No. 99-1792

In the
SUPREME COURT OF THE UNITED STATES

DIRECTOR OF REVENUE OF MISSOURI,
Petitioner,

v.

CoBANK, ACB, as Successor to the
National Bank for Cooperatives,
Respondent.

On Writ of Certiorari
to the Supreme Court of Missouri

# REPLY BRIEF FOR PETITIONER

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"[T]he political process is 'uniquely adapted to accommodating the competing demands'" of federal programs and state taxation. *United States v. New Mexico*, 455 U.S. 720, 737 (1982) (quoting *Massachusetts v. United States*, 435 U.S. 444, 456 (1978) (plurality opinion)). Contrary to the arguments set forth by respondent CoBank, that process did not, in 1985, result in the grant to Banks for Cooperatives (BFCs) of an immunity from state and local taxes beyond any they had ever

enjoyed – indeed, so broad as to be nearly unique among federally-chartered financial institutions.

**1. The line between entities with implied immunity from state taxation and those without is defined by the criteria in *United States v. New Mexico*.**

As the scope of federal activity has widened, both the numbers and kinds of entities that Congress has created to carry out its objectives have multiplied. Federally chartered organizations range from important national institutions such as the American National Red Cross (*see* 36 U.S.C. § 300101 (Supp. IV 1998)), to organizations with somewhat less national prominence, such as the Agricultural Hall of Fame (36 U.S.C. § 20101(a) (Supp. IV 1998)) and the National Ski Patrol System (36 U.S.C. § 152702(a) (Supp. IV 1998)). Congress has even authorized the creation of entirely private entities, such as ComSat (47 U.S.C. § 731), and the Union Pacific Railroad (Act of July 1, 1862, § 1, 12 Stat. 489). It is undisputed (indeed, nearly tautological) that entities created or otherwise endorsed by Congress perform governmental functions, that is, activities that Congress has determined to promote the national interest.[1] This Court has never held, as

[1] *See, e.g.*, 36 U.S.C. § 152502 (3) (Supp. IV 1998) (National Safety Council, a federally chartered corporation, is "to arouse and maintain the interest of the People of the United States . . . in safety and accident prevention"); 36 U.S.C. § 70902 (Supp. IV 1998) (purposes of Future Farmers of America, a federally chartered corporation, include "to develop character, train for useful citizenship, and foster patriotism, and thereby develop competent and aggressive rural and agricultural leadership"); 36 U.S.C. § 130502 (Supp. IV 1998) (Little League Baseball, Incorporated, a federally chartered corporation, is "using the disciplines of the native American game of baseball, to teach spirit and competitive will to win, physical fitness through individual sacrifice, the values of team play, and wholesome well being through healthy social association.").



CoBank urges, that all federally chartered entities are automatically entitled to immunity, absent an express statutory waiver, from all state and local taxes. Clearly there are some entities that have automatic immunity by constitutional decree (which Congress may waive). For others, lacking constitutional immunity, Congress may provide immunity in whatever manner it wishes. Thus the first question in this case is what sort of entity CoBank is.

The line between entities whose immunity is implied or presumed, and those whose immunity is not, matters here because, as both the Director and CoBank make clear in their briefs, whether and how the states can tax BFCs depends on the meaning of what 12 U.S.C. § 2134 does not say. It does not expressly say whether states could impose an income tax on the BFCs. Nor, for that matter, does it expressly say whether states could impose franchise, sales, personal property, real property, or other taxes on BFCs. Did Congress thus leave BFCs immune from such taxes, an argument necessarily based on a claim that they were on the "implied immunity" side of the line? Or did it leave them subject to state and local taxation, as they would be on the "no immunity provided" side of the line? CoBank and the Director disagree as to the line between the two groups.

CoBank defines the line in two ways. First, it defines it according to labels, *i.e.*, it claims that merely being labeled a "federal instrumentality," or even just being a "federally chartered fiscal institution," is enough to place an entity in the

implied immunity group. Respondent's Brief (Resp. Br.) at 22-24. But in labeling the entities it authorizes, Congress has not shown the kind of consistency that would be required to permit labels to define the scope of implied immunity. That is demonstrated dramatically by the Rural Telephone Bank, invoked by CoBank. The Rural Telephone Bank is statutorily designated both as "an instrumentality of the United States" (7 U.S.C. § 941(c)), and as "an agency of the United States" (7 U.S.C. § 943(a)). The Bank is then made subject to the Government Corporation Control Act in the same manner and to the same extent as if it were included in the definition of "wholly owned Government corporation." 7 U.S.C. § 943(c). The kind of confusion created by use of overlapping and inconsistently defined terms like "agency," "instrumentality," and "government corporation" explains why CoBank is unable to cite authority for – or to even explain the logic behind – a claim that the line defining agencies with Supremacy Clause implied immunity hangs on Congress's choice of label. But it does explain why Congress has so consistently defined the precise scope of immunity given to federally chartered but privately owned entities. *See* Petitioner's Brief (Pet. Br.) at 23-26.

Second, CoBank suggests that the line can be drawn according to whether the entity "performs an important governmental function." Resp. Br. at 24-25. But besides being without precedential support, such a line is entirely unworkable in the absence of some definition of "important governmental function," which CoBank fails to provide. Any Congressionally chartered entity would claim that it "performs an important governmental function" and thus has implied tax immunity. And who is to prove otherwise? For both "important" and "governmental" are fluid concepts. And as demonstrated by their commercial competitors, the BFCs' "important governmental functions" may be performed even by



entirely private organizations. Federal contractors and federal employees, too, perform important governmental functions, yet they are not immunized from taxation by the Supremacy Clause. CoBank's proposed formulation is nothing more than a return to the expansive intergovernmental tax immunity doctrine, which held that any state tax that had an impact on federal operations was unconstitutional under *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). That is a doctrine that this Court has, at length, rejected. *See* Pet. Br. at 14-16.

By rejecting "important governmental functions" as the test for defining the scope of implied immunity, the Director does not suggest that whether a Congressionally-chartered entity performs "governmental functions" is unimportant. The fact that an entity will perform governmental functions is what empowers Congress to immunize it from taxation. That was suggested by this Court in *Federal Land Bank of St. Paul v. Bismarck Lumber Co.*, 314 U.S. 95 (1941), which CoBank misreads (Resp. Br. at 24-5) to hold that a Farm Credit System institution is entitled to immunity by the force of the Supremacy Clause alone. In *Bismarck Lumber*, this Court held that Congress has the power to provide such immunity pursuant to the Necessary and Proper Clause. *Id.* at 102-03 ("Congress has authority to prescribe tax immunity for activities connected with, or in furtherance of, the lending functions of federal credit agencies"). *See also Arkansas v. Farm Cred. Servs.*, 520 U.S. 821, 829 (1997) (tax immunity is "a permitted consequence" of federal instrumentality designation). That leaves open the question of whether and how Congress exercised that power. Here, of course, whether Congress could grant immunity from income taxes to the BFCs is not in dispute; Congress did so,

without protest from Missouri, until 1985. The question is whether Congress continued to do so after 1985.[2]

To answer that question, the Court should once again use the criteria articulated in *United States v. New Mexico*: that implied immunity be given only to "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, at least insofar as the activity being taxed is concerned." 455 U.S. at 735. CoBank attacks the use of that test by asserting that it applies only to "federal contractors, not federal instrumentalities." Resp. Br. at 30. Though it was certainly adopted in the context of contractors, it is not limited to that context.

The question posed in *New Mexico*, as in other contractor tax cases, was when could a privately owned, for-profit enterprise, performing services for the Government, claim the United States' constitutional tax immunity? This question is subsidiary to the larger question of when a private party may claim a tax exemption as to benefits received in the performance of activities which also serve the purposes of the United States. It is closely related to issues like the taxability of federal employees' salaries and the taxability of federal creditors. Thus, rather than being limited to contractor tax cases, the *New Mexico* test has been cited in a wide variety of non-contractor cases. *E.g., Jefferson County v. Acker*, 527 U.S. 423, 436-37 (1999) (case involving the taxation of Federal Judges' salaries; citing *New Mexico* for the proposition that this

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[2] *Federal Land Bank v. Kiowa County*, 368 U.S. 146 (1961), upon which Cobank also relies, is of little help in answering that question. Because the Court there was construing express statutory language, it did not consider the availability of implied immunity. *Id.* at 156.



Court has reaffirmed "'a narrow approach to governmental tax immunity," and "contract[ed] the once expansive intergovernmental tax immunity doctrine"); *South Carolina v. Baker*, 485 U.S. 505, 516-527 (1988) (discussing *New Mexico* among developments in the doctrine of intergovernmental tax immunity that required overruling previous precedent granting such immunity to state bond interest paid to private parties); *Rockford Life Ins. Co. v. Illinois Dept. of Revenue*, 482 U.S. 182, 191 n.11 (1987) (case involving state taxability of federally guaranteed bonds; citing *New Mexico* for the proposition that taxability would not necessarily be improper even if such taxability was shown to affect the "federal fisc").

One such non-contractor case was *California State Bd. of Equalization v. Sierra Summit, Inc.*, where this Court considered the taxability of a bankruptcy liquidation sale. 490 U.S. 844, 845-46 (1989). The Court rejected the argument that a sales tax on the bankruptcy trustee impermissibly interfered with the federal operations of the bankruptcy court, recognizing that the argument rested on a view of intergovernmental tax immunity that the Court had rejected in cases beginning with *James v. Dravo Contracting*, 302 U.S. 134 (1937). Rather than stretch immunity to the points urged there by Sierra Summit and here by CoBank, the Court held, again, that "absolute tax immunity is appropriate only when the tax is 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.'" *Id.* at 848-49 (quoting *New Mexico*, 455 U.S. at 735). Applying the *New Mexico* test, the Court upheld the sales tax because it was nondiscriminatory, and because the bankruptcy trustee was not so closely connected to the Government that the two could not realistically be viewed as separate entities. *Id.* at 849-50.

Whether CoBank, a privately owned corporation that operates for the profit of its private shareholders, falls within the absolute constitutional immunity from taxation now reserved to the United States itself, is well within the realm of questions the *New Mexico* test was designed to answer.[3] By contrast, that test does not answer other questions regarding intergovernmental tax immunity. In particular, this Court expressly excluded discriminatory taxes from the approach it took in *New Mexico*. Thus "state taxes on contractors are constitutionally invalid if they discriminate against the Federal Government, or substantially interfere with its activities," regardless of whether the entity being taxed is entitled to implied immunity. 455 U.S. at 735 n.11. Similarly, the fact that federal employees are not protected from nondiscriminatory state taxes does not deprive them of the protection from discriminatory taxes that *M'Culloch* established. *See e.g, Jefferson County v. Acker*, 527 U.S. at 436-37; *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 811 (1989).

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[3] Because it rejects the use of the *New Mexico* test, CoBank does not explain how it would apply to the Rural Telephone Bank, CoBank's "apt illustration" of a federal instrumentality with implied immunity. Resp. Br. at 28. The Bank is "an agency of the United States," subject to the supervision and direction of the Secretary of Agriculture, able to use the facilities and services of employees of the Secretary without cost, and subject to the Federal Tort Claims Act and to supervision of certain litigation by the Attorney General. 7 U.S.C. § 943 (a), (b), and (e). Because of ties to the government that the BFCs do not have, the Bank could plausibly be said to be "so closely connected to the Government that the two cannot realistically be viewed as separate entities" (*New Mexico*, 455 U.S. at 735).



By failing to distinguish between the issue here and that raised by claims of discriminatory taxes, CoBank not only reads *New Mexico* and its successors too narrowly, but also misinterprets this Court's holding in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983). Noting that the Court in *Memphis Bank* called 31 U.S.C. § 742 a codification of the constitutional rule, CoBank presents the "relevant part" of that statute, which provides that federal obligations are exempt from state tax unless otherwise provided for by law. Resp. Br. at 25. CoBank neglects to mention that § 742 statutorily defines the scope of immunity; it does not invoke or rely on implied immunity alone. And CoBank fails to acknowledge that the "constitutional rule" the Court applied was that "[w]here, as here, the economic but not the legal incidence of the tax falls on 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." 459 U.S. at 397.

The Court in *Memphis Bank* made clear that the scope of the protection from discriminatory taxes is wider than the protection from nondiscriminatory taxes: "Although the scope of the Federal Government's constitutional tax immunity has been interpreted more narrowly in recent years, there has been no departure from the principle that state taxes are constitutionally invalid if they discriminate against the Government. *See, e.g., United States v. New Mexico*." 459 U.S. at 397 n.7. Thus, the reason the Tennessee tax was invalidated was not solely, as CoBank implies, because it was a tax on the holders of Federal Credit Bank bonds, but rather because it violated the ban on discriminatory taxes that is "at the heart of modern intergovernmental tax immunity case law." *South Carolina v. Baker*, 485 U.S. at 525-26. Because CoBank never claims that Missouri's corporate income tax is

discriminatory, it cannot rely on that ban, nor on this Court's decision not to use the *New Mexico* test to define its reach.

**2. Congress, by merely authorizing temporary, indirect federal financial assistance, did not confer broad tax immunity.**

The BFCs, because they are designated governmental instrumentalities that perform functions that benefit the government, are entitled to "enjoy the benefits and immunities conferred by explicit statutes." *Arkansas v. Farm Cred. Servs.*, 520 U.S. at 829. But in claiming that BFCs are immune from state income taxes, CoBank cannot point to any "explicit statute." Thus it picks and chooses from the legislative history of the 1985 Amendments to justify its theory that Congress restored – or even expanded[4] – the BFCs' broad tax immunity without saying a word.

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[4] The Director pointed out that CoBank's rationale would preclude the imposition even of property taxes. In its brief, CoBank denies that premise, arguing that implied immunity never applied to property taxes, and citing *M'Culloch*. Resp. Br. at 36. That argument ignores post-*M'Culloch* holdings. *E.g. Rohr Aircraft Corp. v. County of San Diego*, 362 U.S. 628, 634 (1960) ("[T]he general rule is 'that lands owned by the United States of America or its instrumentalities are immune from state and local taxation.'"); *United States v. County of Fresno*, 429 U.S. 452 (1977). It fails to articulate a rationale for a line between real property and all other taxes. And it fails to explain why Congress has so consistently addressed the property tax question when it more specifically defines the nature of a financial institution's immunity. Pet. Br. at 25-26.



CoBank begins with the impetus for the 1985 Amendments: a crisis in American agriculture. But then it ignores the response to that crisis: the restructuring of the Farm Credit System to make it more independent and self-sufficient. CoBank stresses the "new federal assistance" authorized by the 1985 Amendments, but disregards that this assistance would be available only as a last resort, after the Farm Credit Administration certified that it had made the maximum practicable efforts on its own to deal with its financial stress. Even then, the Secretary of Treasury would have discretion as to whether the federal government would backstop the System's finances. And the assistance, if provided, was to go not to the BFCs, but to a separate temporary entity, the Farm Credit System Capital Corporation.[5]

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[5] Indeed, "[t]he Committee rejected the idea of a direct, mandated infusion of Federal funds into the Farm Credit System. This idea was rejected for a variety of reasons including the testimony from the U.S. Department of the Treasury that if the System uses its own resources effectively, outside assistance is not now needed and not likely to be needed through 1987, even though by 1988 the System's capital will be substantially reduced." H.R. Rep. No. 425, 99th Cong., 1st Sess. 14 (1985), *reprinted in* 1985 U.S.C.C.A.N. 2587, 2600-01. Both the Undersecretary of Agriculture and the Assistant Secretary of the Treasury testified before the Committee; both emphasized that the Farm Credit System was not in need of federal financial assistance. *Id.* at 35, 1985 U.S.C.C.A.N. at 2621. The $ 4 billion of federal funds to which CoBank repeatedly refers were part of the Agricultural Credit Act of 1987, appropriated two years after the 1985 Amendments and in conjunction with another restructuring of the Farm Credit System. *See* H.R. Rep. No. 295, 100th Cong., 1st Sess., *reprinted in* 1987 U.S.C.C.A.N. 2723.

CoBank is unable, of course, to point to legislative history tying this change to the amendment of Section 2134. CoBank argues that Congress's silence on BFC taxation is not surprising for two reasons. First, because Congress by eliminating the states' ability to tax the BFCs did not make an important change in the law. States were not authorized to tax BFCs during periods of federal investment prior to the 1985 Amendments, CoBank says, and the change in Section 2134 simply "conformed" the statute to "the fact of new federal investment." Resp. Br. at 36. But prior to the 1985 Amendments, a BFC was immune from state and local taxes (except real property taxes) only while the Governor of the Farm Credit Administration owned its stock. After the 1985 Amendments, according to CoBank, all BFCs are always immune because of the mere possibility that the Secretary of the Treasury may authorize, as a last resort, discretionary financial assistance to the Farm Credit System through a temporary[6] corporation separate and apart from BFCs. The differences between the original capitalization and ownership of the BFCs and the post-1985 status of the Farm Credit System are too great to support CoBank's argument.

CoBank also claims that, given the time constraints in passing the 1985 Amendments, "it is not surprising that Congress did not provide a specific explanation of the amendment to Section 2134." Resp. Br. at 37. But Congress did provide an explanation, just not CoBank's explanation. CoBank itself invokes the legislative history that contains that

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[6] The 1985 Amendments included a section that terminated, on December 31, 1990, the Capital Corporation's authority to take on new liabilities. The House Committee believed that "five years should be adequate to see the System through its difficult period." H.R. Rep. No. 425 at 14, 1985 U.S.C.C.A.N. at 2600.



explanation, claiming that because of "new federal assistance," it makes sense that Congress labeled the change to Section 2134 as a "technical and conforming amendment." Resp. Br. at 37. This claim ignores the full explanation for the change included in the House Committee Report. That Report explained the change as "technical and conforming" because it resulted from "the elimination of the authority [of the Farm Credit Administration] to make separate investments in individual institutions" and the deletion of "references to the Governor of the Farm Credit Administration . . . since such office . . . will no longer exist." H.R. Rep. No. 425 at 28-29, 1985 U.S.C.C.A.N. at 2615. The sentences deleted from Section 2134 referred to an exemption that applied when the Governor of the Farm Credit Administration held stock in BFCs – much as the government once held shares in the Second Bank of the United States. *See First Agricultural Nat'l Bank of Berkshire Cty. v. State Tax Comm'n*, 392 U.S. 339, 355 (1968) (Marshall, J., dissenting). As to BFCs, that power, long dormant, was eliminated by the 1985 amendment.

## CONCLUSION

Petitioner respectfully requests this Court to reverse the judgment of the Missouri Supreme Court and to render judgment for Petitioner.

Respectfully submitted,

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