry Friedman,* and *Richard B. Geltman.*

Solicitor General Fried argued the cause for defendant. With him on the brief were *Acting Assistant Attorney General Durney, Deputy Solicitor General Lauber, Andrew J. Pincus, Michael L. Paup,* and *Francis M. Allegra.**

* Briefs of *amici curiae* were filed for the Commonwealth of Pennsylvania et al. by *LeRoy S. Zimmerman,* Attorney General of Pennsylvania, *Michael A. Roman,* Deputy Attorney General, and *Suellen M. Wolfe,* Chief Deputy Attorney General, and by the Attorneys General for their respective States as follows: *Grace Berg Schaible* of Alaska, *Robert K. Corbin* of Arizona, *Robert Butterworth* of Florida, *Warren Price III* of Hawaii, *Linley E. Pearson* of Indiana, *Thomas J. Miller* of Iowa, *William J. Guste, Jr.,* of Louisiana, *J. Joseph Curran, Jr.,* of Maryland, *Edwin L. Pittman* of Mississippi, *William L. Webster* of Missouri, *Mike Greely* of Montana, *Stephen E. Merrill* of New Hampshire, *W. Cary Edwards* of New Jersey, *Lacy H. Thornburg* of North Carolina, *Nicholas Spaeth* of North Dakota, *Anthony J. Celebrezze, Jr.,* of Ohio, *Robert Henry* of Oklahoma, *Jeffrey Amestoy* of Vermont, *Mary Sue Terry* of Virginia, *Charlie Brown* of West Virginia, *Donald J. Hanaway* of Wisconsin, and *Joseph B. Meyer* of Wyoming; for the Government Finance Officers Association by *John J. Keohane* and *Donald J. Robinson;* and for the Public Securities Association by *Glenn M. Young, Paul E. Gutermann,* and *Joseph R. Cortese.*

Justice BRENNAN delivered the opinion of the Court.

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Pub.L. 97-248, 96 Stat. 596, 26 U.S.C. § 103(j)(1), removes the federal income tax exemption for interest earned on publicly offered long-term bonds issued by state and local governments unless those bonds are ***508** issued in registered form.[FN1] This original jurisdiction case presents the issues whether § 310(b)(1) of TEFRA either (1) violates the Tenth Amendment and constitutional principles of federalism by compelling States to issue bonds in registered form or (2) violates the doctrine of intergovernmental tax immunity by taxing the interest earned on unregistered state bonds.

> FN1. For simplicity, we will refer to state and local governments collectively as "States" and will refer to publicly offered long-term bonds as "bonds."

I

Historically, bonds have been issued as either registered bonds or bearer bonds. These two types of bonds differ in the mechanisms used for transfer-

ring ownership and making payments. Ownership of a registered bond is recorded on a central list, and a transfer of record ownership requires entering the change on that list.[FN2] The record owner automatically receives interest payments by check or electronic transfer of funds from the issuer's paying agent. Ownership of a bearer bond, in contrast, is presumed from possession and is transferred by physically handing over the bond. The bondowner obtains interest payments by presenting bond coupons to a bank that in turn presents the coupons to the issuer's paying agent.

> FN2. The record owner of a registered bond may sometimes differ, however, from the beneficial owner, and sellers can transfer beneficial ownership of most types of registered bonds without entering a change on the central list.

In 1982, Congress enacted TEFRA, which contains a variety of provisions, including § 310, designed to reduce the federal deficit by promoting compliance with the tax laws. Congress had become concerned**1359 about the growing magnitude of tax evasion; Internal Revenue Service (IRS) studies indicated that unreported income had grown from an estimated range of $31.1 billion to $32.2 billion in 1973 to a range of $93.3 billion to $97 billion in 1981. Compliance Gap: Hearing before the Subcommittee on Oversight of the Internal *509 Revenue Service of the Senate Committee on Finance, 97th Cong., 2d Sess., 126 (1982). Unregistered bonds apparently became a focus of attention because they left no paper trail and thus facilitated tax evasion. Then Assistant Secretary of the Treasury for Tax Policy John Chapoton testified before the House Ways and Means Committee that a registration requirement would help prevent tax evasion because bearer bonds often represent unreported and untaxed income that, without a system of recorded ownership, the IRS has difficulty reconstructing. Hearings on H.R. 6300 before the House Committee on Ways and Means, 97th Cong., 2d Sess., 35 (1982). He also expressed concern that bearer bonds were being used to avoid estate and gift taxes and as a medium of exchange in the illegal sector. *Ibid.* In reporting out the bill containing the provision that eventually became § 310 of TEFRA, the Senate Finance Committee Report expressed the same concerns:

> "The committee believes that a fair and efficient system of information reporting and withholding cannot be achieved with respect to interest-bearing obligations as long as a significant volume of long-term bearer instruments is issued. A system of book-entry registration will preserve the liquidity of obligations while requiring the creation of ownership records that can produce useful information reports with respect to both the payment of interest and the sale of obligations prior to maturity through brokers. Furthermore, registration will reduce the ability of noncompliant taxpayers to conceal income and property from the reach of the income, estate, and gift taxes. Finally, the registration requirement may reduce the volume of readily negotiable substitutes for cash available to persons engaged in illegal activities." S.Rep. No. 97-494, Vol. 1, p. 242 (1982), U.S.Code Cong. & Admin.News 1982, pp. 781, 995.

Section 310 was designed to meet these concerns by providing powerful incentives to issue bonds in registered form.

*510 Because § 310 aims to address the tax evasion concerns posed generally by unregistered bonds, it covers not only state bonds but also bonds issued by the United States and private corporations. Section 310(a) requires the United States to issue publicly offered bonds with a maturity of more than one year in registered form.[FN3] With respect to similar bonds issued by private corporations, §§ 310(b)(2)-(6) impose a series of tax penalties on nonregistration. Corporations declining to issue the covered bonds in registered form lose tax deductions and adjustments for interest paid on the bonds, §§ 310(b)(2) and (3), and must pay a special excise tax on the bond principal, § 310(b)(4). Hold-

ers of these unregistered corporate bonds generally cannot deduct capital losses or claim capital-gain treatment for any losses or gains sustained on the bonds. §§ 310(b)(5) and (6). Section 310(b)(1) completes this statutory scheme by denying the federal income tax exemption for interest earned on state bonds to owners of long-term publicly offered state bonds that are not issued in registered form.

> FN3. Section 310 also provides various special exceptions to the registration requirements and incentives provided under subsections (a) and (b) for long-term publicly offered bonds issued by private corporations and Federal and State Governments, but those exceptions are not relevant here.

South Carolina invoked the original jurisdiction of this Court, contending that § 310(b)(1) is constitutionally invalid under the Tenth Amendment and the doctrine of **1360 intergovernmental tax immunity. We granted South Carolina leave to file the instant complaint against the Secretary of the Treasury of the United States, *South Carolina v. Regan,* 465 U.S. 367, 104 S.Ct. 1107, 79 L.Ed.2d 372 (1984), and appointed as Special Master the Honorable Samuel J. Roberts, 466 U.S. 948, 104 S.Ct. 2148, 80 L.Ed.2d 535 (1984). The National Governors' Association (NGA) intervened.[FN4] After conducting hearings and taking evidence, the Special Master concluded that § 310(b)(1) was constitutional and recommended *511 entering judgment for the defendant. South Carolina and the NGA filed exceptions to various factual findings of the Special Master and to the Master's legal conclusions concerning their constitutional challenges.

> FN4. The Special Master's recommendation to grant the NGA's motion for leave to intervene is hereby adopted.

II

We address the claim that § 310(b)(1) violates the Tenth Amendment first. [FN5] South Carolina and the NGA contend, and the Master found, that § 310 effectively requires States to issue bonds in registered form, noting that if States issued bonds in unregistered form, competition from other nonexempt bonds would force States to increase the interest paid on state bonds by 28-35%, and that even though almost all state bonds were issued in bearer form before § 310 became effective, since then no State has issued a bearer bond. Report of Special Master 2, 23-24. South Carolina and the NGA thus argue that, for purposes of Tenth Amendment analysis, we must treat § 310 as if it simply banned bearer bonds altogether without giving States the option to issue nonexempt bearer bonds. The Secretary does not dispute the finding that § 310 effectively requires registration, see Brief for Defendant 19 (urging the Court to adopt all the Master's findings), preferring to argue that § 310 survives Tenth Amendment scrutiny because a blanket prohibition by Congress on the issuance of bearer bonds can apply to States without violating the Tenth Amendment. For the purposes of Tenth Amendment analysis, then, we treat § 310 as if it directly regulated States by prohibiting outright the issuance of bearer bonds.[FN6]

> FN5. We use "the Tenth Amendment" to encompass any implied constitutional limitation on Congress' authority to regulate state activities, whether grounded in the Tenth Amendment itself or in principles of federalism derived generally from the Constitution.

> FN6. Given our holding *infra,* at ----, that a federal tax on the interest paid on state bonds does not violate the intergovernmental tax immunity doctrine, one could argue that any law exempting state bond interest from the tax applicable to interest on other bonds is, in effect, a subsidy, and that Congress' decision to subsidize only registered state bonds must be judged under our Spending Clause cases. See generally *South Dakota v. Dole,* 483 U.S. 203, 210-211, 107 S.Ct. 2793, 2797-2798, 97

L.Ed.2d 171 (1987) (stating that "a perceived Tenth Amendment limitation on congressional regulation of state affairs did not concomitantly limit the range of conditions legitimately placed on federal grants," but that at some point "the financial inducement offered by Congress might be so coercive" as to be unconstitutional). The parties have not, however, chosen to attack or defend § 310(b)(1) based on a Spending Clause theory, and we decline to address the unlitigated issues of whether Spending Clause analysis applies or what its import would be in this case.

***512** A

[1] The Tenth Amendment limits on Congress' authority to regulate state activities are set out in *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 105 S.Ct. 1005, 83 L.Ed.2d 1016 (1985). *Garcia* holds that the limits are structural, not substantive-*i.e.,* that States must find their protection from congressional regulation through the national political process, not through judicially defined spheres of unregulable state activity. ****1361***Id.,* at 537-554, 105 S.Ct., at 1010-1019. South Carolina contends that the political process failed here because Congress had no concrete evidence quantifying the tax evasion attributable to unregistered state bonds and relied instead on anecdotal evidence that taxpayers have concealed taxable income using bearer bonds. It also argues that Congress chose an ineffective remedy by requiring registration because most bond sales are handled by brokers who must file information reports regardless of the form of the bond and because beneficial ownership of registered bonds need not necessarily be recorded.

Although *Garcia* left open the possibility that some extraordinary defects in the national political process might render congressional regulation of state activities invalid under the Tenth Amendment, the Court in *Garcia* had no occasion to identify or define the defects that might lead to such invalidation. See *id.,* at 556, 105 S.Ct., at 1020. Nor do we attempt any definitive articulation here. It suffices to observe that South ***513** Carolina has not even alleged that it was deprived of any right to participate in the national political process or that it was singled out in a way that left it politically isolated and powerless. Cf. *United States v. Carolene Products Co.,* 304 U.S. 144, 152, n. 4, 58 S.Ct. 778, 783, n. 4, 82 L.Ed. 1234 (1938). Rather, South Carolina argues that the political process failed here because § 310(b)(1) was "imposed by the vote of an uninformed Congress relying upon incomplete information." Brief for Plaintiff 101. [FN7] But nothing in *Garcia* or the Tenth Amendment authorizes courts to second-guess the substantive basis for congressional legislation. Cf. *Minnesota v. Clover Leaf Creamery Co.,* 449 U.S. 456, 464, 101 S.Ct. 715, 724, 66 L.Ed.2d 659 (1981). Where, as here, the national political *process* did not operate in a defective manner, the Tenth Amendment is not implicated.

FN7. South Carolina also filed a number of exceptions to the Master's findings that the registration requirement imposed little financial or administrative burden on States and had little effect on States' ability to raise capital. These exceptions, and the NGA's exception to the Master's failure to find an interest rate differential between registered and bearer bonds, raise no issue concerning the operation of the national political process, and we need not address them here.

B

[2] The NGA argues that § 310 is invalid because it commandeers the state legislative and administrative process by coercing States into enacting legislation authorizing bond registration and into administering the registration scheme. They cite *FERC v. Mississippi,* 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532 (1982), which left open the possibility that the Tenth Amendment might set some limits on Congress' power to compel States to regulate

on behalf of federal interests, *id.,* at 761-764, 102 S.Ct., at 2138-2140. The extent to which the Tenth Amendment claim left open in *FERC* survives *Garcia* or poses constitutional limitations independent of those discussed in *Garcia* is far from clear. We need not, however, address that issue because we find the claim discussed in *FERC* inapplicable to § 310.

514** The federal statute at issue in *FERC* required state utility commissions to do the following: (1) adjudicate and enforce federal standards, (2) either consider adopting certain federal standards or cease regulating public utilities, and (3) follow certain procedures. The Court in *FERC* first distinguished *National League of Cities v. Usery,* 426 U.S. 833, 96 S.Ct. 2465, 49 L.Ed.2d 245 (1976), noting that the statute in *National League of Cities* presented questions concerning "the extent to which state sovereignty shields the States from generally applicable federal regulations," whereas the statute in *FERC* "attempts to use state regulatory machinery to advance federal goals." ****1362FERC,* 456 U.S., at 759, 102 S.Ct., at 2137. The Court in *FERC* then concluded that, whatever constitutional limitations might exist on the federal power to compel state regulatory activity, Congress had the power to require that state adjudicative bodies adjudicate federal issues and to require that States regulating in a pre-emptible field consider suggested federal standards and follow federally mandated procedures. *Id.,* at 759-767, 102 S.Ct., at 2137-2142 .

Because, by hypothesis, § 310 effectively prohibits issuing unregistered bonds, it presents the very situation *FERC* distinguished from a commandeering of state regulatory machinery: the extent to which the Tenth Amendment "shields the States from generally applicable federal regulations." 456 U.S., at 759, 102 S.Ct., at 2137. Section 310 regulates state activities; it does not, as did the statute in *FERC,* seek to control or influence the manner in which States regulate private parties. The NGA nonetheless contends that § 310 has commandeered the state legislative and administrative process because many state legislatures had to amend a substantial number of statutes in order to issue bonds in registered form and because state officials had to devote substantial effort to determine how best to implement a registered bond system. Such "commandeering" is, however, an inevitable consequence of regulating a state activity. Any federal regulation demands compliance. That a State wishing to engage in certain***515** activity must take administrative and sometimes legislative action to comply with federal standards regulating that activity is a commonplace that presents no constitutional defect. After *Garcia,* for example, several States and municipalities had to take administrative and legislative action to alter the employment practices or raise the funds necessary to comply with the wage and overtime provisions of the Federal Labor Standards Act.[FN8] Indeed, even the pre-*Garcia* line of Tenth Amendment cases recognized that Congress could constitutionally impose federal requirements on States that States could meet only by amending their statutes. See *EEOC v. Wyoming,* 460 U.S. 226, 253-254, and n. 2, 103 S.Ct. 1054, 1069-1070, and n. 2, 75 L.Ed.2d 18 (1983) (Burger, C.J., dissenting) (citing state statutes from over half the States that did not comply with the federal statute upheld by the Court). Under the NGA's theory, moreover, any State could immunize its activities from federal regulation by simply codifying the manner in which it engages in those activities. In short, the NGA's theory of "commandeering" would not only render *Garcia* a nullity, but would also restrict congressional regulation of state activities even more tightly than it was restricted under the now overruled *National League of Cities* line of cases. We find the theory foreclosed by precedent, and uphold the constitutionality of § 310 under the Tenth Amendment.

FN8. See generally Hearings on S. 1570 before the Subcommittee on Labor of the Senate Committee on Labor and Human Resources, 99th Cong., 1st Sess. (1985); The Impact of the Supreme Court's Garcia

Decision Upon States and Their Political Subdivisions: Hearing before the Subcommittee on Economic Goals and Intergovernmental Policy of the Joint Economic Committee, Congress of the United States, 99th Cong., 1st Sess. (1985).

III

South Carolina contends that even if a statute banning state bearer bonds entirely would be constitutional, § 310 unconstitutionally violates the doctrine of intergovernmental tax immunity because it imposes a tax on the interest earned on a state bond. We agree with South Carolina that § 310 is ***516** inconsistent with *Pollock v. Farmers' Loan & Trust Co.,* 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895), which held that any interest earned on a state bond was immune from federal taxation.

The Secretary and the Master, however, suggest that we should uphold the constitutionality of § 310 without explicitly overruling *Pollock* because § 310 does not abolish ****1363** the tax exemption for state bond interest entirely but rather taxes the interest on state bonds only if the bonds are not issued in the form Congress requires. In our view, however, this suggestion implicitly rests on a rather mischievous proposition of law. If, for example, Congress imposed a tax that applied exclusively to South Carolina and levied the tax directly on the South Carolina treasury, we would be obligated to adjudicate the constitutionality of that tax even if Congress allowed South Carolina to escape the tax by restructuring its state government in a way Congress found more to its liking. The United States cannot convert an unconstitutional tax into a constitutional one simply by making the tax conditional. Whether Congress could have imposed the condition by direct regulation is irrelevant; Congress cannot employ unconstitutional means to reach a constitutional end. Under *Pollock,* a tax on the interest income derived from any state bond was considered a direct tax on the State and thus unconstitutional. 157 U.S., at 585-586, 15 S.Ct., at 691. If this constitutional rule still applies, Congress cannot threaten to tax the interest on state bonds that do not conform to congressional dictates. We thus decline to follow a suggestion that would force us to embrace implicitly a proposition of law far more controversial than the current validity of *Pollock* 's ban on taxing state bond interest, and proceed to address whether *Pollock* should be explicitly overruled.[FN9]

FN9. The Secretary also argues that we need not reach the tax immunity issue on the ground that, because all state bonds have been issued in registered form since § 310 became effective, no federal tax on state bearer bond interest has ever actually been imposed. We see no reason, however, why South Carolina cannot bring a facial challenge to § 310 rather than an as-applied challenge.

***517** Under the intergovernmental tax immunity jurisprudence prevailing at the time, *Pollock* did not represent a unique immunity limited to income derived from state bonds. Rather, *Pollock* merely represented one application of the more general rule that neither the Federal nor the State Governments could tax income an individual directly derived from *any* contract with another government.[FN10] Not only was it unconstitutional for the Federal Government to tax a bondowner on the interest he or she received on any state bond, but it was also unconstitutional to tax a state employee on the income earned from his employment contract, *Collector v. Day,* 11 Wall. 113, 20 L.Ed. 122 (1871), to tax a lessee on income derived from lands leased from a State, *Burnet v. Coronado Oil,* 285 U.S. 393, 52 S.Ct. 443, 76 L.Ed. 815 (1932), or to impose a sales tax on proceeds a vendor derived from selling a product to a state agency, *Indian Motocycle Co. v. United States,* 283 U.S. 570, 51 S.Ct. 601, 75 L.Ed. 1277 (1931). Income derived from the same kinds of contracts with the Federal Government were likewise immune from taxation by the States. See *Weston v. City Council of Charle-*

ston, 2 Pet. 449, 7 L.Ed. 481 (1829) (federal bond interest immune from state taxation); *Dobbins v. Commissioners of Erie County,* 16 Pet. 435, 10 L.Ed. 1022 (1842) (federal employee immune from state tax on salary); *Gillespie v. Oklahoma,* 257 U.S. 501, 42 S.Ct. 171, 66 L.Ed. 338 (1922) (income derived from federal lease immune from state tax); *Panhandle Oil Co. v. Mississippi ex rel. Knox,* 277 U.S. 218, 48 S.Ct. 451, 72 L.Ed. 857 (1928) (vendor immune from sales tax on vendor's proceeds from sale to the United States). Cases concerning the tax immunity of income derived from state contracts freely cited principles established in federal tax immunity cases, and vice versa. See, ***518**1364***e.g., Coronado Oil, supra,* 285 U.S., at 398, 52 S.Ct., at 444; *Indian Motocycle, supra,* 283 U.S., at 575-579, 51 S.Ct., at 602-604; *Pollock, supra,* 157 U.S., at 586, 15 S.Ct., at 691. See generally *Indian Motocycle, supra,* 283 U.S., at 575, 51 S.Ct., at 602 (immunity of States from federal tax equal to immunity of Federal Government from state tax); *Metcalf & Eddy v. Mitchell,* 269 U.S. 514, 521-522, 46 S.Ct. 172, 173-174, 70 L.Ed. 384 (1926); *Collector v. Day, supra,* 11 Wall., at 127.

> FN10. Income indirectly derived from a contract with the government was treated differently. See, *e.g., Willcuts v. Bunn,* 282 U.S. 216, 227-230, 51 S.Ct. 125, 127-129, 75 L.Ed. 304 (1931) (constitutional to tax capital gain on sale of state bond because State not a party to the sale contract); see also *Greiner v. Lewellyn,* 258 U.S. 384, 42 S.Ct. 324, 66 L.Ed. 676 (1922) (constitutional to tax transfer of estate even though state bonds are included in determining the value of the estate).

This general rule was based on the rationale that any tax on income a party received under a contract with the government was a tax on the contract and thus a tax "on" the government because it burdened the government's power to enter into the contract. The Court in *Pollock* borrowed its reasoning directly from the decision in *Weston* exempting federal bond interest from state taxation:

> " 'The right to tax the contract to any extent, when made, must operate upon the power to borrow before it is exercised, and have a sensible influence on the contract. The extent of this influence depends on the will of a distinct government. To any extent, however inconsiderable, it is a burden on the operations of government.... The tax on government stock is thought by this court to be a tax on the contract, a tax on the [government's] power to borrow money ... and consequently to be repugnant to the Constitution.' " *Pollock, supra,* 157 U.S., at 586, 15 S.Ct., at 691, quoting *Weston, supra,* 2 Pet., at 467, 468 .

Thus, although a tax was collected from an independent private party, the tax was considered to be "on" the government because the tax burden might be passed on to it through the contract. This reasoning was used to define the basic scope of both federal and state tax immunities with respect to all types of government contracts.[FN11] See, ***519***e.g., Coronado Oil, supra,* 285 U.S., at 400-401, 52 S.Ct., at 444-445 ("Here the lease ... was an instrumentality of the State.... To tax the income of the lessee arising therefrom would amount to an imposition upon the lease itself"); *Panhandle Oil, supra,* 277 U.S., at 222, 48 S.Ct., at 452 ("It is immaterial that the seller and not the purchaser is required to ****1365** report and make payment to the State. Sale and purchase constitute a transaction by which the tax is measured and on which the burden rests"); *Gillespie, supra,* 257 U.S., at 505-506, 42 S.Ct., at 172-173 (" 'A tax upon the leases is a tax upon the power to make them ...' " (quoting *Indian Territory Illuminating Oil Co. v. Oklahoma,* 240 U.S. 522, 530, 36 S.Ct. 453, 456, 60 L.Ed. 779 (1916))). The commonality of the rationale underlying all these immunities for government contracts ***520** was highlighted by *Indian Motocycle,* 283 U.S. 570, 51 S.Ct. 601, 75 L.Ed. 1277 (1931). In that case, the Court reviewed the then current status of intergovernmental tax immunity doctrine, ob-

serving that a tax on interest earned on a state or federal bond was unconstitutional because it would burden the exercise of the government's power to borrow money and that a tax on the salary of a State or Federal Government employee was unconstitutional because it would burden the government's power to obtain the employee's services. *Id.,* 283 U.S., at 576-578, 51 S.Ct., at 603-604. It then concluded that under the same principle a sales tax imposed on a vendor for a sale to a state agency was unconstitutional because it would burden the sale transaction. *Id.,* 283 U.S., at 579, 51 S.Ct. at 604.

> FN11. The sources of the state and federal immunities are, of course, different: the state immunity arises from the constitutional structure and a concern for protecting state sovereignty whereas the federal immunity arises from the Supremacy Clause. The immunities have also differed somewhat in their underlying political theory and in their doctrinal contours. Many of this Court's opinions have suggested that the Constitution should be interpreted to confer a greater tax immunity on the Federal Government than on States because all the people of the States are represented in the Federal Government whereas all the people of the Federal Government are not represented in individual States. *Helvering v. Gerhardt,* 304 U.S. 405, 412, 58 S.Ct. 969, 971, 82 L.Ed. 1427 (1938); *McCulloch v. Maryland,* 4 Wheat. 316, 435-436, 4 L.Ed. 579 (1819); *New York v. United States,* 326 U.S. 572, 577, and n. 3, 66 S.Ct. 310, 312, and n. 3, 90 L.Ed. 326 (1946) (opinion of Frankfurter, J.). In fact, the federal tax immunity has always been greater than the States' immunity. The Federal Government, for example, possesses the power to enact statutes immunizing those with whom it deals from state taxation even if intergovernmental tax immunity doctrine would not otherwise confer an immunity. See, *e.g., Graves v. New York ex rel. O'Keefe,* 306 U.S. 466, 478, 59 S.Ct. 595, 597, 83 L.Ed. 927 (1939). The States lack any such power. Also, although the Federal Government has always enjoyed blanket immunity from any state tax considered to be "on" the Government under the prevailing methodology, the States have never enjoyed immunity from all federal taxes considered to be "on" a State. See *infra,* at 1367, and n. 14. To some, *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 105 S.Ct. 1005, 83 L.Ed.2d 1016 (1985), may suggest further limitations on state tax immunity. We need not, however, decide here the extent to which the scope of the federal and state immunities differ or the extent, if any, to which States are currently immune from direct nondiscriminatory federal taxation. It is enough for our purposes that federal and state tax immunity cases have always shared the identical methodology for determining whether a tax is "on" a government, and that this identity has persisted even though the methodology for both federal and state immunities has changed as intergovernmental tax immunity doctrine shifted into the modern era. See *Graves, supra,* 306 U.S., at 485, 59 S.Ct., at 601.

The rationale underlying *Pollock* and the general immunity for government contract income has been thoroughly repudiated by modern intergovernmental immunity caselaw. In *Graves v. New York ex rel. O'Keefe,* 306 U.S. 466, 59 S.Ct. 595, 83 L.Ed. 927 (1939), the Court announced: "The theory ... that a tax on income is legally or economically a tax on its source, is no longer tenable." *Id.,* at 480, 59 S.Ct., at 598. The Court explained:

> "So much of the burden of a nondiscriminatory general tax upon the incomes of employees of a government, state or national, as may be passed on economically to that govern-

ment, through the effect of the tax on the price level of labor or materials, is but the normal incident of the organization within the same territory of two governments, each possessing the taxing power. The burden, so far as it can be said to exist or to affect the government in any indirect or incidental way, is one which the Constitution presupposes...." *Id.,* at 487, 59 S.Ct., at 601.

See also *James v. Dravo Contracting Co.,* 302 U.S. 134, 160, 58 S.Ct. 208, 221, 82 L.Ed. 155 (1937) (the fact that a tax on a Government contractor "may increase the cost to the Government ... would not invalidate the tax"); *Helvering v. Gerhardt,* 304 U.S. 405, 424, 58 S.Ct. 969, 977, 82 L.Ed. 1427 (1938). The thoroughness with which the Court abandoned the burden theory was demonstrated most emphatically when the Court upheld a state sales tax imposed on a Government ***521** contractor even though the financial burden of the tax was entirely passed on, through a cost-plus contract, to the Federal Government. *Alabama v. King & Boozer,* 314 U.S. 1, 62 S.Ct. 43, 86 L.Ed. 3 (1941). The Court stated:

"The Government, rightly we think, disclaims any contention that the Constitution, unaided by Congressional legislation, prohibits a tax exacted from the contractors merely because it is passed on economically, by the terms of the contract or otherwise, as part of the construction cost to the Government. So far as such a nondiscriminatory state tax upon the contractor enters into the cost of the materials to the Government, that is but a normal incident of the organization within the same territory of two independent taxing sovereignties. The asserted right of the one to be free of taxation by the other does not spell immunity from paying the added costs, attributable to the taxation of those who furnish supplies to the Government and who have been granted no tax immunity. So far as a different view has prevailed, we think it no longer tenable." *Id.,* at 8-9, 62 S.Ct., at 45-46 (citations omitted).

King & Boozer thus completely foreclosed any claim that the nondiscriminatory imposition****1366** of costs on private entities that pass them on to States or the Federal Government unconstitutionally burdens state or federal functions. Subsequent cases have consistently reaffirmed the principle that a nondiscriminatory tax collected from private parties contracting with another government is constitutional even though part or all of the financial burden falls on the other government. See *Washington v. United States,* 460 U.S. 536, 540, 103 S.Ct. 1344, 1347, 75 L.Ed.2d 264 (1983); *United States v. New Mexico,* 455 U.S. 720, 734, 102 S.Ct. 1373-1382, 71 L.Ed.2d 580 (1982); *United States v. County of Fresno,* 429 U.S. 452, 460-462, and n. 9, 97 S.Ct. 699, 703-705, and n. 9 (1977); *United States v. City of Detroit,* 355 U.S. 466, 469, 78 S.Ct. 474, 476, 2 L.Ed.2d 424 (1958).

With the rationale for conferring a tax immunity on parties dealing with another government rejected, the government ***522** contract immunities recognized under prior doctrine were, one by one, eliminated. Overruling *Burnet v. Coronado Oil,* 285 U.S. 393, 52 S.Ct. 443, 76 L.Ed. 815 (1932), and *Gillespie v. Oklahoma,* 257 U.S. 501, 42 S.Ct. 171, 66 L.Ed. 338 (1922), the Court upheld the constitutionality of a federal tax on net income a corporation derived from a state lease in *Helvering v. Mountain Producers Corp.,* 303 U.S. 376, 58 S.Ct. 623, 82 L.Ed. 907 (1938). See also *Oklahoma Tax Comm'n v. Texas Co.,* 336 U.S. 342, 69 S.Ct. 561, 93 L.Ed. 721 (1949) (upholding constitutionality of state tax on gross income derived from Indian lease). Later, the Court explicitly overruled *Collector v. Day,* 11 Wall. 113, 20 L.Ed. 122 (1871), and upheld the constitutionality of a nondiscriminatory state tax on the salary of a federal employee. *Graves v. New York ex rel. O'Keefe, supra.*[FN12] And in the course of upholding a sales tax on a cost-plus Government contractor, the Court in *King & Boozer* overruled *Panhandle Oil Co. v. Mississippi ex rel. Knox,* 277 U.S. 218, 48 S.Ct. 451, 72 L.Ed. 857 (1928). See also *James, supra* (upholding state tax on gross income independent contractor received from Federal Government). The only pre-

modern tax immunity for parties to government contracts that has so far avoided being explicitly overruled is the immunity for recipients of governmental bond interest.[FN13] That this Court ***523** has yet to overrule *Pollock* explicitly, however, is explained not by any distinction between the income derived from government bonds and the income derived from other government contracts, but by the historical fact that Congress has always exempted state bond interest from taxation by statute, beginning with the very first federal income tax statute. Act of Oct. 3, 1913, ch. 16, § II(B), 38 Stat. 168.

FN12. Prior to that the Court had already confined *Collector v. Day* to its facts in *Helvering v. Gerhardt,* 304 U.S. 405, 58 S.Ct. 969, 82 L.Ed. 1427 (1938), which upheld the constitutionality of a federal tax on the salaries of state employees involved in state construction projects.

FN13. South Carolina and the Government Finance Officers Association as *amicus curiae* argue that the legislative history of the Sixteenth Amendment, which authorizes Congress to "collect taxes on incomes, from whatever source derived, without apportionment," manifests an intent to freeze into the Constitution the tax immunity for state bond interest that existed in 1913. We disagree. The legislative history merely shows that the words "from whatever source derived" of the Sixteenth Amendment were not affirmatively intended to authorize Congress to tax state bond interest or to have any other effect on which incomes were subject to federal taxation, and that the sole purpose of the Sixteenth Amendment was to remove the apportionment requirement for whichever incomes were otherwise taxable. 45 Cong.Rec. 2245-2246 (1910); *id.,* at 2539; see also *Brushaber v. Union Pacific R. Co.,* 240 U.S. 1, 17-18, 36 S.Ct. 236, 241-242, 60 L.Ed. 493 (1916). Indeed, if the Sixteenth Amendment had frozen into the Constitution all the tax immunities that existed in 1913, then most of modern intergovernmental tax immunity doctrine would be invalid.

[3] In sum, then, under current intergovernmental tax immunity doctrine the States can never tax the United States directly but can tax any private parties with whom it does business, even though the financial burden falls on the United States, as long as the tax does not discriminate against the United States or those with ****1367** whom it deals. See *Washington, supra,* 460 U.S., at 540, 103 S.Ct., at 1347; *County of Fresno, supra,* 429 U.S., at 460-463, 97 S.Ct., at 703-705; *City of Detroit, supra,* 355 U.S., at 473, 78 S.Ct., at 478; *Oklahoma Tax Comm'n, supra,* 336 U.S., at 359-364, 69 S.Ct., at 570-573. A tax is considered to be directly on the Federal Government only "when the levy falls on the United States itself, or on an agency or instrumentality so closely connected to the Government that the two cannot realistically be viewed as separate entities." *New Mexico, supra,* 455 U.S., at 735, 102 S.Ct., at 1383. The rule with respect to state tax immunity is essentially the same, see, *e.g., Graves, supra,* 306 U.S., at 485, 59 S.Ct., at 600; *Mountain Producers Corp., supra,* 303 U.S., at 386-387, 58 S.Ct., at 627-628, except that at least some nondiscriminatory federal taxes can be collected directly from the States even though a parallel state tax could not be collected directly from the Federal Government.[FN14] See generally n. 11, *supra.*

FN14. All federal activities are immune from direct state taxation, see *Graves,* 306 U.S., at 477, 59 S.Ct., at 596, but at least some state activities have always been subject to direct federal taxation. For a time, only the States' governmental, as opposed to proprietary, activities enjoyed tax immunity, see *e.g., Helvering v. Powers,* 293 U.S. 214, 227, 55 S.Ct. 171, 174, 79 L.Ed. 291 (1934); *South Carolina v. United*

States, 199 U.S. 437, 454-463, 26 S.Ct. 110, 113-117, 50 L.Ed. 261 (1905), but this distinction was subsequently abandoned as untenable by all eight Justices participating in *New York v. United States,* 326 U.S. 572, 66 S.Ct. 310, 90 L.Ed. 326 (1946). See *id.,* at 579-581, 583, 66 S.Ct., at 313-314, 315 (opinion of Frankfurter, J., joined by Rutledge, J.); *id.,* at 586, 66 S.Ct., at 316 (Stone, C.J., concurring, joined by Reed, Murphy and Burton, JJ.); *id.,* at 591, 66 S.Ct., at 318 (Douglas, J., dissenting, joined by Black, J.). Two Justices reasoned that any nondiscriminatory tax on a State was constitutional, even if directly collected from the State. See *id.,* at 582-584, 66 S.Ct., at 314-315 (Frankfurter, J., joined by Rutledge, J.). Four other Justices declined to hold that every nondiscriminatory tax levied directly on a State would be constitutional because "there may be non-discriminatory taxes which, *when laid on a State,* would nevertheless impair the sovereign status of the State quite as much as a like tax imposed by a State on property or activities of the national government. *Mayo v. United States,* 319 U.S. 441, 447-448, 63 S.Ct. 1137, 1140-1141, 87 L.Ed. 1504 (1943). This is not because the tax can be regarded as discriminatory but *because a sovereign government is the taxpayer,* and the tax, even though non-discriminatory, may be regarded as infringing its sovereignty." 326 U.S., at 587, 66 S.Ct., at 316 (Stone, C.J., concurring, joined by Reed, Murphy, and Burton, JJ.) (emphasis added) (the cited discussion from *Mayo* stressed the difference between levying a tax on a government and on those with whom the government deals); see also 326 U.S., at 588, 66 S.Ct., at 317 ("Only when and because the subject of taxation is State property or a State activity must we consider whether such a nondiscriminatory tax unduly interferes with the performance of the State's functions of government"). The four Justices then concluded that the tax at issue was constitutional even though directly levied on the State because recognizing an immunity would "accomplish a withdrawal from the taxing power of the nation a subject of taxation of a nature which has been traditionally within that power from the beginning." *Ibid.* We need not concern ourselves here, however, with the extent to which, if any, States are currently immune from direct federal taxation. See n. 11, *supra.* For our purposes, the important principle *New York* reaffirms is that the issue whether a nondiscriminatory federal tax might nonetheless violate state tax immunity does not even arise unless the Federal Government seeks to collect the tax directly from a State.

[4] ***524** We thus confirm that subsequent case law has overruled the holding in *Pollock* that state bond interest is immune from a nondiscriminatory federal tax. We see no constitutional reason for treating persons who receive interest on government bonds differently than persons who receive income from other types of contracts with the government, and no tenable rationale for distinguishing the costs imposed on States by a tax on state bond interest from the costs imposed ***525** by a tax on the income from any other state contract. We stated in *Graves* that "as applied to the taxation of salaries of the employees of one government, the purpose of the immunity was not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government, whose benefits they enjoy, or to give an advantage to a government by enabling it to engage ****1368** employees at salaries lower than those paid for like services by other employers, public or private...." 306 U.S., at 483, 59 S.Ct., at 600. Likewise, the owners of state bonds have no constitutional entitlement not to pay taxes on income they earn from state bonds, and States have no constitu-

tional entitlement to issue bonds paying lower interest rates than other issuers.[FN15]

> FN15. South Carolina distinguishes the taxes by arguing that the interest paid to a State's bondholders is more essential to the maintenance of a state government than the salaries paid to employees. This strikes us as counterintuitive in fact. More importantly, the essential/nonessential distinction it invokes is exactly the type of distinction we concluded was unworkable in *Garcia,* 469 U.S., at 542-547, 105 S.Ct., at 1013-1016 (rejecting rules of state immunity turning on whether a governmental function is "essential," "governmental" versus "proprietary," "traditional," "uniquely governmental," "necessary," or "integral").
>
> " 'There is not, and there cannot be, any unchanging line of demarcation between essential and non-essential governmental functions. Many governmental functions of today have at some time in the past been non-governmental. The genius of our government provides that, within the sphere of constitutional action, the people-acting not through the courts but through their elected legislative representatives-have the power to determine as conditions demand, what services and functions the public welfare requires.' " *Id.,* at 546, 105 S.Ct., at 1015, quoting *Gerhardt,* 304 U.S., at 427, 58 S.Ct., at 978 (Black, J., concurring).
>
> Similarly, Justice O'CONNOR would have us judge the constitutionality of each tax imposing an indirect burden on state and local governments by determining whether the tax had "substantial" adverse effects on those governments. *Post,* at 1370-1372. We fail to see how this substantiality test distinguishes taxes on state employees' salaries. More importantly, we disagree with Justice O'CONNOR'S apparent assumption that if this Court does not undertake the open-ended and administratively daunting inquiry required by her test, we leave States at the mercy of a congressional power to destroy them via excessive taxation. *Post,* at 1371-1372. The nondiscrimination principle at the heart of modern intergovernmental tax immunity case law does not leave States unprotected from excessive federal taxation-it merely recognizes that the best safeguard against excessive taxation (and the most judicially manageable) is the requirement that the government tax in a nondiscriminatory fashion. For where a government imposes a nondiscriminatory tax, judges can term the tax "excessive" only by second-guessing the extent to which the taxing government and its people have taxed themselves, and the threat of destroying another government can be realized only if the taxing government is willing to impose taxes that will also destroy itself or its constituents.

***526** Indeed, this Court has in effect acknowledged that a holder of a Government bond could constitutionally be taxed on bond interest in *Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392, 103 S.Ct. 692, 74 L.Ed.2d 562 (1983), which involved a state tax on federal bond interest. Although that case involved an interpretation of 31 U.S.C. § 742, we premised our statutory interpretation on the observation that "[o]ur decisions have treated § 742 as principally a restatement of the constitutional rule." 459 U.S., at 397, 103 S.Ct., at 695. We then stated: "Where, *as here,* the economic but not the legal incidence of the tax falls upon the Federal Government, such a tax generally does not violate the constitutional immunity if it does not discriminate against holders of federal property or those with whom the Federal Government deals."

Ibid. (emphasis added).

[5] TEFRA § 310 thus clearly imposes no direct tax on the States. The tax is imposed on and collected from bondholders, not States, and any increased administrative costs incurred by States in implementing the registration system are not "taxes" within the meaning of the tax immunity doctrine. See generally *United States v. Mississippi Tax Comm'n,* 421 U.S. 599, 606, 95 S.Ct. 1872, 1877, 44 L.Ed.2d 404 (1975) (describing tax as an enforced contribution to provide for the support of government). Nor does § 310 discriminate against States. The provisions of § 310 seek to assure that *all* publicly offered long-term bonds are issued in registered form, whether issued by state or local ***527** governments, the Federal Government, or private corporations. See *supra,* at ----. Accordingly, the Federal Government has directly imposed the same registration requirement on itself that it has ****1369** effectively imposed on States. The incentives States have to switch to registered bonds are necessarily different than those of corporate bond issuers because only state bonds enjoy any exemption from the federal tax on bond interest, but the sanctions for issuing unregistered corporate bonds are comparably severe. See *ibid.* Removing the tax exemption for interest earned on state bonds would not, moreover, create a discrimination between state and corporate bonds since corporate bond interest is already subject to federal tax.

IV

Because the federal imposition of a bond registration requirement on States does not violate the Tenth Amendment and because a nondiscriminatory federal tax on the interest earned on state bonds does not violate the intergovernmental tax immunity doctrine, we uphold the constitutionality of § 310(b)(1),[FN16] overrule the exceptions to the Special Master's Report, and approve his recommendation to enter judgment for the defendant.

> FN16. Because we hold that Congress could have prohibited States from issuing any unregistered bonds by direct regulation, we necessarily reject South Carolina's argument that § 310(b)(1) is an impermissible regulatory tax because it imposes a tax on activities not subject to federal regulatory power. That § 310(b) is purely regulatory in purpose and effect and was never intended to raise any federal revenue does not alone render it unconstitutional. See *Minor v. United States,* 396 U.S. 87, 98, n. 13, 90 S.Ct. 284, 289, n. 13, 24 L.Ed.2d 283 (1969).

It is so ordered.

Justice KENNEDY took no part in the consideration or decision of this case.

Justice STEVENS, concurring.

Although the Court properly finds support for its holding in *Garcia v. San Antonio Metropolitan Transit Authority,* ***528** 469 U.S. 528, 105 S.Ct. 1005, 83 L.Ed.2d 1016 (1985), the outcome of this case was equally clear well before that case was decided. See *South Carolina v. Regan,* 465 U.S. 367, 403-419, 104 S.Ct. 1107, 1127-1136, 79 L.Ed.2d 372 (1984) (STEVENS, J., concurring in part and dissenting in part). It should be emphasized, however, that neither the Court's decision today, nor what I have written in the past, expresses any opinion about the wisdom of taxing the interest on bonds issued by state or local governments.

Justice SCALIA, concurring in part and concurring in the judgment.

I join in the Court's judgment, and in its opinion except for Part II. I do not join the latter because, as observed by THE CHIEF JUSTICE, *post,* at 1370, it unnecessarily casts doubt upon *FERC v. Mississippi,* 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532 (1982), and because it misdescribes the holding in *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 105 S.Ct. 1005, 83 L.Ed.2d 1016 (1985). I do not read *Garcia* as adopting-in fact I read it as explicitly disclaiming-the proposition attributed to it in today's opinion, *ante,* at 1360, that the "national political process" is the States' only constitutional protection, and that noth-

ing except the demonstration of "some extraordinary defects" in the operation of that process can justify judicial relief. We said in *Garcia:* "These cases do not require us to identify or define what affirmative limits *the constitutional structure* might impose on federal action affecting the States under the Commerce Clause. See *Coyle v. Oklahoma,* 221 U.S. 559 [31 S.Ct. 688, 55 L.Ed.2d 853] (1911)." 469 U.S., at 556, 105 S.Ct., at 1020 (emphasis added). I agree only that that structure does not prohibit what the Federal Government has done here.

Chief Justice REHNQUIST, concurring in the judgment.

Today the Court reaches two results regarding § 310(b)(1) of TEFRA that I believe are analytically distinct. First, the Court finds that § 310(b)(1) does not violate the Tenth Amendment by compelling ****1370** States to issue bonds in registered form. Second, the majority concludes that the statute ***529** also does not contravene the doctrine of intergovernmental tax immunity; in doing so, the majority overrules our decision in *Pollock v. Farmers' Loan & Trust Co.,* 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895). While I agree that the principles of intergovernmental tax immunity are not threatened in this case, in my view the Court unnecessarily casts doubt on the protective scope of the Tenth Amendment in the course of upholding § 310(b)(1).

The Special Master appointed by the Court made a number of factual determinations about the impact that the TEFRA registration requirements would have upon the States. Most notably, the Special Master found that the registration requirements have had no substantive effect on the abilities of States to raise debt capital, on the political processes by which States decide to issue debt, or on the power of the States to choose the purpose to which they will dedicate the proceeds of their tax-exempt borrowing. After an exhaustive investigation, the Special Master summarized: "TEFRA has not changed how much the States borrow, for what purposes they borrow, how they decide to borrow, or any other obviously important aspect of the borrowing process." Report of Special Master 118.

This well-supported conclusion that § 310(b)(1) has had a *de minimis* impact on the States should end, rather than begin, the Court's constitutional inquiry. Even the more expansive conception of the Tenth Amendment espoused in *National League of Cities v. Usery,* 426 U.S. 833, 96 S.Ct. 2465, 49 L.Ed.2d 245 (1976), recognized that only congressional action that "operate[s] to directly displace the States' freedom to structure integral operations in areas of traditional governmental functions," runs afoul of the authority granted Congress. *Id.,* at 852, 96 S.Ct., at 2474. The Special Master determined that no such displacement has occurred through the implementation of the TEFRA requirements; I see no need to go further, as the majority does, to discuss the possibility of defects in the national political process that spawned TEFRA, nor to hypothesize that the Tenth Amendment***530** concerns voiced in *FERC v. Mississippi,* 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532 (1982), may not have survived *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 105 S.Ct. 1005, 83 L.Ed.2d 1016 (1985). Those issues, intriguing as they may be, are of no moment in the present case and are best left unaddressed until clearly presen- ted.

Justice O'CONNOR, dissenting.

The Court today overrules a precedent that it has honored for nearly 100 years and expresses a willingness to cancel the constitutional immunity that traditionally has shielded the interest paid on state and local bonds from federal taxation. Henceforth the ability of state and local governments to finance their activities will depend in part on whether Congress voluntarily abstains from tapping this permissible source of additional income tax revenue. I believe that state autonomy is an important factor to be considered in reviewing the National Government's exercise of its enumerated powers. *Garcia v. San Antonio Metropolitan Transit Authority,* 469 U.S. 528, 581, 105 S.Ct. 1005, 1033, 83 L.Ed.2d 1016 (1985) (O'CONNOR, J., joined by

Powell and REHNQUIST, JJ., dissenting). I dissent from the decision to overrule *Pollock v. Farmers' Loan & Trust Co.,* 157 U.S. 429, 15 S.Ct. 673, 39 L.Ed. 759 (1895), and I would invalidate Congress' attempt to regulate the sovereign States by threatening to deprive them of this tax immunity, which would increase their dependence on the National Government.

Section 310(b)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), 26 U.S.C. § 103(j)(1), provides that the interest paid on state and local bonds will be subject to federal income tax unless the bonds are issued in registered form. The Court readily concludes that Congress could have prohibited outright the issuance **1371 of bearer bonds without violating the Tenth Amendment. *Ante,* at 1360-1361. But regardless of whether Congress could have required registration of the bonds directly under its commerce power, I agree with the Court that Congress may not accomplish the same end by an unconstitutional means. *Ante,* at 1362-1363. *531 In my view, the Tenth Amendment and principles of federalism inherent in the Constitution prohibit Congress from taxing or threatening to tax the interest paid on state and municipal bonds. It is also arguable that the States' autonomy is protected from substantial federal incursions by virtue of the Guarantee Clause of the Constitution, Art. IV, § 4. See Merritt, The Guarantee Clause and State Autonomy: Federalism for a Third Century, 88 Colum.L.Rev. 1, 70-78 (1988) (arguing that judicial enforcement of the Guarantee Clause is proper).

The Court never expressly considers whether federal taxation of state and local bond interest violates the Constitution. Instead, the majority characterizes the federal tax exemption for state and local bond interest as an aspect of intergovernmental tax immunity, and it describes the decline of the intergovernmental tax immunity doctrine in this century. But constitutional principles do not depend upon the rise or fall of particular legal doctrines. This Court has a continuing responsibility "to oversee the Federal Government's compliance with its duty to respect the legitimate interests of the States." *Garcia, supra,* 469 U.S., at 581, 105 S.Ct., at 1033 (O'CONNOR, J., joined by Powell and REHNQUIST, JJ., dissenting). In my view, the Court shirks its responsibility because it fails to inquire into the substantial adverse effects on state and local governments that would follow from federal taxation of the interest on state and local bonds.

Long-term debt obligations are an essential source of funding for state and local governments. In 1974, state and local governments issued approximately $23 billion of new municipal bonds; in 1984, they issued $102 billion of new bonds. Report of Special Master 20. State and local governments rely heavily on borrowed funds to finance education, road construction, and utilities, among other purposes. As the Court recognizes, States will have to increase the interest rates they pay on bonds by 28-35% if the interest is subject to the federal income tax. *Ante,* at 1360. Governmental operations *532 will be hindered severely if the cost of capital rises by one-third. If Congress may tax the interest paid on state and local bonds, it may strike at the very heart of state and local government activities.

In the pivotal cases which first set limits to intergovernmental tax immunity, this Court paid close attention to the practical effects of its decisions. The Court limited the government's immunity only after it determined that application of a tax would not substantially affect government operations. Thus in the first case to uphold federal income taxation of revenue earned by a state contractor, this Court observed that "neither government may destroy the other nor curtail in any substantial manner the exercise of its powers." *Metcalf & Eddy v. Mitchell,* 269 U.S. 514, 523-524, 46 S.Ct. 172, 174-175, 70 L.Ed. 384 (1926). When this Court extended its holding to the case of a state tax on a federal contractor, it expressly noted that the tax "does not interfere in any substantial way with the performance of federal functions." *James v.*

Dravo Contracting Co., 302 U.S. 134, 161, 58 S.Ct. 208, 221, 82 L.Ed. 155 (1937). In upholding the application of the federal income tax to income derived from a state lease, this Court decided that mere theoretical concerns about interference with the functions of government did not justify immunity, but that "[r]egard must be had to substance and direct effects." *Helvering v. Mountain Producers Corp.,* 303 U.S. 376, 386, 58 S.Ct. 623, 627, 82 L.Ed. 907 (1938). In *Helvering v. Gerhardt,* 304 U.S. 405, 58 S.Ct. 969, 82 L.Ed. 1427 (1938), this Court upheld the application of the federal income tax to income earned by a state employee, because there is "[no] immunity**1372 when the burden on the state is so speculative and uncertain that if allowed it would restrict the federal taxing power without affording any corresponding tangible protection to the state government." *Id.,* at 419-420, 58 S.Ct., at 974-975.

The instant case differs critically from the cases quoted above because the Special Master found that, if the interest on state and local bonds is taxed, the cost of borrowing by state and local governments would rise substantially. This ***533** certainly would affect seriously state and local government operations. The majority is unconcerned with this difference because it is satisfied with the formal test of intergovernmental tax immunity that can be distilled from later cases. Under this test, if a tax is not imposed directly on the government, and does not discriminate against the government, then it does not violate intergovernmental tax immunity. See *ante,* at 1366-1367.

I do not think the Court's bipartite test adequately accommodates the constitutional concerns raised by the prospect of applying the federal income tax to the interest paid on state and local bonds. This Court has a duty to inquire into the devastating effects that such an innovation would have on state and local governments. Although Congress has taken a relatively less burdensome step in subjecting only income from bearer bonds to federal taxation, the erosion of state sovereignty is likely to occur a step at a time. "If there is any danger, it lies in the tyranny of small decisions-in the prospect that Congress will nibble away at state sovereignty, bit by bit, until someday essentially nothing is left but a gutted shell." L. Tribe, American Constitutional Law 381 (2d ed. 1988).

Federal taxation of state activities is inherently a threat to state sovereignty. As Chief Justice Marshall observed long ago, "the power to tax involves the power to destroy." *McCulloch v. Maryland,* 4 Wheat. 316, 431, 4 L.Ed. 579 (1819). Justice Holmes later qualified this principle, observing that "[t]he power to tax is not the power to destroy while this Court sits." *Panhandle Oil Co. v. Mississippi ex rel. Knox,* 277 U.S. 218, 223, 48 S.Ct. 451, 453, 72 L.Ed. 857 (1928) (Holmes, J., joined by Brandeis and Stone, JJ., dissenting). If this Court is the States' sole protector against the threat of crushing taxation, it must take seriously its responsibility to sit in judgment of federal tax initiatives. I do not think that the Court has lived up to its constitutional role in this case. The Court has failed to enforce the constitutional safeguards of state autonomy and ***534** self-sufficiency that may be found in the Tenth Amendment and the Guarantee Clause, as well as in the principles of federalism implicit in the Constitution. I respectfully dissent.

U.S.,1988.
South Carolina v. Baker
485 U.S. 505, 108 S.Ct. 1355, 99 L.Ed.2d 592, 61 A.F.T.R.2d 88-995, 56 USLW 4311, 88-1 USTC P 9284

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EXHIBIT 5

PUTNAM COUNTY
INDUSTRIAL DEVELOPMENT AGENCY

For Additional Information or
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General information with respect to the participants, costs and advantages of **bond** and "**straight lease**" financing is as follows:

BOND FINANCING

ISSUER: PUTNAM COUNTY INDUSTRIAL DEVELOPMENT AGENCY ("PCIDA") (hereinafter "Issuer"). PCIDA coordinates and administers such financing for the County of Putnam. To a limited degree the Issuer assists in structuring the financing although that is principally the responsibility of the Borrower, Underwriter and Borrower's Counsel. The Issuer processes Borrower's application, adopts an inducement resolution, participates in "scoping meetings" that define the structure of the financing and negotiates the final form of the financing documents. PCIDA charges a fee at Bond closing equal to ½% of the amount of the issue for a not-for-profit borrower and 1% for a for-profit borrower.

BORROWER: AN EXISTING BUSINESS OR NOT-FOR-PROFIT ENTITY[1] OR AN ENTITY SPECIFICALLY FORMED FOR THE FINANCING TRANSACTION. Borrower will submit an Application to the Issuer, obtain a commitment for credit enhancement, if necessary, from a Participating Lender (defined below) participate in scoping meetings and document negotiations, as necessary, execute the loan and security documents, submit requisitions and receive bond proceeds to acquire, renovate and equip the project in exchange for the Borrower's promise to repay the bond debt and all expenses related to the financing and the project. The customary financing structures include a sale and leaseback (or lease and leaseback) between the Borrower and Issuer and an installment sale format in which Borrower retains title and executes a loan and note with respect to debt service and project costs.

[1] May need to use LDC due to temporary "sunset" of Not-for-Profit section on the IDA Act.

USER(S):	BORROWER AND/OR SUB-TENANTS. In a customary financing, the Borrower leases the facility from the Issuer for its own use and/or for the use of others. If other users are involved, they do so under sub-leases between Borrower and such user, such sub-leases being subject and subordinate to the Lease between the Issuer and the Borrower. If an installment sale format is utilized, Borrower leases directly to other users of the facility.
PARTICIPATING LENDER:	BANK OR INSURANCE COMPANY. Often the credit of the bonds is enhanced by the issuance of a letter of credit or the placement of insurance (although not all issues have credit enhancement, in which case the bonds are sold "non-rated" or they enjoy the same credit rating as the Borrower). The Participating Lender reviews the credit of the Borrower and, if found acceptable, issues a commitment for a letter of credit or other form of Credit Enhancement which provides the most widely-acceptable security for the bonds. The Participating Lender takes the credit risk of the Borrower. If a letter of credit is utilized, it may be a "direct pay" or "calamity" letter depending on several variables. (For a Variable Rate Demand Bond it must be a direct payment letter of credit.) Typically the Trustee for bondholders has the benefit of the first mortgage lien on the project and any other collateral that the Participating Lender deems necessary. The Participating Lender takes the mortgage and other collateral by assignment if called upon to redeem the bonds in the event of default or may be a co-mortgagee with the Trustee.
BOND TRUSTEE:	A BANK. The Issuer usually requires that the Trustee be a bank qualified to do business in the State. The Trustee holds the unexpended bond proceeds for disbursement to the Borrower as requisitions are submitted. It administers the various Bond Funds (as provided in the Trust Indenture). It also disburses payments to the Bondholders and performs additional duties as set forth in the bond documents.
UNDERWRITER/ PLACEMENT AGENT:	INVESTMENT BANKING DEPARTMENT OF AN INVESTMENT BANKING FIRM OR AN INSTITUTIONAL BANK. Unless Borrower is able to find a purchaser for the bonds on its own (which is highly unusual), bonds are usually sold through an Underwriter or a Placement Agent. The Underwriter/ Placement Agent assists the Borrower in structuring the financing, including obtaining satisfactory Credit Enhancement. It may purchase ("underwrite") the bonds from the Issuer for resale to Bondholders or it may sell ("place") the bonds directly to the Bondholders on behalf of Borrower. The Underwriter/Placement Agent is selected by the Borrower and approved by the Issuer.

BONDHOLDERS: BOND FUNDS AND/OR INVESTORS. Bondholders purchase the Bonds, the proceeds of which are deposited with the Trustee and used by the Issuer to make the loan to the Borrower. Bondholders do so in exchange for Borrower's promise of repayment through the Bond Trustee and in reliance on the promise of the Participating Lender to provide funds for repayment in the event of a default by Borrower.

BOND COUNSEL: Bond Counsel is selected by the Issuer and advises it on legal matters and project eligibility. Bond Counsel participates in scoping meetings and document negotiations, prepares the Trust Indenture, Lease Agreement or Installment Sale Agreement and all other bond financing documents. It also provides the "approving opinion" concerning bond validity and tax treatment of interest on the bonds that is relied upon by the Bondholders as well as all of the principal participants in the transaction.

STATUTORY AUTHORITY: In New York State and, therefore, for PCIDA: Article 18-A of the General Municipal Law of the State of New York, as amended.

RATES AND TERMS: Recent information provided by underwriters with whom this office has worked indicates that if this financing were to close today, taxable fixed rates would be 50-100 basis points over 10 year Treasuries for a 10 year bond or 125-200 basis points over 20 year Treasuries for a 20 year bond **with** credit enhancement. **Without** credit enhancement rates would range from 125-200 basis points over for a 10 year bond and as much as 300 basis points over for a 20-year bond. The term of the financing can be up to 40 years depending on the desires of Borrower but usually don't exceed 30 years. The length of the term would affect the rate of interest, with a longer term generally requiring a higher rate of interest. An investment bank of your choosing should be consulted for more accurate information on rates.

The chart at the end of this memorandum is a comparison of tax-exempt variable rates compared to alternative bank rates as provided by an investment bank using May 10, 2010 rates. Variable rate bond issues have been used mostly for the last decade.

COSTS AND FEES: Aggregate costs and fees will be determined by the number of principal participants in the financing transaction. Assuming all of the principal participants mentioned above, as well as their counsels, and other necessary secondary participants not mentioned above, such as Borrower's accountants and a title company, estimated costs for a PCIDA issue are generally 3-6% of principal amount of bond. Some are calculated as a percentage of the bond size; others are hourly fees.

Certain of bond financing costs would be incurred in a conventional financing. Accordingly, the Borrower should examine the incremental bond financing costs.

Aggregate costs and fees will be determined by the number of principal participants in the financing transaction. Assuming all of the principal participants mentioned above, as well as their counsels, and other necessary secondary participants not mentioned above, such as Borrower's accountants and a title company, and further assuming a (rounded) project cost of $9,000,000 (including financing and other costs listed below), estimated financing costs and fees are as follows:

Item	*Estimated Fees*	
IDA fee	$ 45,000	(not-for-profit borrower - $90,000 for a for-profit borrower)
IDA Local Counsel	10,000	
IDA Bond Counsel	60,000	
Bank Letter of Credit fee (1 %)	90,000*	
LC Bank Counsel Fee	30,000*	
Trustee fee	3,500	
Trustee Counsel fee	3,000	
Underwriter's fee	100,000	
Underwriter's Counsel fee	40,000	
Remarketing Agent fee (.10% annually if lower floater)	-0-	
Remarketing Agent Counsel fee	-0-	
Accounting fees	10,000	
Borrower's counsel- IDA Financing	75,000	
Printing of Bonds	3,000*	
Title Charges (mortgage and fee policies only)	40,000	
TOTAL	**$ 510,000**	

* These items may not be incurred if it is determined to have the bonds sold non-rated without credit enhancement as discussed above. That would reduce the above estimated costs by $123,000 and bring the above costs down to **$387,000**, approximately 4% of project costs.

Note that certain of the above costs would be incurred in a conventional financing. For instance:

1. The Underwriter's fee is analogous to a loan commitment fee.

2. The Underwriter's Counsel fee is equivalent to the lender's attorney fee.

3. Accounting fees may be incurred in a conventional financing depending on the financials required by a lender prior to loan commitment and/or closing.

financing may be closed concurrently with or subsequent to a "straight lease" closing. The Issuer's Straight-Lease Transaction Fee is determined by formula based on a percentage of benefits received by the Borrower.

Benefits that would be received as the result of closing a "straight lease" with PCIDA are as follows:

1. Sales tax savings on materials purchased and incorporated into the project.

2. 1.05% mortgage tax savings if funds are borrowed pursuant to a concurrent or subsequent mortgage financing.

3. Energy cost savings for gas and electric usage may be available to companies with respect to certain projects. An IDA "straight lease" may qualify a project for such an incentive. There is a limited amount of power available under some programs although other power may be available under the State's "Power for Jobs" program under certain circumstances.

4. Property tax abatement pursuant to a Payment in Lieu of Tax Agreement as described in the bond financing discussion above.

The parties involved in a "straight lease" transaction include the PCIDA, its local counsel, Borrower, Borrower's counsel and a title company. Since no bonds are issued in a "straight lease" transaction, there is no Participating Lender, Bond Trustee, Underwriter/Placement Agent, Bondholders, Remarketing Agent, counsels for each of these participants or Bond Counsel to the Issuer.

Estimated fees to complete a "straight lease" transaction with the PCIDA are approximately $35-75,000.

Proposed Series 2010 Financing
Conventional Bank Loan vs. Tax-Exempt Bond Cost of Funds
$9,000,000 Loan / Par Amount

Type of Structure	Net Debt Service: Commercial Bank Loan @ 6.00%	Commercial Bank Loan @ 7.00%	Commercial Bank Loan @ 8.00%	LOC Backed Tax-Exempt Variable-Rate Bond SIFMA Index @ 2.00%[1]
2011	409,333	458,333	507,333	323,000
2012	625,500	695,450	770,600	495,047
2013	628,300	698,450	773,800	493,632
2014	625,500	695,750	771,200	497,006
2015	727,400	797,700	873,200	495,044
2016	628,700	698,950	774,400	492,898
2017	629,400	699,500	769,800	495,543
2018	624,500	699,350	769,800	497,822
2019	624,300	698,500	774,000	494,765
2020	728,500	796,950	872,000	496,497
2021	626,800	699,700	769,200	492,891
2022	624,500	696,400	770,600	494,076
2023	626,600	697,400	770,800	494,896
2024	627,800	697,350	769,800	495,350
2025	728,100	796,250	872,600	495,440
2026	627,500	699,100	773,800	495,164
2027	626,000	695,550	773,400	494,524
2028	628,600	695,950	771,400	493,518
2029	625,000	699,950	772,800	497,120
2030	725,500	797,200	872,200	495,202
2031	624,800	698,050	769,600	497,892
2032	627,900	697,150	770,000	495,061
2033	624,500	699,500	773,000	496,838
2034	624,900	699,750	768,200	493,095
2035	728,800	797,900	871,000	493,959
2036	625,900	698,950	770,600	494,276
2037	626,500	697,550	772,000	494,045
2038	625,300	698,700	769,800	493,267
2039	627,300	697,050	769,000	496,914
2040	627,200	697,600	769,200	494,858
Total Net DS [2]	$19,080,933	$21,195,983	$23,375,133	$14,679,639
Max. Ann Net DS [3]	$728,800	$797,900	$873,200	$497,892
Net Present Value of DS[4]	$8,648,104	$9,605,439	$10,598,036	$6,652,309
Average Coupon	6.00%	7.00%	8.00%	2.00%
All-In TIC [5]	5.920%	6.930%	7.940%	4.050%
COI [7]	$100,000	$100,000	$100,000	$350,000

(1) Variable rate bonds backed by a rated letter of credit are priced off the SIFMA index.
The SIFMA Index is comprised of 7-day high-grade tax exempt variable rate paper. Current SIFMA Index is 0.25%.
(2) For variable rate bonds, net debt service includes Letter of Credit bank fees and remarketing fees.
(3) Maximum annual debt service from years 2011 to 2040
(4) The present value of future debt service payments at an assumed discount rate of 6.00%.
(5) The true cost of funds taking into account principal, interest, and loan/bond expenses.
(6) Takes into consideration additional refinancing costs of $100K associated with a bank loan every fifth year.
(7) Costs of issuance include fees to various counsel, underwriter's discount, rating agencies, IDA fees

EXHIBIT 6

Tax-Exempt Bonds: The Secret to Low-Cost Financing

The many advantages of using tax-exempt bonds for capital projects, long a favorite financing instrument of large institutions and government agencies, are too often overlooked, or even unknown, by many private nonprofit schools. Today more than ever, tax-exempt bonds can be especially useful and cost-effective for such schools when faced with a demonstrated need for capital funds to expand and improve their facilities to better serve their students, implement their charter purpose(s), and fulfill their educational mission.

Today, many private nonprofit schools face a financial dilemma when seeking to expand, construct, and/or equip new facilities. They can demonstrate both demand for new or improved facilities and improvement in the school's finances from such facilities. Despite that, donations from patrons, alumni, corporations, and the community, traditional sources of capital and endowment funds, have slowed, reflecting the impact of the nation's difficult economy, government cutbacks, and reduced or more narrowly focused corporate philanthropy. As a result, private schools seeking to launch a capital campaign to add needed facilities are finding that raising capital funds in a timely manner has become increasingly difficult. A planned three-year capital campaign will more likely stretch to six, seven, or more years. Further, by the time the funds are raised, an estimated $6 million or $7 million capital project may have increased to $10 million or more because of 10%–15% compounded annual cost increases. Realistically, capital campaign fundraising efforts never catch up with cost creep.

A number of private schools have found a solution to this dilemma. They have initiated the financing of their projects through low-cost, tax-exempt bonds made available through state and local bond issuers, either dovetailing them with a capital campaign or using them as a stand-alone source of capital. Over the past few years, we have worked closely with many private schools, such as the Professional Children's School in New York City, the Masters School in Dobbs Ferry, N.Y., and the Rectory School in Pomfret, Conn., that have found tax-exempt bond financing an advantageous solution to capital needs. They and many other schools have discovered that bond financing enables them to borrow funds now and move ahead quickly with the construction of needed facilities, completing and putting these facilities into service years earlier than would have been possible if they had waited to raise the funds through a traditional multiyear capital campaign.

Architectural drawing of the Masters School in Dobbs Ferry, N.Y., which recently raised $17.6 million with a triple tax-exempt issue having an initial interest rate of about 1.5%.

By Joseph P. Carlucci, Esq., and Robert C. Schneider, Esq.

Who Issues Tax-Exempt Bonds?

Tax-exempt bonds are issued by authorities or agencies created by state statutes that vary from state to state. Some bond issuers are called industrial development agencies, others development authorities, and still others health and educational facilities authorities or similar names. Although state statutes may vary from state to state, applicable provisions of the federal Internal Revenue Code (providing tax exemption from income tax) are uniformly applied throughout the country.

Bond issuers exist to provide a variety of incentives and financing assistance, including issuing bonds on behalf of borrowers, such as schools, to finance their capital projects. This type of financing is available to both nonprofit and for-profit entities. More than 1,000 such issuers are in operation across the country. Many states have created county, regional, and local city/town/village agencies to issue bonds. In New York State, for instance, there are more than 150 issuers at the county, town, and village level. In other states, such as Connecticut, the issuer operates statewide, and there are no local issuers. (The Connecticut Development Authority coordinates bond financing for for-profit businesses statewide, and the State of Connecticut Health and Education Facilities Authority issues bonds to finance capital projects for schools, hospitals, and nonprofit institutions statewide.)

The Particulars

Bond issues are not obligations of a municipality, state, or county and are not backed by municipal, state, or county taxes. Rather, bond repayment is the obligation of the borrowing school. However, the bonds are repayable at a relatively low interest rate compared with conventional rates and offer a number of other benefits. Bonds typically are issued with 10- to 30-year maturities, and the rate of interest they carry may be fixed or floating (variable). In today's low-interest-rate environment, bonds for school projects are usually issued as variable-rate bonds.

As capital market instruments, bonds customarily reflect more flexible terms and far more attractive interest rates for the borrower than comparable bank loans. Because they are tax-exempt, bonds are in great demand and are highly marketable. Further increasing their attractiveness, the interest on bonds issued on behalf of nonprofit schools is triple tax-exempt, meaning the interest earned on the bonds is exempt from federal, state, and local (e.g., New York City) income taxes, thereby making them especially desirable investments among individual and institutional purchasers in high-tax states. For example, the Masters School in Dobbs Ferry, N.Y., recently raised $17.6 million with a triple tax-exempt bond issue having an initial interest rate of approximately 1.5%.

Also worthy of noting, bond financing for schools has no geographic limitations. This type of financing is available in every state that has created issuers for the purpose of assisting schools and other nonprofits in financing cap-

As noted earlier, by working with economic development, industrial development, or heath and education bond issuers, schools have gained access to low-cost financing that has long been the province of giant institutions and government. Although the downturn in the economy may have disrupted traditional fund-raising, it has also resulted in significantly lower interest rates, including bond interest rates. Thus, schools now enjoy unparalleled, low-cost borrowing opportunities. Regardless of the state of the economy, however, tax-exempt bonds always carry a relatively lower interest cost than traditional or conventional sources of financing available through banks and insurance companies.

By working with economic development, industrial development, or heath and education bond issuers, schools have gained access to low-cost financing that has long been the province of giant institutions and government.

The customary stated goal of agencies and authorities that issue tax-exempt bonds is to encourage

- economically sound projects supporting business development and
- projects supporting the capital needs of nonprofit organizations involved in educational, cultural, recreational, or other charitable endeavors.

Limitations and Pitfalls

Fundamental to an analysis of the financial advantages available to schools through bond financing is to understand and recognize that bond financing may be used only for capital projects, not operating costs. For this reason, we routinely encourage clients to develop a five-year capital program. (We sometimes suggest the school make a five-year "wish list" that includes projects beyond what the school initially plans to finance with bonds, such as capital projects that it might be contemplating financing from cash available from operations in the next three to five years.) By including such additional projects in a bond financing, cash from operations can be used for noncapital items, whereas capital project costs, even though not planned for a few years out, are financed through bonds at the lowest interest cost and for the longest term the school would otherwise never realize.

Properly structured, money raised through a capital campaign should not be restricted to or acknowledged as having been received for "a building project." It should be designed to be flexible and not reduce or limit the amount

sue. In effect, the campaign should focus on raising funds for "purposes determined at the discretion of the board" of the school. That will give the board the flexibility to apply campaign fund receipts to redeem a portion of the bond issue (to reduce debt service) or to increase the size of the endowment or other worthwhile purposes.

Since bond proceeds can be used only for financing capital projects, identifying contributions raised through a capital campaign specifically for a construction project will result in a reduction in the size of the bond issue. This is so because IRS regulations require that amounts raised and earmarked for a "building" campaign must be applied to "building" costs, thereby reducing the bond issue at closing (or requiring early redemption of long-term bonds when the earmarked contributions are received). Accordingly, campaign receipts that must be applied to the "building" will be unavailable for the school board to apply to other important uses, such as the endowment.

An example of how the foregoing can become a problem occurred with a client that hired a fund-raising consultant whose work was ongoing while the bond financing team was working toward a bond closing. Despite clearly stated advice on campaign strategy and campaign literature, the fund-raising consultant kept issuing reports on how much had been raised each week and month "toward the construction of the dining hall and dormitory." Warning after warning was given, but the consultant was so focused on being able to say he satisfied his "goal" that he ignored the warnings. The initial determination of bond counsel was that the amount raised must reduce the size of the bond issue. The problem was "solved" by the board's decision to expand the size and scope of the building project (because it felt comfortable that it could service the debt on the original bond amount). Thus, the capital campaign funds raised in the wrong manner were offset by increased project costs, and the bond closed at its original size.

In our experience, it is not unusual for schools to think of a capital campaign first when capital needs (including increasing the size of the endowment) are identified. They may undertake a survey. Campaign coordinators will talk to community leaders regarding the viability of a campaign. Perhaps they will organize a focus group. Key donors may say yes. The fund-raisers quickly will move ahead to develop campaign materials and begin to raise money. Then, sometime during this process, a board member will become aware of the value of seeking bond financing. At that point, the school will bring in counsel experienced in bond financing and find that commitments it has already entered into or simply the wording in its campaign materials has reduced its flexibility. This can be a costly error.

One highly regarded organization launched its capital campaign (for building and endowment) and, only months later, began working with experienced counsel with the goal of borrowing significant funds through a bond issue. On examining the ongoing fund-raising activity, bond counduce the size of the proposed bond issue by $4.5 million. The campaign committee had acknowledged each gift with a letter thanking the donor and noting that the contribution or pledge "would be used for the expansion project." Each letter earmarked every dollar contributed or pledged to construction, thus the funds could not be used for endowment or other purposes. The acknowledgment letters lowered the amount of the low-cost bond financing from $14.5 million to $10 million, effectively reducing the money available for the endowment by that same amount.

Our advice to a school considering an expansion or construction of new facilities is to bring experienced borrower's counsel into the process early, before launching the capital campaign. Bringing in counsel experienced in representing borrowers in bond financings early in the fund-raising process can help avoid potentially costly problems.

In an interest rate environment where the endowment can earn more than the "all in" cost to carry the bonds, there is no financial incentive to pay down the bonds quickly. Instead, it is better to devise a plan giving the board maximum flexibility. If a capital campaign is properly designed, the board will be able to determine at the appropriate time whether to reduce the bond debt to a level with which it is comfortable, increase the endowment, or enhance educational offerings or other worthwhile projects to advance the school, its faculty, and its students.

A board that is overly ambitious in paying down bond debt can find that its strategy has backfired. Often during the time of a capital campaign, an organization's needs change: operating and/or construction costs may increase faster than expected, urgent new projects may be identified, or major equipment may need repair or replacement. Because some of these costs cannot be paid with bond proceeds, either because they don't qualify or the cost is so modest as to make an additional bond issue uneconomic, the newly identified but unexpected demand for funds can have unwanted results. They may have to come from campaign contributions (assuming operations can't fund them); they may reduce amounts available for the original project components; they may require extending the capital campaign; or they may have to be paid from the endowment, thereby having a negative effect on the school's long-term financial stability.

An example of the foregoing occurred when a school's board determined that the school would reduce the bond issue by $5 million on the fifth anniversary of the closing of a 30-year issue, which bonds were credit enhanced by a letter of credit from a rated bank. It was recommended that such board "policy" be reflected only in the credit reimbursement agreement between the school and the credit bank, in case future circumstances might lead the board to determine it imprudent to pay down $5 million, in which case the future board would have to deal only with the credit bank to modify the required paydown. At the time of the closing, the board insisted that the requirement be re-

ified in the future. Not surprisingly, four years after closing, the board decided that a $5 million payment was not in the school's best financial interests. To avoid the payment, the school was required, for tax reasons, to redeem the entire bond issue and close a new one at a significant cost that could have been avoided.

AN ADDED PLUS

In addition to reducing the time needed to raise funds to construct a capital project, experience has shown that a bond issue, in effect, acts to jump-start a capital campaign and improve the number and size of donations. Given the opportunity to visit the opening of a new facility and see it being used (or ready to be used), potential donors are impressed and moved to be part of a successful program. Everyone wants to be part of a successful project, and a finished building simply conveys a greater impact and visceral excitement than plans and sketches shown in campaign brochures.

This point was brought home to us at the opening night of an attractive new visitors' center at a historic site (used for educational purposes) in Dutchess County, N.Y. That night, we watched as a number of board members and donors who had made pledges payable over a 10-year period wrote checks for their entire pledge. We saw others, impressed by the completed facility, substantially increase their pledges.

Bond Financing—The Participants and the Process

SCHOOL

Working with experienced counsel, a school must submit an application to its local or state bond-issuing agency. In most cases, the school will also seek to obtain a commitment for credit enhancement from a bank or insurance company. Credit enhancement allows the school to access the least costly type of funds—variable-rate demand bonds. The school's senior staff, often with the help of board members and their counsel, will participate in agency meetings and document negotiations, as necessary. The school will execute the loan and security documents and, on sale of the bonds, submit requisitions for bond proceeds to acquire, construct, and equip the facility. In exchange, the school will promise to repay the bond debt and all expenses related to financing of the project.

BOND ISSUER

State or local industrial/economic development/education/health financing agencies issue bonds, acting as a financing conduit. They issue the bonds on behalf of the school, but the issuer is not liable for repayment. The bonds are not municipal obligations backed by taxes. Repayment is solely the obligation of the borrower, the school. Issuing agencies may assist in structuring the financing, but that is principally the responsibility of the school, underwriter, and borrower's counsel. The issuer processes the school's application, adopts an inducement resolution, participates in scoping meetings regarding the structure of the financing, and negotiates the final form of the financing documents.

PARTICIPATING LENDER

A critical factor for the issue to succeed is project creditworthiness. The bonds need investors who are willing to purchase them. Often, the school will need a credit enhancer, usually a bank, which will issue a letter of credit, or an insurance company, which will issue an insurance policy. In either case, it is the creditworthiness of the bank or insurance company that ensures repayment of the bond. The school may therefore seek a letter of credit from a bank to enhance the credit rating of the bond issue. Issuance of a letter of credit is based on a review of the school's credit. Not all bond issues have credit enhancement. In those cases, the bonds are sold "nonrated" or carry the same credit rating as the school. A letter of credit or other form of credit enhancement provides the most widely acceptable security for bonds. It increases a project's creditworthiness by substituting the bank's credit rating for the school's in the marketplace and makes the bonds marketable to a larger universe of purchasers.

Bonds that are credit enhanced are well suited for schools with a modest endowment or financial history. In effect, the participating lender takes on the credit risk of the school, should the school prove unable to make the bond payments as they come due.

Given the current interest rate environment, most bonds being issued for schools are variable-rate bonds, for which the interest rate is reset weekly and thus enjoy the lowest possible rate in the market. Over the term of a variable-rate bond issue, rising interest rates may drive the bond's interest rate higher. To protect the school from periodic interest rate fluctuations, the board may choose to "fix" part or all of the issue synthetically through the purchase of an interest rate swap, cap, or collar for some period of time (3 years, 5 years, 10 years). These derivatives may be purchased at closing or any time thereafter. We often see a school "fix" one-third of the issue for five years, another one-third for 10 years, and the remaining one-third "floats." Some or the entire floating portion would be redeemed if the school had a successful capital campaign (or exceptional operating results) and the board decided to prepay a portion of the bond issue and thereby reduce its annual debt service.

TRUSTEE

Acting as trustee, a bank will administer the bond issue. The issuer often requires that the trustee be a bank qualified to do business in the state. The trustee holds the unexpended bond proceeds for disbursement to the school as requisitions are submitted over the course of construction and equipping of the project. It also disburses payments received from the school to the bondholders and performs other duties as may be set forth in the bond documents.

UNDERWRITER

Bonds customarily are sold through an underwriter or placement agent. The underwriter assists the school in structuring the financing, including, when necessary, obtaining satisfactory credit enhancement. The underwriter will either place (sell) the bonds to the bondholders on a "best efforts" basis on behalf of the school or buy the bonds from the issuer at closing and then resell them to investors. The underwriter is selected by the school and approved by the issuer.

BONDHOLDERS

Bondholders are investors (individuals, institutions, bond funds, and others) who purchase the bonds. They do so in exchange for the school's promise of repayment through the bond trustee and, where applicable, by relying on the promise of the participating lender (the credit enhancer) to provide funds for repayment in the event the school defaults. Proceeds from the sale of the bonds are deposited with the trustee and disbursed to the school to pay for approved project costs.

BOND COUNSEL

The bond counsel advises the issuer on legal matters and project eligibility and drafts the bond-financing documents. Counsel also provides the "approving opinion" concerning bond validity and tax treatment of interest on the bonds that is relied on by the bondholders and all of the transaction's principal participants.

COSTS

Generally, the issuer assesses a fee at closing. In New York, for example, the fee for a private, nonprofit school is often 0.5 % of the principal amount of the bond issue and decreases at different levels as the bond size increases. Aggregate costs and fees are determined by the number of principal participants involved in the financing transaction. Including all participants mentioned earlier and their counsel, plus borrower's accountants and a title company, the costs may aggregate 3% to 5% of the principal amount of the bond issue. Although seemingly costly at first blush, a number of the same costs would be incurred in conventional financing (borrower's counsel, bank fees, bank counsel, title charges, survey charges, environmental reports, etc.). Thus, one must look at the marginal or incremental costs, offset by the benefits of bond financing.

Savings and other benefits realized in a bond financing that offset incremental closing costs include:

- a substantially longer repayment term (typically as long as 30 years) than available through conventional bank financing;
- significant interest cost savings over the life of the bond issue—well below conventional bank interest rates, particularly if tax-exempt variable-rate demand bonds are used, resulting in interest savings of 3%–5% per year;
- lower annual debt service as a result of a longer repayment term and lower interest costs;
- sales tax abatement on certain project costs (usually already available to nonprofits);
- mortgage tax abatement (an important savings in a state like New York);
- reduced energy costs (through programs often paired with qualifying activities, such as closing a tax-exempt bond issue);
- property tax abatement (also usually not an issue for nonprofits, except with respect to nonmission portions of a project); and
- the opportunity to access other government programs and benefits tied to bond issues in certain states.

Conclusion

Although bond financing also is available to meet the capital needs of for-profit organizations, tax-exempt bond financing is particularly well suited for nonprofit private schools because of the flexibility such financing brings, particularly when "married" with a capital campaign. Over the past few years, we have worked closely with a number of schools in different states that have used such bonds to build and expand needed facilities. These schools were able to borrow millions for capital improvements. The issues were as small as $1.8 million and as large as $17.6 million, with the majority between $4 million and $7 million. They closed with initial interest rates as low as 0.95%.

Over the years, an increasing number of schools have found that bonds are a viable and beneficial addition to their capital fund-raising arsenal, and current low interest rates have made bonds increasingly attractive to these organizations. As more schools become aware of the opportunities available to them through their regional and local issuing agencies, the number of schools moving ahead to build much-needed new facilities will continue to increase. Consequently, each school will strengthen itself with new facilities, allowing for more and better academic and extracurricular programs that better serve its students and, ultimately, ensuring its survival in the increasingly competitive marketplace that is private education in this country today. ▩

Joseph P. Carlucci and Robert C. Schneider are partner and counsel, respectively, at Cuddy & Feder LLP, a law firm with offices in White Plains, New York, and Fishkill, N.Y., and Norwalk, Conn. They primarily represent borrowers and underwriters in tax-exempt and taxable bond financing transactions with an emphasis on nonprofit borrowers, including private schools.

Manufacturing.net

Project Financing Aid For Manufacturers Doubled To $20 Million

By Anita LaFond, News Editor, Manufacturing.net
Manufacturing.Net - January 15, 2007

As of January 1, manufacturers can take advantage of a new, cost-saving financial benefit – an increase, to $20 million, in the limit of capital expenditures for projects that can be financed through industrial development agencies.

According to Joseph P. Carlucci, partner at the law firm Cuddy & Feder LLP, and head of its industrial development agency practice group, this is double the amount previously allowed by the Economic Development Agency. The low-cost project financing aid will help to increase economic development, create jobs and expand local economies.

Under the old capital expenditure rules, a manufacturer seeking financing assistance from industrial development or economic development agencies, could not spend more than $10 million on capital expenditures for a particular project.

With the new regulations, manufacturers that are spending up to $20 million in acquisition, construction and equipment costs can apply for a tax-exempt bond issue to cover up to $10 million of the costs of the new facility, and finance the remainder with a taxable bond issue, or other financing, Carlucci said.

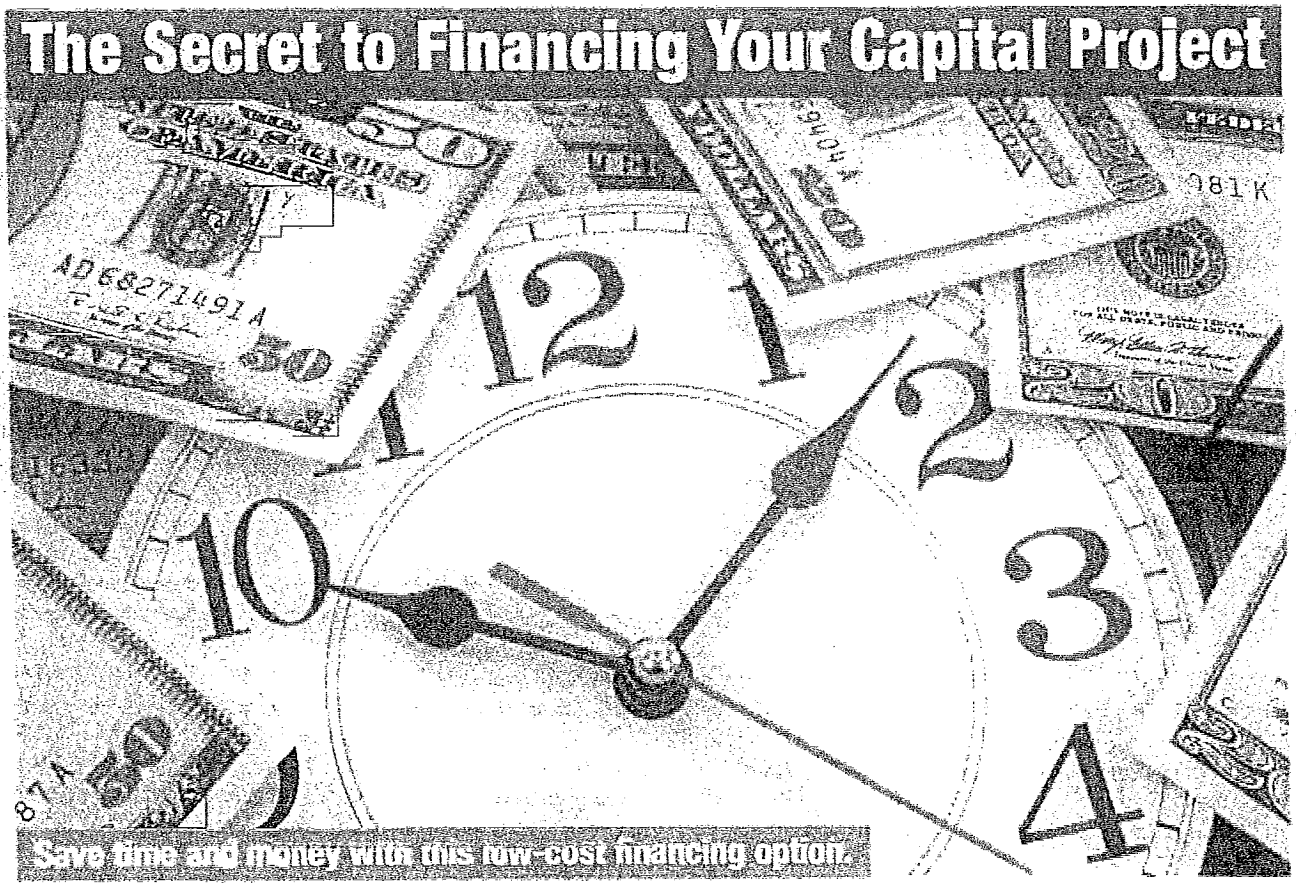
With construction loan rates now at, or near, 8.5 percent, manufacturers will now be able to finance up to $10 million of new facility costs through federally tax exempt bonds at rates that are currently about 3.8 percent, said Carlucci.

A significant portion of the remaining costs could be financed with taxable bonds, issued by industrial development agencies, with interest rates that now range between 3.75 percent to 4.75 percent, still lower than conventional bank loans, noted Carlucci.

The new $20 million spending limit is available if a company's total expenditures are made within the geographic area where the industrial development agency is authorized to issue bonds and if the total expenditures, including the funds from the bond issue, do not exceed $20 million over a six-year period, said Robert C. Schneider, Special Counsel at Cuddy & Feder.

The six year period includes the three years prior to the bond issue, and three years following, he said. Any manufacturing company can also apply for a $1 million initial bond to finance a new facility with a "stand alone" tax-exempt bond, he added.

The Secret to Financing Your Capital Project



By Joseph P. Carlucci & Robert C. Schneider

There's a financing alternative available to nonprofits in most areas of the country that could reduce new-project financing costs by hundreds of thousands of dollars. For many nonprofits, however, it's an unintentional but well-kept secret. It is unknown or ignored by a surprising number of organizations preparing to finance capital projects. For those who know about it, however, the savings are huge.

- **The Masters School** in Dobbs Ferry, New York, was able to cut the cost of financing a new $17.6 million science building by some $600,000 a year. The building was financed with a bond issue that carried an interest rate of 3.4% to 3.5% over the initial 10 years of a 30-year bond. A bank loan would have been around 5% to 5.5%.
- **The Seamen's Society**, seeking a new facility to better serve abused and neglected children, purchased and renovated a commercial building near the Ferry Terminal on Staten Island with the proceeds from a $5.4 million low-interest bond.
- **An assisted-housing project** in Vigo County, Indiana, was made possible with a $7.5 million, tax-exempt, variable-rate bond at an initial interest rate of under 2.0%.
- **The Professional Children's School** in New York was able to complete a 14,000 sq. ft. addition with funds raised through an $8 million variable-rate bond. The bond carried an initial interest rate of between 1% and 2%.
- **The Boys and Girls Club** of Greenwich, Connecticut, expanded its facilities and service to the community with the aid of $14.8 million variable-rate bonds with an opening interest rate of 1.2%.

> Traditional capital campaign fundraising efforts rarely catch up with the cost creep.

What Is the Secret?

In each of the above cases, the financing "secret" was the use of low-cost, often tax-exempt bonds issued by state, county, or city economic or industrial development agencies. Such bonds are issued by authorities or agencies created by state statute. The specifics vary a bit from state to state. Depending on the state, the entities issuing the bonds may be called industrial development agencies, economic development authorities, educational facilities authorities, or something similar. Although state statutes may vary, IRS provisions exempting certain bonds from income tax are uniformly applied throughout the country.

The economic or industrial development agencies provide incentives and financing assistance, including bonds, on behalf of borrowers planning capital projects. More than 1,000 such agencies exist across the nation. In New

foot factory for the production of sophisticated, tight tolerance, precision metal parts, in Tustin, Calif., through a $5 million bond issued by the California Statewide Communities Development Authority. The low cost bonds – the opening interest rate on the $5 million bonds was 3.8 percent, significantly below today's bank financing costs – is expected to save Interplex hundreds of thousands of dollars in acquisition and construction financing costs for the new expanded facility.

The Masters School in Dobbs Ferry, New York found it was able to cut the cost of financing a new $17.6 million science building by some $600,000 a year.

The bond's interest rate was at 3.4 percent to 3.5 percent over a 10 year average. A bank loan issued at the same time would have been around 5 to 5.5 percent.

IDA issued tax-exempt bonds can be especially useful and cost-effective for nonprofit organizations, such as private schools and cultural institutions with a demonstrated need for capital funds to expand and improve their facilities to better serve their students or community members, implement their charter purpose and fulfill their mission.

These are just a few of more than 50 industrial and economic development agency bond financing capital projects we have been involved in over the past several years. And surprisingly, most of the key executives at these organizations had only little or no knowledge or understanding of the availability or advantages of low-cost bond financing for their projects when we first met with them.

We have also pointed out that such bond financing can be used to refund higher cost debt that the organization had been saddled with in previous years, a fact especially useful in an era of volatile interest rates. In one recent instance, John 1. Haas Inc. was the borrower in a $10 million bond financing that was used to complete the refunding of debt issued in 1989 and extend the maturity of the bonds for another 22 years at a rate which has averaged under 5 percent, to date, including closing costs. Had the refunding not been available, the firm would have had to use $10 million of its equity to pay the maturing bonds and then borrowed needed funds at taxable rates in excess of 6 percent going forward.

As our experience has shown, low-interest rate bonds have helped a variety of business, manufacturers, private schools, nonprofit institutions and housing developers across the country to substantially reduce the cost of financing needed facilities. And, in the most recent years, they have done it at interest rates that have been below 2 percent– far below construction financing costs, or bridge loans that were available through other financing channels. In addition, this type of financing often brings with it certain tax abatements and economic incentives such as reduced energy costs. The quid pro quo for receiving such benefits is the creation or retention of jobs, or increasing tax ratables.

Within the recent period of low interest rates, the bonds have been more often issued as variable rate bonds. As capital market instruments, bonds most often have more flexible terms and far more attractive interest rates than comparable bank loans. Because the interest paid to bondholders is exempt from income taxes, the bonds are highly marketable to individual and institutional investors in high tax brackets, particularly where they may be taxed on three levels, federal, state and local.

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Commercial Real Estate Monthly

Using the Overlooked Secret Of Low-Cost Capital Financing

By Joseph P. Carlucci and Robert C. Schneider
Contributing Writers

A financing alternative that could reduce new project financing costs by hundreds of thousands of dollars a year remains often ignored, or little known, by a surprising number of otherwise sophisticated real estate executives involved in new capital projects. We have begun calling it "the best kept secret in real estate financing today."

The secret – albeit an unintentional secret – is low-interest rate bond financing issued through local or regional industrial development agencies. These bonds may either tax-exempt or federally taxable bonds. The bonds are administered by state or local industrial development or economic development agencies and are available to companies, manufacturers and nonprofit institutions planning new capital projects.

There are more than 1,000 such state and local agencies nationwide. These agencies exist to encourage and support local industrial and economic development, increase employment and expand the tax base. These agencies may offer a variety of economic benefits, including issuing bonds on behalf of borrowers to finance their capital projects. These securities are not obligations of the municipality or any government entity, and the bonds are not backed by municipal or state taxes. Rather, these are solely the corporate obligation of the borrowers.

As capital market instruments, the advantage to the company or nonprofit borrower is that these bonds offer more flexible terms and are available at far more attractive interest rates when compared to bank loans. The bonds are typically issued with 10 to 40 year maturities. The interest rate may be fixed, floating or variable and their benefits are substantial.

For example, in only the last few years we have seen Fortunoff, a specialty retailer, reduce the cost of financing the development of a new department store by $2.5 million a year on a 30-year bond financing.

Interplex Industries Inc. lowered its acquisition, renovation and equipment financing costs for an industrial facility in Rhode Island by as much as 5 percent a year for 30 years.

And, more recently, Interplex Nacal Inc. has completed financing for a new 37,000-square-

enhancement from a bank or insurance company. Credit enhancement allows the borrower to access bonds that carry the lowest interest cost – variable-rate demand bonds.

• The Bond Issuer: CHEFA or CDA in Connecticut – The state agencies act as a financing conduit. They issue the bonds on behalf of the borrower, but are not liable for repayment. Repayment is solely the obligation of the borrower. The appropriate State agency processes the application, adopts an inducement resolution, reviews and approves the financing structure and negotiates the final form of the financing documents.

• Credit Enhancement – A letter of credit or other form of credit enhancement provides the most widely acceptable security for the bonds. It increases the bonds' credit-worthiness, enhances their marketability and reduces the interest rate to be paid by the borrower. In effect, the credit enhancer takes on the credit risk of the borrower and pays the bondholders should the borrower prove unable to pay the bonds and default. Not all bond issues have credit enhancement. In those cases the bonds are sold "non-rated" and carry the same credit rating as the borrower.

• Trustee – A bank, serving as trustee, will administer the disbursement of bond proceeds to the borrower upon receipt of approved requisitions. It also disburses payments of interest and principal from the borrower to the bondholders. The issuer customarily requires that the trustee be a bank qualified to do business in the State.

• Underwriter – Bonds are normally sold through an underwriter or a placement agent. The underwriter or placement agent assists the non-profit borrower in structuring the financing, including, where necessary, obtaining satisfactory credit enhancement. The underwriter will underwrite (purchase) the bonds and assume the market risk of finding and selling the bonds to the bondholder. A placement agent will place (sell) the bonds to the bondholders on a best efforts basis with no guarantees that all the bonds will be sold.

• Bondholders – Bondholders are individual or institutional investors who purchase the bonds. They do so in exchange for the borrower's promise of repayment and, where applicable, by relying on the promise of the credit enhancer to provide funds for repayment in the event of a default by the borrower. Upon purchase of the bonds, the proceeds are deposited with the trustee and the funds are disbursed to the borrower in a manner essentially similar to the manner in which a conventional construction loan is administered (i.e., payments against approved requisitions). Bondholders receive periodic payments (monthly, quarterly, semi-annually or annually) of interest or principal and interest as described in the bond.

• Credit Enhancer's Counsel – Where credit enhancement is used, the credit enhancer, usually a bank, engages counsel to prepare a variety of documents that define the relationship between the borrower and the bank, particularly the procedures that will be followed should the borrower default and the bank's letter of credit is called upon to provide funds to redeem the defaulted bonds. The principal document of many prepared by this counsel is the Letter of Credit Reimbursement Agreement which provides, among other things, for the "work out" that will occur in the event of borrower's default.

• Bond Counsel – Bond counsel advises the issuer and other project participants on certain legal matters, including project eligibility, and prepares the bond financing documents. Bond counsel also provides the "approving opinion" that is relied upon by the bondholders and all the principal participants in the transaction concerning the validity of the bonds and tax treatment of interest received on the bonds.

This article is but a cursory explanation of an arcane, little known type of financing that is of substantial benefit to borrowers. Any borrower wishing to obtain the advantages of tax-exempt bond financing (or taxable bond financing for that matter) should engage experienced counsel and let him or her guide you through the process. The benefits are well worth the time and effort. ■

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Tax-Exempt Bonds Overlooked As Construction Financing Tool

By Joseph P. Carlucci and Robert C. Schneider

Tax-exempt bonds have aided manufacturers, private schools, nonprofit institutions, housing developers and utilities build needed facilities in Connecticut and across the country. The newly renovated and expanded facilities at places like The Rectory School in Pomfret, The Greenwich Boys and Girls Club in Greenwich, The Academy of Our Lady of Mercy/Lauralton Hall in Milford, various water facilities of The Connecticut Water Company and the Doran Manufacturing plant in Norwalk, were all built with lower cost construction financing made possible through tax-exempt bonds authorized by the Connecticut Development Authority or the Connecticut Health and Education Facilities Authority. And yet, the many advantages of tax-exempt bonds for capital projects are too often overlooked, or even unknown, by many in real estate.

We often refer to tax-exempt bond financing as "the best kept secret in real estate financing." More times than not, when we meet with a new client to discuss the financing of a real estate project, we find that even among experienced developers, manufacturers, and non-profit institutions, many have little knowledge or understanding of the availability of low-cost, tax-exempt bonds, and how these instruments can sharply reduce financing costs.

Where can you find a construction, bridge and/or permanent loan for 1 to 1? percent plus a credit enhancement fee that usually is 1 percent. Yet that is what the Boys & Girls Club of Greenwich is paying for the $14.8 million raised to build their newly renovated and expanded facility through a tax-exempt variable rate bond issued by the Connecticut Health and Education Facilities Authority. And that is a financing cost that many manufacturing companies and nonprofit institutions are paying today to finance capital projects using 30-year bonds issued through state industrial and economic development agencies.

State agencies exist to provide financing assistance, including issuing bonds on behalf of the borrower for the financing of capital projects that will confer benefits not only on the borrower (through lower interest and other cost savings) but also on state and community residents (through improved facilities, job creation/retention, increased tax ratables, etc.). The financing is available for both nonprofit institutions and profit-making corporations. In Connecticut the statewide Connecticut Development Authority coordinates financing for businesses and the State of Connecticut Health & Education Facilities Authority administers the financing for schools, hospitals and other non-profit institutions engaged in cultural, recreational and charitable endeavors.

Bond Pricing

More than 1,000 such agencies are in operation across the country. Bonds issued by these agencies are not obligations of a municipality, state or county and are not backed by a pledge of property taxes. Rather, these are obligations of the borrowers (developers, corporations or non-profit institutions). In addition to being a low interest source of project financing, the bonds offer a number of other benefits. They are typically issued with maturities of from 10 to 30 years. The rate may be fixed or variable. With today's low interest rates, the bonds are more often issued as a variable rate bond. As capital market instruments, bonds often have more flexible terms and far more attractive interest rates than comparable bank loans. Because the interest paid to bondholders is exempt from income taxes, the bonds are highly marketable to individual and institutional investors in high tax brackets, particularly where they may be taxed at three levels: federal, state and local (such as New York City). In addition, bond financing transactions often make possible other economic incentives that are obtained from the agencies which issue the bonds or through the State Department of Economic and Community Development in Connecticut.

In working with CDA and CHEFA, companies and non-profit institutions gained access to low cost financing that has long been the province of giant institutions and municipalities. Today these companies and non-profit institutions enjoy unparalleled, low cost borrowing opportunities. Regardless of the state of the economy, tax-exempt bonds consistently offer relatively lower financing costs than other sources of financing.

The Players

One caveat that is fundamental to utilizing the financial advantages and incentives available through CDA and CHEFA is understanding that bond financing may only be used for capital expenses (property, construction and equipment costs) and not for operating expenses.

To further understand how this financing works, the following describes the principal participants and components in a bond financing:

• The Borrower – The borrower, working with experienced counsel, must submit an application to the appropriate state bond-issuing agency. In most cases, the borrower, especially in the case of nonprofits, or a company with limited credit history, will also seek to obtain a commitment for credit

continued on page 2

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enhancement from a bank or insurance company. Credit enhancement allows the borrower to access bonds that carry the lowest interest cost – variable-rate demand bonds.

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