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WILL THE "SUNSET" ON THE AMERICAN DREAM? TWO YEARS OF EXPERIENCE UNDER THE MORTGAGE SUBSIDY BOND TAX ACT

I. Introduction

The main problem in housing today is not availability, but affordability.¹ During the 1970's, housing demand for both residential and investment purposes caused the prices of homes to rise at a rate in excess of increases in the Consumer Price Index.² This price rise, coupled with high interest rates, has had a severe impact on low and moderate income homebuyers who have been unable to afford financing from conventional lenders.³ In the late 1970’s, state and local housing finance agencies (HFAs) responded to these conditions by

¹. THE REPORT OF THE PRESIDENT'S COMMISSION ON HOUSING xxii (March 1982) [hereinafter cited as THE PRESIDENT’S REPORT]. The Report presents the findings of a 30 member Commission established in June, 1981 by President Reagan to study options for the development of a national housing policy in the areas of housing assistance for low income people, homeownership, rental housing, housing finance, and housing regulations. See also U.S. DEP’T OF HOUSING AND URBAN DEVELOPMENT, THE PRESIDENT’S NATIONAL URBAN POLICY REPORT 31 (1982) (problems of housing availability are decreasing, but problems of housing affordability continue to escalate) [hereinafter cited as H.U.D. Report]; 1981-82 Miscellaneous Tax Bills, X: Hearing Before the Subcomm. on Taxation and Debt Management of the Comm. on Finance, United States Senate, 97th Cong., 1st Sess. 265 (1981) (statement of Richard K. Helmbrecht, President, Council of State Housing Agencies) (in 1970, the cost of a new home was approximately $23,000 and interest rates were about 8%; by 1980, prices increased 250% and interest rates rose to approximately 15% and above) [hereinafter cited as 1981 Hearing].

². THE PRESIDENT’S REPORT, supra note 1, at xxv. Homes became a way of saving, not only a place to live. As prices rose however, those unable to make such a heavy commitment to savings were unable to acquire homes. Id.

³. Id. Between 1963 and 1973, the initial monthly mortgage payment as a percentage of household income for people buying homes remained stable at approximately 24-34%. Id. As home prices and interest rates increased, the figure rose to 55% in 1980. Id. Existing homeowners were protected from rising interest rates by fixed rate mortgages. Id. The resale value of their homes helped to set off increases in taxes, maintenance and fuel bills. Id. See also H.U.D. REPORT, supra note 1, at 4 (“By the end of the 1970’s, the problem of housing affordability increased as the percentage of income devoted to housing rose for both owners and renters.”); 1981 Hearing, supra note 1, at 265 (statement of Richard K. Helmbrecht) (“New mortgage financing techniques and double wage earner households will keep homeownership within reach of many middle income households, however, most moderate and all low income households will be priced out of the market”).
issuing single-family mortgage bonds to finance mortgage loans for single-family homebuyers.\(^4\)
In a typical single-family housing program, the issuer sells bonds and uses the proceeds to purchase mortgages originated for low and moderate income families by traditional lending institutions. The mortgages purchased bear a rate of interest that is slightly higher than the yield paid by the issuer to the bondholders. The same financial institution that originates the mortgage loan usually collects the monthly mortgage payments from the borrower, which are eventually used to retire the bonds. Since the interest earned on qualifying bonds is exempt from federal taxation, the issuer can pay bondholders a lower yield than is available on competing taxable securities. This

Survey, supra, at 14. The State of Kansas can issue only general obligation bonds, not revenue bonds. Id. at 22. The Governor of Washington has approved a bill to create an HFA in the State of Washington. Id. at 71. The Constitution of the State of Ohio was amended on November 2, 1982, by popular vote (53%) to allow a single family mortgage revenue bond program. Id. at 54.


10. Note, Tax-Exempt Mortgage Revenue Bonds: Another Case of “Opiate Economics?”, 11 Loy. U. Chi. L.J. 473, 474 (1980) (tax-exemption allows HFAs to market bonds at lower interest rates); see also R. Kormendi & T. Nagle, The Interest Rate and Tax Revenue Effects of Mortgage Revenue Bonds 5 (University of Chicago, Apr. 1980) [hereinafter cited as R. Kormendi] (high tax bracket investors are most willing to accept a lower yield in return for the exemption; low bracket investors are usually unwilling to forego higher yields on taxable securities for the
ability to borrow in the tax-exempt market reduces the issuer's cost of borrowing funds. The benefit realized by the issuer is passed on to participating homebuyers in the form of discounted mortgage rates.  

To the extent an interest rate differential exists between program mortgage loans and mortgage loans available from conventional lenders, bond-financed homeowners receive an indirect, non-cash benefit from the federal government, which is deprived of the revenues on the interest income paid to the single-family bondholders.

In 1980, Congress passed the Mortgage Subsidy Bond Tax Act (the Act), which placed new and far-reaching restrictions on the issuance of tax-exempt bonds to finance single-family homes. The Act amends the Internal Revenue Code by adding section 103A, which, with certain exceptions, generally denies a tax exclusion for the interest earned on single-family mortgage revenue bonds. The exceptions

benefit of the tax exemption); R. Forbes, supra note 7, at 8 (lower interest rates prevail in the tax-exempt market).

11. R. Forbes, supra note 7, at 8; The President's Report, supra note 1, at 170. When tax-exempt yields are sufficiently below taxable ones, bond-financed mortgages will significantly reduce the cost of financing homeownership. See, e.g., Colorado Housing Finance Authority Annual Report 1981, at 3. This is the fundamental purpose of mortgage revenue bond programs. See R. Forbes, supra note 7, at 8. See generally 1981 Hearing, supra note 1, at 108 (statement of John E. Chapoton, Dep't of Treasury).

12. R. Forbes, supra note 7, at 2 (tax-exempt mortgage revenue bonds reduce the interest rate paid by homeowners on their mortgages).

13. See notes 16-18 infra and accompanying text.


15. See notes 51-63 infra and accompanying text for a discussion of the Act's restrictions. Transitional rules provide that in general, the restrictions on the use of mortgage subsidy bonds would not apply to bonds issued prior to January 1, 1981, if the proceeds of the bonds were committed to purchasers within one year from the date of issuance. Pub. L. No. 96-499, § 1104(a)(2), 94 Stat. 2670 (1980). Exceptions to this rule were provided if the governing body, having authority to issue the obligations, took official action to issue the bonds before April 25, 1979. Id § 1104(b), 94 Stat. at 2670-72.

16. I.R.C. § 103A(a)(Supp. V 1981). Generally, interest on any bond is not tax-exempt if a significant portion of the proceeds is to be used to finance mortgages on single-family housing. Id. § 103A(b)(1). The Act also amended I.R.C. § 103 to provide that interest on an industrial development bond (IDB), substantially all of the proceeds of which are used to provide mortgage financing for a qualified residential rental property, is exempt from federal income taxation. Pub. L. No. 96-499, § 1103, 94 Stat. 2669-70 (1980) (codified at I.R.C. § 103(b)(4)(A)(Supp. V 1981). A project will be treated as a qualified residential rental property only if 20% (15% in targeted areas) or more of the units in the project are to be occupied by individuals of low or moderate income at all times during the qualified project period. TEFRA § 221(a); I.R.C. § 103(b)(4)(A)(West Supp. No. 3 1982). The focus of this Comment is on single-family mortgage bonds and not industrial development bonds for residen-
provided are for qualified mortgage bonds issued before January 1, 1984, and qualified veterans’ bonds, which meet the requirements set forth in the Act. A “sunset provision” of the Act denies tax-exempt status to all single-family bonds issued after December 31, 1983, with the exception of qualified veterans’ bonds. Consequently, the Act will prohibit tax exempt revenue bond-financed programs for single-family homeowners after 1983.

This term Congress must decide whether to extend the provisions of the Act and allow the continued but restricted use of single-family revenue bonds, or let their tax-exempt status expire at its appointed date. This Comment will examine the validity and effectiveness of selected major provisions of the Act which are unique to single-family mortgage revenue bonds. The analysis is based on two years of experience by HFAs issuing bonds since the passage of the Act. The Comment begins by tracing the development of events leading up to the passage and amendment of the Act. Next, it evaluates whether certain
sections have been successful in accomplishing their intended purpose. Finally, it discusses the application of the constitutional doctrine of inter-governmental tax immunity to the sunset provision of the Act to determine whether Congress possesses the authority to eliminate the tax-exemption for all single-family mortgage revenue bonds.

II. Legislative History of the Mortgage Subsidy Bond Tax Act

In the late 1950's, state housing finance agencies became very active selling tax-exempt bonds to finance multi-family housing.\(^23\) Prior to 1968, the interest on all state and local bonds was exempt from federal income taxation regardless of the government's intended use of the proceeds.\(^24\) In 1968, the Revenue Expenditure and Control Act of 1968\(^25\) amended section 103 of the Internal Revenue Code to provide that, with certain exceptions, tax exempt status would be denied to industrial development bonds (IDBs) issued on or after January 1, 1969.\(^26\) One of the exceptions to this rule provided tax-exempt status to IDBs issued to finance residential real property for family units.\(^27\) No

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26. Id. § 107, 82 Stat. at 266-68. The Act defined industrial development bonds as an issue "all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not . . . a governmental unit, or an organization . . . exempt from tax under § 501(a). . ." of the Internal Revenue Code. Pub. L. No. 90-364, § 107(a)(c)(1)-(3), 82 Stat. 251, 266-67 (1968). Exceptions were provided for certain exempt activities, industrial parks, and small issue bonds. Id. § 107(a)(c)(4)-(6), 82 Stat. at 267-68. The Congressional Budget Office contends that these activities serve only "quasi-public" purposes because much of the benefit enures to individuals or corporations. See Congressional Budget Office, 96th Cong., 1st Sess., Tax-Exempt Bonds for Single-Family Housing 2 (Comm. Print April 1979) [hereinafter cited as CBO 1979 Report].

distinction was made between IDBs issued for multi-family rental housing and those issued for single-family owner-occupied residences.\textsuperscript{28} Thus, the Revenue Expenditure and Control Act\textsuperscript{29} did not affect the issuance of tax-exempt housing bonds. The 1970's brought a shift in tax-exempt mortgage bond financing away from multi-family housing.\textsuperscript{30} HFAs placed a growing emphasis on accommodating low and moderate income persons in the market for single-family homes.\textsuperscript{31} In 1976, the volume of state and local tax-exempt single-family bond issues was approximately $700 million.\textsuperscript{32} In 1979, volume rose to approximately $7.8 billion, and in 1980, volume soared to $10.5 billion.\textsuperscript{33} Between 1976 and 1979, the percentage of

\footnotesize{(codified at I.R.C. § 103(b)(4)(A) (Supp. V 1981)). See note 16 \textit{supra} for an explanation of the current provision.}

\footnotesize{28. H.R. CONF. REP. No. 1533, 90th Cong. 2nd Sess., \textit{reprinted in} 1968 U.S. CODE CONG. & AD. NEWS 2341, 2383-84. Although the brief explanation in the conference report refers only to multi-family housing, single-family homes were not specifically excluded. \textit{Id.} They probably were never considered by the conferees since states did not begin to issue these bonds until 1970. CBO 1979 \textit{REPORT}, \textit{supra} note 26, at 3 n.2.}


\footnotesize{30. CBO 1979 \textit{REPORT}, \textit{supra} note 26, at xiii. The Congressional Budget Office report commented that state agencies have "recently shifted their efforts sharply toward single-family housing, much of it in suburban areas and much of it aimed at middle-income families." \textit{Id.} See also \textit{THE PRESIDENT'S REPORT}, \textit{supra} note 1, at 109-70 (until 1979, virtually all HFA activity focused on multi-family housing).}

\footnotesize{31. CBO 1979 \textit{REPORT}, \textit{supra} note 26, at xiii. The first tax-exempt bonds for owner-occupied housing were issued in California after World War I. CBO 1980 \textit{REPORT}, \textit{supra} note 4, at 2. Shortly after World War II, Oregon issued bonds to provide veterans with below-market-rate mortgage loans. \textit{Id.} "In the early 1970's, state housing agencies started issuing bonds to finance mortgages on single-family housing for all state residents of low- or moderate-income." \textit{Id.} In 1978, "62\% of new state agency tax-exempt bond issues were for single-family housing, up from 26\% in 1975." CBO 1979 \textit{REPORT}, \textit{supra} note 26, at xiii. 1978 also marked the beginning of heavy activity by local issuers in the single-family bond market. Nineteen localities in seven states issued about $550 million of these bonds. \textit{Id.} at 1. Then, in the first quarter of 1979, 32 localities in 12 states issued an additional $1 billion of single-family bonds. \textit{Id.}

\footnotesize{32. \textit{THE PRESIDENT'S REPORT}, \textit{supra} note 1, at 170 (Table 12.3). The volume of state and local single-family tax-exempt revenue bonds rose Sharply from $700 million in 1976, to $1 billion in 1977, $3.4 billion in 1978, $7.8 billion in 1979, and $10.5 billion in 1980. \textit{Id.}

\footnotesize{33. \textit{Id.} The passage of the Act greatly distorted 1980 single-family bond volume figures. Investment bankers and issuers feared the potentially adverse impact of the federal restrictions on their ability to issue housing bonds and rushed to market single-family bonds they believed might be their last. Quint, \textit{Sellers of Mortgage Bonds Race Curbs}, N.Y. Times, Nov. 29, 1980, at D1, col. 3. Bonds which were issued at the end of 1980 to avoid the restrictions of the Act inflated the yearly volume figure. Daily Bond Buyer, Jan. 7, 1981, at 1, col. 2. In December alone, 83 issues were brought to market amounting to $3.63 billion, approximately one-half the 1979 total. Daily Bond Buyer, Jan. 19, 1981, at 1, col. 2.}
bonds issued for owner-occupied housing rose from 1.8% of the total state and local bond market to 20.4%. The proliferation of single-family bonds began to raise doubts about the propriety of using tax-exempt bonds to finance residential mortgages that were thought to often benefit middle-income persons.

In an attempt to control the issuance of single-family bonds, the House of Representatives passed the Mortgage Subsidy Bond Tax Act of 1979, but the bill, however, did not clear the Senate. Eventually, a

34. H.R. Rep. No. 1167, 96th Cong., 2d Sess. 445, reprinted in 1980 U.S. Code Cong. & Ad. News 5526, 5808 (Table 2). (The table represents the percentage distribution of purposes for which tax-exempt bonds were issued by state and local governments between 1976 and 1979. The figure cited includes bonds issued for both single and multi-family housing.)


Virginia has a provision whereby a city may determine that in providing safe and sanitary residential housing, it is necessary and desirable to provide housing to persons of other than low and moderate incomes. Va. Code § 36-55.25(e), (f)(Supp. 1982). The validity of this provision was upheld in Infants v. Virginia Hous. Dev. Auth., 221 Va. 659, 670-75, 272 S.E.2d 649, 655-59 (1980).

36. This was one of two predecessor versions of the Act. H.R. 5741, 96th Cong., 1st Sess. (1979), was passed by the House on Mar. 26, 1980. 126 Cong. Rec. H2237
modified version of the House Bill was enacted—The Mortgage Subsidy Bond Tax Act of 1980.\footnote{37}


Imposition of the Act had a dramatic impact on bond volume. Due to uncertainties regarding several of its provisions, few single-family bonds were issued in 1981 before November. CBO 1980 REPORT, supra note 4, at 5; see also Daily Bond Buyer, Mar. 13, 1981, at 3, col. 3 (lack of treasury regulations makes it difficult for bond counsel to provide an opinion on the tax-exempt status of single-family issues). The main reason for these uncertainties and the resultant delay was that temporary regulations were not issued by the Treasury until Nov. 5, 1981. \textit{Id.} See also \textit{The President's Report}, supra note 1, at 170 (technical problems and lack of regulations caused the decline in bond volume in 1981). Those single-family bonds that did come to market were mostly exempted from the Act by transitional rules. See I.R.C. § 103A(g)(7)(Supp. V 1981); see also note 15 supra for operation of transitional rules. These rules allowed certain issues in progress at the time the Act was enacted to be marketed free of restrictions. CBO 1980 REPORT, supra note 4, at 5. See also \textit{The President's Report}, supra note 1, at 170 (as of March, 1982, virtually no single-family bonds had been issued since the Act was imposed, with the exception of issues already in progress).

The Act came under immediate criticism by members of Congress who believed it was too severe and contrary to congressional intent. Various Senators criticized the Act, complaining that it: "[V]irtually shut down the mortgage . . . bond market . . . ," 127 CONG. REC. S5936 (daily ed. June 9, 1981) (statement of Sen. Bumpers); "meant to tighten up eligibility requirements and limit the overall level of such issues, [instead] the restrictions have put a complete stop to the housing bond programs across the country. . . .," \textit{id.} at 5938 (statement of Sen. Pryor); and that it "contained a number of provisions which inadvertently made it impossible for state and local governments to issue tax-exempt mortgage revenue bonds. . . ." 127 CONG. REC. S10,280 (daily ed. Sept. 23, 1981) (statement of Sen. Sasser). For contrary views, see 1982 Hearing, supra note 4, at 72-74 (statement of John E. Chapoton, Treasury Dept.)(contending that high interest rates, rather than provisions of the Act, were responsible for inhibiting bond volume); see also 1981 Hearing, supra note 1, at 100 (statement of Sen. Dole)(high interest rates and a variety of financial variables probably had more of an influence on reduced bond volume than the provisions of the Act).

Opponents of the Act contended that it was wrought with restrictions that prevented state and local governments from marketing single-family bonds because states feared that a violation of any provision would cause the bonds to lose their tax-exempt status. \textit{See, e.g.}, 127 CONG. REC. S5934 (daily ed. June 9, 1981)(statement of Sen. Sasser proposing legislation to remove what he perceived to be various technical problems contained in the Act). The imposition of the Act's restrictions (see notes 51-63 infra and accompanying text for discussion of the Act’s restrictions) was considered by some members of Congress to be particularly untimely due to the tight money...}
Primarily, Congress intended to curtail revenue losses suffered by the Treasury because of high tax bracket investors who purchase the bonds as a means of escaping taxation on interest income.\textsuperscript{38} Congress questioned whether tax-exempt financing was an efficient method of "subsidizing" housing.\textsuperscript{39} Another concern was that states and localities could, by issuing bonds, circumvent the federal budget appropriations process by providing funds for housing which were not originally allocated by the Congress as direct expenditures.\textsuperscript{40} Moreover, Con-

policy the Federal Reserve had recently adopted. This fiscal policy sent interest rates to record high levels and sent home sales plummeting. See 1981 Hearing, supra note 1, at 67 (statement of Sen. Carl Levin); 127 CONG. REC. S5936 (daily ed. June 9, 1981)(statement of Sen. Bumpers)(single family mortgage bonds are necessary due to the Federal Reserve's tighter control on credit, which sent housing prices and interest rates to record high levels).

In August of 1981, the Treasury Department issued temporary guidelines which provided definitional certainty about the provisions of the Act for the first time. 46 Fed. Reg. 34,314-25 (1981)(codified at 26 C.F.R. § 103A (1982)). In November, 1981, one of the regulations was amended. 46 Fed. Reg. 55,514 (1981). This amendment served to clarify the rule that 95% of the mortgagors must meet the Act's eligibility requirements, in order for the bonds to qualify as tax-exempt. The amendment replaced an absolute 95% standard with one that allows an issuer to rely in good faith upon certification by the mortgagor, seller, and loan originator that each party complied with particular requirements of the Act. Treas. Reg. § 6a.103A-2(c)(1982). See note 54 infra. As a result, the marketability of the bonds improved since bond counsel could once again provide unqualified opinions as to the tax-exempt status of single-family bonds. See Daily Bond Buyer, Nov. 23, 1981, at 1, col. 3; see also 1981 Hearing, supra note 1, at 258 ("[a]t the present time . . . our bond underwriters [said] it would be difficult—if not impossible to successfully market our bonds with a qualified opinion . . . ")(statement of Grady Haynes, Chairman of Tennessee Housing Development Agency); Daily Bond Buyer, Sept. 2, 1981, at 1, col. 2 (Public Securities Association claimed that uncertainty prevented counsel from providing unqualified opinions that mortgage revenue bond interest is tax-exempt).

The definitional certainty provided by the regulations and a slight drop in interest rates resulted in a flurry of activity in the fourth quarter of 1981. CBO 1980 Report, supra note 4, at 5. Nevertheless, volume for 1981 was approximately $3 billion, down by more than $7 billion from the previous year. See notes 88-103 infra and accompanying text for a discussion of volume limitations; see note 32 supra for 1980 single-family volume figure. See also COUNCIL OF STATE HOUSING AGENCIES, IN SUPPORT OF MORTGAGE REVENUE BONDS 1 (undated)(estimating that volume for 1981 was about 15% of the congressionally imposed limit).


gress believed that too large a supply of single-family bonds would increase the interest rates of other municipal obligations forced to compete in the bond market.

At least three bills were introduced into the Senate in 1981 and 1982 to ease the restrictions of the Act. Many recommendations of the proposed bills were incorporated into the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA). TEFRA amended and liberalized the Act in certain important respects. Congress considered the relaxation of single-family bond restrictions allowed by TEFRA to be the least costly and most effective way to channel temporary assistance to the distressed housing industry. The liberalized provisions, however,

the federal government. Id. Prior to the Act, the federal government could control direct federal housing expenditures for budgetary purposes, while it could not control the volume of state housing bond issues. Id. As a result, reductions in the budget for direct housing expenditures were being negated by an uncontrolled increase in tax-exempt housing bond volume. Id.

41. Id. at 447, reprinted in 1980 U.S. Code Cong. & Ad. News at 5810. See also Daily Bond Buyer, Sept. 30, 1981, at 1, col. 3 (memorandum released by the United States Office of Management and Budget states that proliferation of single-family issues drove up the cost of municipal borrowing for other projects). Congress also observed that the percentage of total fixed investment devoted to residential purposes in this country was already higher than most other countries. H.R. Rep. No. 1167, 96th Cong., 2d Sess. 446, reprinted in 1980 U.S. Code Cong. & Ad. News 5526, 5809. Any additional increase would come at the expense of other forms of investment. Id. at 446-47, reprinted in U.S. Code Cong. & Ad. News at 5809-10.


44. The maximum arbitrage spread (see notes 59-63 infra and accompanying text) between the yield on a bond and the mortgage interest rate it subsidizes was increased to 1¼% from 1%. TEFRA § 220(a)(1)(codified at I.R.C. § 103A (j)(2)(West Supp. No. 3 1982)). The maximum purchase price (see notes 110-22 infra and accompanying text) for homes located in targeted areas was raised from 110% to 120% of the average area purchase price. TEFRA § 220(d)(2) (codified at I.R.C. § 103A(f)(5)(West Supp. No. 3 1982)). Only 90% of borrowers using mortgage bonds need to be first-time homebuyers (see notes 104-09 infra and accompanying text), a decrease of 10% from the old rule (100%). TEFRA § 220(c)(1)(codified at I.R.C. § 103A(e)(1)(West Supp. No. 3 1982)).

45. S. Rep. No. 494, 97th Cong., 2d Sess. 184, reprinted in 1982 U.S. Code Cong. & Ad. News 3, 165-66 (Supp. No. 7). To provide this assistance, the regulations were relaxed in order to ensure that the volume of mortgage subsidy bonds would increase toward its maximum limit in each state. Id. Congress acknowledged that in order to attain their objective, it would be necessary to dilute the original purpose of the Act, which was to direct the financing to those individuals whom Congress deemed to have the greatest need. Id.
are only a temporary measure. On December 31, 1983, the Act's sunset provision will terminate the tax-exempt status of all single-family mortgage revenue bonds. 46

III. The Mortgage Subsidy Bond Tax Act

A. Purpose of the Act

The purpose of the Mortgage Subsidy Bond Tax Act is "to direct the subsidy from the use of tax-exempt bonds for owner occupied housing to those individuals who have the greatest need for the subsidy, to increase the efficiency of the subsidy, and to restrict the overall revenue loss from the use of tax-exempt bonds for owner occupied

47. H.R. CONF. REP. No. 1479, 96th Cong., 2d Sess. 171, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5903, 5955. See notes 55-58 infra and accompanying text for a discussion of mortgage eligibility requirements which direct the "subsidy" to those individuals with the greatest need.
48. H.R. CONF. REP. No. 1479, 96th Cong., 2d Sess. 171, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5903, 5955. Congress was concerned with the efficiency of using tax-exempt bonds to finance owner-occupied single-family housing. H.R. REP. No. 1167, 96th Cong., 2d Sess. 446, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5799-809. The Act includes arbitrage restrictions designed to increase the efficiency of these bonds by limiting the amount of administrative and issuance costs which can be passed on to the mortgagor. Id at 436-46, reprinted in 1980 U.S. CODE CONG. & AD. NEWS at 5799-809. See notes 59-63 infra and accompanying text for a discussion of arbitrage. Opponents of mortgage revenue bonds contend that they are an inefficient vehicle for the financing of single-family housing since the revenue loss to the federal government significantly exceeds the interest cost savings to those receiving the subsidy. Department of the Treasury, Treasury News, May 21, 1982, at 10; see also CBO 1979 REPORT, supra note 26, at 47-55. (Treasury revenue loss estimates for projected single-family bond volume); Daily Bond Buyer, Sept. 30, 1981, at 1, col. 3 (Treasury regards tax-exempt financing as inefficient).
For an opposing view, largely discrediting Treasury estimates, see R. Kormendi, supra note 10, at 29 (arguing that Congressional Budget Office and Treasury calculations of the interest rate and tax revenue effects of mortgage revenue bonds are inaccurate due to an over-simplified view of capital markets and erroneous statistical procedure); see generally J. Esser, MORTGAGE REVENUE BONDS . . . EFFICIENT OR INEFFICIENT?, (Sept. 13, 1979)(Director of Liaison, Municipal Finance Officers Association)(acknowledging and analyzing the wide variation in cost/benefit estimates); R. Forbes, supra note 7, at 2-5 (adopting a middle ground between Treasury/CBO figures and those of Kormendi and Nagle).
49. H.R. CONF. REP. No. 1479, 96th Cong., 2d Sess. 171, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5903, 5955. This is accomplished mainly by limiting the volume of single-family bonds which a state may issue in any given year. See notes 88-103 infra and accompanying text for a discussion of volume limitations.
To effectuate this purpose, the Act imposes substantial requirements and restrictions on the financing of home mortgage loans by an issuer of tax-exempt obligations.

B. The Act’s Restrictions

The Act’s restrictions may be grouped into three distinct categories. First, there are general restrictions placed upon the issuer. These include: (1) volume limitations on the amount of bonds a state may issue in any given year, (2) a mandatory allocation of a portion of the bond proceeds for the purpose of originating mortgage loans in targeted areas, (3) a requirement that all bonds be issued in registered form as opposed to bearer form, and (4) a requirement that the issuer in good faith, attempt to make sure that all of the program borrowers meet the Act’s eligibility requirements.

Second, there are mortgage eligibility requirements for individuals receiving program loans. The mortgage eligibility requirements in-
clude: (1) purchase price limitations, 55 (2) a restriction that the mortgage loans be used to purchase principal residences for individuals who have had no ownership interest in a home within the past three years, 56 (3) a prohibition on the refinancing of existing mortgages, 57 and (4) rules governing the assumability of these mortgages. 58

Finally, there are arbitrage restrictions. 59 These restrictions require that the yield on a bond-financed mortgage not exceed the yield paid by the issuer to bondholders by more than 1.125% points. 60 Also, the interest profits that can be earned from the temporary investment of bond proceeds in other securities is limited 61 and must be passed through to either the mortgagors 62 or to the federal government. 63

The single biggest problem in evaluating the provisions of the Mortgage Subsidy Bond Tax Act is the relatively small number of bond offerings that have been issued subject to its provisions. Although


59. Generally, arbitrage restrictions limit the extent to which an issuer may temporarily invest bond proceeds in investments which earn a yield higher than that offered on the bonds. See generally Note, The IRS’s Application of Arbitrage Provisions: Overregulation of Municipal Finance, 10 FORDHAM URB. L.J. 659 (1982) for a complete discussion of the development and current application of the Internal Revenue Code’s arbitrage provisions. This Comment does not discuss arbitrage restrictions at great length because most of the restrictiveness of the Act’s arbitrage rules was eliminated by TEFRA. See note 37 supra.

60. TEFRA § 220(a)(1), (3)(codified at I.R.C. § 103A(i)(2)(West Supp. No. 3 1982)).


enacted in December 1980, bonds regulated by the Act were not issued until November 1981. As a result, this Comment must evaluate the effectiveness of the Act, based on a limited amount of actual experience. In this short time, however, certain provisions of the Act have raised controversy because they are either too restrictive and exclude groups of people in need of assistance, have arbitrarily favored certain jurisdictions, or have been counter-productive in achieving their intended purpose.

C. The Controversial Provisions

1. Targeted Areas

The purpose of allocating funds for targeted areas is to promote the economic growth and revitalization of remote, underdeveloped, or blighted areas of a state. There are two kinds of targeted areas; qualified census tracts and areas of chronic economic distress (ACEDs). The former is decided solely on the basis of 1980 census median income data. Qualified census tracts are those census tracts within a state in which seventy percent or more of the families have an income of eighty percent or less of the statewide median family income. ACEDs are designated voluntarily by a state and approved by the Department of Housing and Urban Development and the Treasury Department on the basis of criteria relating to substandard housing stock, resident economic need, the potential use of owner financing to improve housing conditions, and whether the area has coverage under a housing assistance plan.

The Act requires that an issuer of single-family mortgage bonds make available, for at least one year, a minimum of twenty percent of the lendable proceeds of each bond issue to originate mortgages in targeted areas. Alternatively, an issuer may reserve for targeted areas forty percent of the average annual volume of mortgage loans originated in targeted areas within its jurisdiction during the preceding three years (forty percent market share). This forty percent

64. See note 37 supra (reasons for delay).
66. Id § 6a.103A-2(b)(4).
67. Id § 6a.103A-2(b)(5)(i).
68. Id § 6a.103A-2(b)(5)(ii)(A)-(D). The regulations provide that a state must file the supporting information for a proposed ACED designation with the Assistant Secretary of Housing. Id. § 6a.103A-2(b)(5)(iv),(v).
market share option may allow an issuer to reserve substantially less than twenty percent of its total bond proceeds. This occurs when targeted areas within an issuer's jurisdiction have generated very few mortgages over the previous three years. For instance, in Alaska, the only targeted area consists of federal land where there has been no mortgage financing during the relevant three year base period. As a result, the state is not required to set aside any bond proceeds for targeted area loans. Therefore, the forty percent market share provision allows some states to defeat the purpose of the targeted area requirement by allocating very few funds from a bond issue for these mortgage loans.

The Act provides two incentives to encourage issuers to increase the amount of funds they reserve for targeted areas. It relaxes some of the Act's restrictions in targeted areas by increasing maximum purchase price limitations on houses located in these areas, and by eliminating the requirement that eligible mortgagors be first-time homebuyers. On the other hand, there are disadvantages. Lenders often have to be persuaded to originate mortgage loans in targeted areas for sale to

require an issuer to set aside more money for targeted areas than could be utilized. H.R. Rep. No. 1167, 96th Cong., 2d Sess. 449, reprinted in 1980 U.S. Code Cong. & Ad. News 5526, 5812. By reserving funds, an issuer designates a portion of the bond proceeds as being available for one year exclusively for the commitment of mortgage loans in targeted areas. Treas. Reg. § 6a.103A-2(h)(i)(1982). During the one year period, the issuer must use reasonable diligence to commit the reserved proceeds to mortgage loans in targeted areas. Id. § 6a.103A-2(h)(ii). If the issuer has used reasonable diligence, and reserved bond proceeds still remain uncommitted, the funds may be used to originate ordinary mortgage loans. 71. See CBO 1980 Report, supra note 4, at xiv.

72. ALASKA HOUSING FINANCE CORP., OFFICIAL STATEMENT 22 (Sept. 1, 1982).

73. Id.

74. CBO 1980 Report, supra note 4, at xiv. The Congressional Budget Office examined 31 official statements and reported that only seven would allocate the full 20% of lendable funds for targeted areas). Ten reserved no funds, twelve reserved between 0% and 20% and two were ambiguous. Id. at 36-37. See also Table I at note 84 infra (survey of the portion of proceeds states intend to reserve from their most recent issue for loans in targeted areas).

75. See note 111 infra and accompanying text. By increasing the purchase price limit, the number of residences eligible for mortgage bond financing within targeted areas is increased.

single-family programs. This presents a problem for the issuer because the faster the agency is able to spend the bond proceeds on mortgage loans, the more secure the terms of the investment for bondholders. It is these mortgage payments that supply the main source of revenue for principal and interest payments on single-family bonds.

To minimize the delay in committing bond proceeds to targeted area mortgage loans, some issuers have taken advantage of the forty percent market share option to reduce the number of targeted loans they are required to make in economically depressed areas. This enables them to commit their bond proceeds to mortgage loans more quickly and increases the security of their mortgage portfolios. As a result, the risk of investment to a prospective bond purchaser is reduced. A smaller reserve for targeted area loans translates into an improved credit rating for the single-family bonds, and allows the issuer to offer a lower yield to bondholders which reduces the issuer's cost of borrowing. Generally, investors will accept a lower rate of return (yield) on a more secure investment. It would appear, therefore, that jurisdictions with a large number of targeted areas are placed at a disadvantage compared with more affluent jurisdictions having fewer targeted areas. This latter group can often reduce its cost of borrowing by exercising the forty percent market share option

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77. CBO 1980 Report, supra note 4, at 36 (stating that this puts jurisdictions with many targeted areas at a disadvantage; generally, problems stem from the fact that these loans are not considered as secure as regular loans).

78. See R. Rosenberg, Single Family Mortgage Bonds, Has Volume Exceeded Demand? 1-2 (Dreuxel, Burnham, Lambert, Inc., Oct. 6, 1982). This study assesses the loan origination status of certain single-family issues and concludes that some issuers will have to “call” their bonds since they are encountering difficulty in committing bond proceeds to mortgage loans. The report states that: “The degree to which there is risk of bonds being called is directly related to the degree to which an issuer can originate single-family mortgage loans from bond proceeds in the time period allocated.” Id. at 1. See also Note, supra note 10, at 476 (the extent to which single-family bonds are collateralized by mortgages contributes to favorable bond rating); Daily Bond Buyer, Oct. 6, 1982, at 1, col. 3; 23, col. 2 (underwriters and investors concerned about the slow rate at which bond proceeds being committed to mortgage loans; if bonds called at par amount, investors lose the gain they had anticipated).

79. See notes 7-8 supra and accompanying text.

80. See generally note 74 supra and accompanying text.

81. See note 78 supra and accompanying text; see also R. Rosenberg, supra note 78, at 2 (mortgage origination time is essential to the security of single-family bonds).

82. See Note, supra note 10, at 476 (favorable bond ratings enable cities to market bonds at a lower interest rate).

83. See CBO 1980 Report, supra note 4, at xiv, 36.
and setting aside fewer than twenty percent of its bond proceeds for targeted areas.\textsuperscript{84}

\begin{table}[h]
\centering
\begin{tabular}{|l|c|c|c|c|c|c|}
\hline
\textbf{State} & \textbf{Percentage of Lendable Funds Set Aside for Targeted Areas\textsuperscript{4}} & \textbf{1981 Per Capita Bonding Authority (in dollars)\textsuperscript{4}} & \textbf{Range of Purchase Price Safe Harbor Limitations (in dollars)\textsubscript{c}} & \textbf{Income Limitations (in thousands)\textsubscript{f}} \\
\hline
AL & 0\% \textsuperscript{(3)} & 51 & 66,500 & 52,700 & 37 \\
AK & 0\% \textsuperscript{(3)} & 500 & 117,400 & 91,200 & 25.6 \textsuperscript{(5)} \\
AZ & 75 & 49,100-107,600 & 84,300 & 22.7-45.75 \\
AR & 87 & 66,500 & 50,700 & 30 \\
CA & 40\% & 94 & 65,000-143,400 & 58,900-123,500 \\
CO & 20\% & 107 & 69,300-81,400 & 57,200-85,400 \\
CT & 20\% & 64 & 72,000-152,900 & 65,100-149,200 \\
DE & 15\% & 336 & 54,600-70,500 & 53,100-60,400 \\
DC & & 109,100-101,900 & & \\
FL & 16\% & 63 & 60,800-88,800 & 43,900-96,900 \\
GA & 20-40\% & 37 & 61,600-89,200 & 48,400-67,000 \\
HI & 20\% & 207 & 127,700-127,700 & 110,000 \\
ID & 212 & 91,300-91,300 & 74,400-74,400 & 28.5 \\
IL & 55 & 71,400-88,400 & 48,000-74,900 & 35.3 \\
IN & 20\% \textsuperscript{(6)} & 40 & 62,600-79,300 & 35,800-56,000 \\
IA & 69 & 55,500 & 47,500 & 24.9 \textsuperscript{33} \\
KS & 85 & 64,000-67,000 & 47,500-78,200 & 28.5 \\
KY & 55 & 65,900-84,500 & 49,600-51,300 & 19.5 \\
LA & 48 & 73,900-92,300 & 57,600-74,800 & 40 \\
ME & 178 & 56,000 & 54,200 & 27 \\
MD & 57 & 51,900-78,000 & 65,600-76,300 & 28.9-33 \\
MA & 1.81\% \textsuperscript{(7)} & 35 & 64,700-64,700 & 51,300-70,600 & 22.31.5 \\
MI & 39 & 73,100-73,100 & 51,800-70,600 & 31.75 \\
MN & 4\% \textsuperscript{(8)} & 59 & 70,900-110,500 & 56,900-60,100 & 23-32 \\
MS & 79 & 61,800 & 43,700 & 35 \\
MO & 45 & 57,300-88,100 & 44,900-64,700 & 28-32 \\
MT & 254 & 64,500 & 60,800 & 34.5-38.5 \\
NE & 0.1\% \textsuperscript{(8)} & 127 & 51,900-51,900 & 41,800-65,200 & 32.5 \\
NV & 5\% & 250 & 89,100 & 57,900 & 23.75-39.25 \\
\hline
\end{tabular}
\caption{Percentage of Lendable Funds Set Aside for Targeted Areas, 1981 Per Capita Bonding Authority, Range of Purchase Price Safe Harbor Limitations, Income Limitations (in thousands).}
\end{table}
TABLE I (cont'd)

<table>
<thead>
<tr>
<th>State</th>
<th>Percentage of Lendable Funds Set Aside for Targeted Areas&lt;sup&gt;a&lt;/sup&gt;</th>
<th>1981 Per Capita Bonding Authority (in dollars)&lt;sup&gt;b&lt;/sup&gt;</th>
<th>Range of Purchase Price Safe Harbor Limitations (in dollars)&lt;sup&gt;c&lt;/sup&gt;</th>
<th>Income Limitations (in thousands)&lt;sup&gt;d&lt;/sup&gt;</th>
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<tbody>
<tr>
<td>NH</td>
<td>20%</td>
<td>217</td>
<td>57,000 to 85,900</td>
<td>40</td>
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<tr>
<td>NJ</td>
<td>20%</td>
<td>43</td>
<td>77,400 to 67,600</td>
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<td>NM</td>
<td>3%</td>
<td>154</td>
<td>83,600 to 52,300</td>
<td>20</td>
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<td>24</td>
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<td>ND</td>
<td>20%</td>
<td>306</td>
<td>64,500 to 60,800</td>
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<td>OH</td>
<td>20%</td>
<td>50</td>
<td>77,000 to 51,800</td>
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<td>OK</td>
<td>20%&lt;sup&gt;(n)&lt;/sup&gt;</td>
<td>66</td>
<td>80,100 to 55,200</td>
<td>38.5 to 42</td>
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<tr>
<td>OR</td>
<td>20%</td>
<td>76</td>
<td>79,100 to 60,300</td>
<td>25.5</td>
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<tr>
<td>PA</td>
<td>20%</td>
<td>36</td>
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<td>RI</td>
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<td>69,900 to 48,300</td>
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<td>64</td>
<td>67,200 to 51,700</td>
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<tr>
<td>SD</td>
<td>20%</td>
<td>290</td>
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<tr>
<td>TN</td>
<td>20%</td>
<td>44</td>
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<td>TX</td>
<td>20%</td>
<td>54</td>
<td>73,100 to 50,900</td>
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<tr>
<td>UT</td>
<td>20%</td>
<td>137</td>
<td>61,900 to 55,100</td>
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<tr>
<td>VT</td>
<td>20%</td>
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<td>56,000 to 48,300</td>
<td>32.5</td>
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<tr>
<td>VA</td>
<td>20%</td>
<td>58</td>
<td>57,000 to 48,300</td>
<td>18 to 33</td>
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<tr>
<td>WA</td>
<td>20%</td>
<td>58</td>
<td>77,300 to 57,100</td>
<td>23.3 to 34&lt;sup&gt;a&lt;/sup&gt;</td>
</tr>
<tr>
<td>WV</td>
<td>20%</td>
<td>103</td>
<td>56,000 to 50,900</td>
<td>32.7</td>
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<tr>
<td>WI</td>
<td>20%</td>
<td>43</td>
<td>70,100 to 51,200</td>
<td>23.3 to 34&lt;sup&gt;a&lt;/sup&gt;</td>
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<tr>
<td>WY</td>
<td>20%</td>
<td>425</td>
<td>64,500 to 60,800</td>
<td>45</td>
</tr>
</tbody>
</table>

<sup>a</sup> 1982 SURVEY, supra note 4, at 1-75.
<sup>b</sup> 1980 CBO REPORT, supra note 4, at 34-35.
<sup>d</sup> See text accompanying notes 72-73 supra.
<sup>e</sup> INDIANA HOUSING FINANCE AUTHORITY, OFFICIAL STATEMENT 18 (April 6, 1982).
<sup>f</sup> Massachusetts is setting aside $3.62 million of a $200 million issue, but mortgage lenders are required to reserve 40% of the issue for the first three months for high priority loans. See MASSACHUSETTS HOUSING FINANCE AGENCY, OFFICIAL STATEMENT 10 (Aug. 10, 1982).
<sup>g</sup> Minnesota is reserving $1.7 million of a $41.9 million issue. See MINNESOTA HOUSING FINANCE AGENCY, OFFICIAL STATEMENT 12 (Aug. 1, 1982).
<sup>h</sup> Nebraska has set aside $100,000 of an $89.4 million issue. See NEBRASKA OFFICIAL STATEMENT, supra note 5, at 17.
<sup>i</sup> See OKLAHOMA OFFICIAL STATEMENT, supra note 5, at 14.
<sup>j</sup> ALASKA HOUSING FINANCE CORPORATION, OFFICIAL STATEMENT, 16 (Sept. 9, 1982).
<sup>k</sup> CONNECTICUT HOUSING FINANCE AUTHORITY, OFFICIAL STATEMENT 11 (Sept. 10, 1982).
<sup(lp) Florida Housing Finance Agency, OFFICIAL STATEMENT 6 (June 1, 1982).
<sup>m</sup> NORTH DAKOTA HOUSING FINANCE AGENCY, OFFICIAL STATEMENT 10 (July 15, 1982).
<sup>n</sup> WISCONSIN HOUSING FINANCE AUTHORITY, OFFICIAL STATEMENT 14 (Dec. 1, 1982).
As a matter of policy, issuers with few qualified census tracts are encouraged to petition the government for additional ACED designations to increase the number of targeted areas within their jurisdictions. The additional designations assure that issuers who are presently reserving less than twenty percent of their bond proceeds for targeted areas will commit a greater percentage of the proceeds from future bond issues to areas that are in need of revitalization. In practice, however, issuers with few qualified census tracts are discouraged from attempting to designate new target areas (ACEDs) because of the added costs of holding aside additional proceeds for targeted area loans. Although some incentives are provided to encourage issuers to set aside additional funds for targeted areas, they do not offset the increased cost of borrowing associated with targeted loans.

2. Volume Limits

The Act limits the volume of single-family bonds that each state is allowed to issue annually. A state may choose for its volume limitation $200 million, or nine percent of the annual volume of state

It is difficult to ascertain exactly how much money from each bond issue is set aside for targeted areas. Official statements are often ambiguous and state they will be in compliance with the targeted area restriction but fail to indicate which of the two alternatives they intend to comply: the 20% provision, or the 40% market share provision. A recent survey conducted by the Council of State Housing Agencies (along with supplemental information supplied by this author) indicates that of 20 states explicitly designating the amount of money they intend to reserve for targeted area loans, California, Colorado, Connecticut, Georgia, Hawaii, Indiana, New Hampshire, New York, Oklahoma, Texas, Virginia and West Virginia intend to reserve at least 20% of their proceeds for targeted area loans. See Table I supra. States reserving less than 20% include: Delaware, 15%; Florida, 16%; Nevada, 5%; and New Mexico, 3%. Id. States reserving less than 20%, but who have expressed the amount in terms of absolute dollar figures, rather than percentages of bond proceeds, include Massachusetts, Minnesota and Nebraska. Id. Approval of targeted areas in the State of Maryland is still pending. See 1982 Survey, supra note 4, at 28. Alaska is not required to reserve any funds for targeted areas. See text accompanying notes 72-73 supra.

85. Issuers are provided with incentives to originate mortgages in targeted areas. See notes 75-76 supra and accompanying text.
86. See notes 75-76 supra and accompanying text.
87. CBO 1980 Report, supra note 4, at xiv (the value of increased purchase prices and removal of the first-time homebuyer requirement is small in comparison with the costs of setting aside additional funds for targeted areas). See also 10 Hous. & Dev. Rep. (BNA) at 103 (July 5, 1982)(only four applications by states requesting an increase in their number of targeted areas were being processed; states which submitted applications were Michigan, Mississippi, New Hampshire and Tennessee).
mortgage originations averaged over the previous three years, whichever provides for a greater bonding authority. Congress created this limitation due to its concern that a very large revenue loss would result if single-family bond volume was not curtailed. Congress also did not want volume to increase to a level where bond-financed mortgages represented a substantial portion of the overall mortgage market. In addition, Congress observed that the proliferation of single-family bonds had driven up the interest rates on municipal bonds issued for other purposes.

One problem with the Act's volume limitations is that they favor sparsely populated states. It stands to reason that very populous states with a large volume of mortgage activity during the previous three years will choose the nine percent option if it provides for a bonding authority in excess of $200 million. By the same token, a smaller state, with less mortgage activity during the relevant three year period will opt for the $200 million limit because it often pro-

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91. See H.R. Rep. No. 1167, 96th Cong., 2d Sess. 450, reprinted in 1980 U.S. Code Cong. & Ad. News 5526, 5813. The original House provision allowed for volume in each state of $50 million or 5% of the average annual volume of statewide mortgage originations during the previous three years, whichever was greater. This provision was amended in Conference to reflect the current allowable figures. H.R. Conf. Rep. No. 1479, 96th Cong., 2d Sess. 174-76, reprinted in 1980 U.S. Code Cong. & Ad. News 5903, 5958-60. Of the 50 states and the District of Columbia, 37 currently have safe harbor volume limits of $200 million. Those having greater limits include (in millions): Arizona, $226; Colorado, $293; Florida, $675; Illinois, $495; Maryland, $229; Michigan, $279; New Jersey, $304; New York, $443; Ohio, $438; Pennsylvania, $381; Texas, $767; Virginia, $229; Washington, $236. The largest is California with $1.943 billion. Rev. Proc. 82-44, 1982-31 I.R.B. 45.

92. H.R. Rep. No. 1167, 96th Cong., 2d Sess. 450, reprinted in 1980 U.S. Code Cong. & Ad. News 5526, 5813. One reason for the limitation is to prevent conventional lenders from having to compete with issuers who can offer mortgage loans at lower rates of interest due to the advantage of tax-exempt financing. Id.

93. Id. at 447, reprinted in 1980 U.S. Code Cong. & Ad. News at 5810. As tax-exempt mortgage bond volume grows, it has a tendency to increase rates of interest on all bonds. Id. As a result, the cost of borrowing for other state and municipal projects is increased. Id.

94. CBO 1980 Report, supra note 4, at xii (stating however that volume limits were not a problem in 1981, since only two states exercised their entire bonding quota).
vides for bonding authority well in excess of nine percent of its three-year average. This formula, therefore, favors smaller states to the extent that $200 million exceeds nine percent of a state's three-year average of mortgage activity. These less populous states possess an advantage in terms of relative bonding authority over more populous states whose best choice is limited to the nine percent option.

A second problem with the formula used to compute nine percent of a state's mortgage volume activity is that it is counter-cyclical. The formula uses mortgage origination statistics compiled during the three immediately preceding years. Therefore, beginning in the second year of a housing recession, volume figures from the recession year immediately preceding the year of issuance replace volume figures from three years prior, presumably a better year for housing and mortgage activity. This problem is compounded in subsequent years because recession statistics are substituted for figures from better years. As a result, states who use the nine percent formula have their

95. Relative bonding authority can be calculated for each state using the $200 million limit by computing what percent of the three-year average of total mortgage originations $200 million represents. This computation has not been conducted on a statewide basis. In 1981, however, a report conducted by the Congressional Budget Office determined the amount of per capita bonding power existing in each state. CBO 1982 Report, supra note 4, at 34-35 (information included in Table I, supra note 84). This was determined by dividing each state's volume limitation by the population as determined by the 1980 census. The results illustrate the extent to which sparsely populated states have an advantage, in terms of per capita bonding authority, over the most populous states who generally choose the option allowing for 9% of their three-year average of mortgage volume activity. The State of Alaska had the most bonding power, equal to $500 per resident. Other states with high per capita bonding power included: Wyoming, $425; Vermont, $391; Delaware, $336; North Dakota, $306. The state with the lowest rate of per capita bonding power was New York with $24 per resident. Other states with low bonding power included: North Carolina, $34; Massachusetts, $35; Indiana, $40; Pennsylvania, $36; Georgia, $37; Michigan, $39; New Jersey, $43; Wisconsin, $43; Tennessee, $44, and Missouri, $45. Id. See Table I, supra note 84.


97. The problem is illustrated by the reduction in safe harbor limitations between the years 1981 and 1982. In 1982, volume figures from 1981, a bad year in housing, replaced those from 1978, a good year in housing. As a result, the average volume over the three-year period was reduced in those states using the 9% computation and the safe harbor limitation figures diminished proportionately. 1982 Mortgage Bond Limits For States Reflect Housing Downturn, 10 Hous. & Dev. Rep. (BNA) at 148-49 (July 19, 1982) (giving a breakdown by state of increases and decreases between the 1981 and 1982 state safe harbor volume limitations).
bonding authority reduced during recessionary periods when they need it most. This also increases the disparity in per capita bonding authority, already discussed, which exists between sparsely and densely populated states. This is because the three-year averaging methodology only reduces volume limits in populous states choosing the nine percent option. In a less populous state whose volume limitation remains $200 million, there is no reduction in per capita bonding authority in recessionary years.

Volume limitations also fail to take into account the extent to which residents of each state depend upon their HFA as a source of mortgage financing. The most pronounced example of this occurs in Alaska. Even though the rate of per capita bonding authority in Alaska is higher than that of any other state, its volume ceiling still may not be high enough. Alaska residents are forced to rely heavily upon their HFA for home mortgage loans because it is the largest source of mortgage financing in the state.

Finally, volume limitations may be responsible for an artificial supply of single-family bonds. This is due to the fact that any surplus in a state's yearly bonding allocation may not be carried over into the next year. Therefore, at the end of 1981, issuers struggled to market bonds in an attempt to exhaust their yearly bonding quota. In this instance issuers were pressured to market their bonds prematurely and the volume limitations actually increased instead of limiting the supply of single-family bonds. This would appear to be the opposite result of what Congress intended the provision to accomplish.

98. For example, 1982 safe harbor volume figures dropped in fifteen states, down a total of $683.2 million from 1981. Id. at 148. The most significant decreases (in millions) occurred in California, down $274.6; Illinois, down $137.2; Ohio, down $102; and Michigan, down $83.7. Id. at 148. Other states whose volume ceilings dropped included Colorado, Georgia, Indiana, Maryland, Minnesota, Missouri, New Jersey, Pennsylvania, Virginia, and Washington. Id. at 148-49. The only increases (in millions) occurred in Florida, up $60.1; New York, up $30.1; and Arizona, up $22.5. Id. at 148. Ceilings in other states remained at $200 million. Id.

99. Per capita bonding authority is calculated by dividing a state's volume limitation by its population. See note 95 supra. If the volume limitation in a state is reduced, per capita bonding authority decreases proportionately.

100. See Table I, supra note 84.

101. ALASKA HOUSING FINANCE CORPORATION, SELECTED CORPORATION AND PROGRAM INFORMATION 1 (Sept. 1982)(stating that the activities of the Alaska HFA constitute "practically the entire Alaskan mortgage market").


103. See Daily Bond Buyer, Nov. 23, 1981, at 1, col. 4.
3. **First-Time Homebuyer Requirement**

The three-year requirement, commonly referred to as the first-time homebuyer rule, provides that after deducting the proceeds used to make loans in targeted areas, ninety percent of the lendable proceeds of a bond issue must be used to originate mortgages for persons who have had no ownership interest in a principal residence during the three years prior to the date on which the mortgage is executed.\(^\text{104}\) Congress believed that individuals with the greatest need for program loans were those of low and moderate income who have difficulty in procuring mortgage money and a down-payment for their first home.\(^\text{105}\) People with existing homes were thought to have sufficient equity to enable them to purchase another home with conventional financing.\(^\text{106}\)

This restriction may operate to discriminate unfairly against persons who have previously owned mobile homes, lived in substandard housing, or have been displaced by condemnation or natural disaster.\(^\text{107}\) Since the Act itself does not provide income limitations for homebuyers,\(^\text{108}\) states will sometimes have below-market-rate mortgages available for affluent or upwardly mobile first-time purchasers while truly destitute families who have previously owned homes and are unable to obtain conventional financing would not qualify.\(^\text{106}\) The first-time homebuyer requirement, therefore, operates unfairly to the extent that it favors persons who are not truly in need of mortgage financing over those who are.

4. **Purchase Price Limitations**

The Act restricts the price of residences purchased with bond-financed mortgages. The acquisition cost of a residence financed must

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104. TEFRA § 220(c)(1)(codified at I.R.C. § 103A(e)(West Supp. No. 3 1982)).
107. CBO 1980 Report, supra note 4, at 39. See also 1981 Hearing, supra note 1, at 45 (hearing was conducted on a tax bill, S.1348, which included a proposed amendment to the Act providing exceptions to the first-time homebuyer rule for individuals whose homes had been made uninhabitable due to disaster or governmental action); 1982 Hearing, supra note 4, at 34 (hearing on a bill with similar provisions introduced by Sens. Roth and Tsongas).
108. See notes 123-28 infra for a discussion of state imposed income limitations.
109. See CBO 1980 Report, supra note 4, at 39. It is the contention of these impoverished and displaced people that a purchase price limit alone would accomplish much of the intent of the first-time homebuyer rule and relieve a great deal of the administrative burden of checking income tax returns for interest deductions on previous mortgages. Id.
not exceed 110% of the average area purchase price in the standard metropolitan statistical area (SMSA) in which it is located.\footnote{110} In the case of targeted areas, the applicable percentage is 120\%.\footnote{111} Purchase price limitations are crucial to prevent the program from being used to subsidize luxury homes.\footnote{112} Throughout the country, price limitations vary widely.\footnote{113} Average area purchase prices are used due to these variations. The average area purchase price of single-family residences in any given area is determined by the Treasury Department using the most recently available statistical data of homes purchased during the previous twelve month period.\footnote{114} The Internal Revenue Service issues safe-harbor purchase price figures\footnote{115} which are relied on by most issuers to avoid the cost of gathering their own statistical information as to average area purchase prices.\footnote{116} The purchase price determinations for SMSAs are made separately for new and previously occupied residences.\footnote{117}

\footnote{110. TEFRA § 220(d)(1)(codified at I.R.C. § 103A(f)(1)(West Supp. No. 3 1982)). SMSAs are those areas “in and around a city of 50,000 inhabitants or more (or equivalent area)” as defined by the Secretary of Commerce. Treas. Reg. § 6a.103A-2(b)(6)(1982).
111. TEFRA § 220(d)(2)(codified at I.R.C. § 103A(f)(5)(West Supp. No. 3 1982)). The increased price limitation is an incentive to encourage homeowners to purchase homes in targeted areas. See note 75 supra and accompanying text.
113. See Table I, supra note 84.
114. Treas. Reg. § 6a.103A-2(f)(3)(1982). An issuer may rely on his own calculations if they are more accurate or comprehensive. Id. § 6a.103A-2(f)(5).
116. CBO 1980 Report, supra note 4, at 39. The safe harbor figures for previously occupied homes range from lows of: $36,700 in parts of New York; $35,500 in parts of Indiana; $36,400 in parts of Pennsylvania; and $41,800 in parts of Nebraska; to highs of: $101,900 in Washington D.C.; $110,000 in Hawaii; and $96,200 in parts of Texas. The figures for new homes range from lows of: $49,100 in parts of Arizona; $54,600 in parts of Delaware; $55,500 in Iowa; $51,900 in parts of Maryland and $51,800 in parts of Pennsylvania; to highs of $143,400 in parts of California; $152,900 in parts of Connecticut; $127,700 in Hawaii; $110,500 in parts of Michigan; $120,000 in parts of New York; $123,000 in parts of Ohio, and $102,000 in parts of Texas. See Rev. Proc. 83-5, 1983-4 I.R.B. 17-20. See also Table I, supra note 84 (breakdown of the range in safe harbor limitations among the SMSA’s in each state; figures are reported separately for new and previously occupied residences).
In the past, safe-harbor figures have not proven to be the most realistic estimate of actual average area purchase prices. These figures are often inconsistent with actual home buying experience. For instance, the difference between safe-harbor purchase price for new and previously occupied homes would appear to be far too large in some areas and far too small in others. If limits are set too low, moderate income persons in need of tax-exempt financing may be unable to purchase a suitable home that is otherwise readily available in the market. If set too high, lower income purchasers may be crowded out of the marketplace by moderate income purchasers. Consequently, the subsidy may sometimes be denied to those individuals who need it most.

5. Income Limitations

The Act imposes no income limitations on the homebuyers. Nevertheless, most states who have single-family programs had imposed them well in advance of the Act's passage. The range of income limitations is usually expressed either as a percentage of state median income.

118. Safe Harbor Rules Released; Variances Could Cause Problems, 9 Hous. & Dev. Rep. (BNA) 243 (Aug. 17, 1981) [hereinafter cited as Safe Harbor Rules Released]. States may rely on their own statistical information for setting limits if they feel their information is more accurate. Treas. Reg. § 6a.103A-2(f)(5)(1982). This is an expensive proposition, however, and in some states the data is not available. Safe Harbor Rules Released, supra, at 244 (the cost could be as high as $100,000). State calculations are also subject to challenge by the I.R.S.

119. Safe Harbor Rules Released, supra note 118, at 244. This article contains comments by state housing agency officials citing specific examples of the inaccuracies of safe harbor limitations. One Washington, D.C. bond attorney pointed out that the methodology used to arrive at these figures is much weaker than that used to calculate mortgage market volume (for state volume limitations). Id. at 243. See note 70 supra and accompanying text for a discussion of the methodology used to calculate state volume limitations.

120. See, e.g., the safe-harbor limitations for the states of: Alaska, Florida, Idaho, Illinois, Indiana, Louisiana, Minnesota, Mississippi, Missouri, New Mexico, New York, Ohio, Oklahoma, Pennsylvania, Texas and Wisconsin. Table I, supra note 84.

121. See, e.g., the safe-harbor limitations for the states of Delaware, Maine, New Hampshire, North Dakota, South Dakota, Vermont, Virginia and Wyoming. Id.

122. Safe Harbor Rules Released, supra note 118, at 243. Another problem is that metropolitan and non-metropolitan areas are often grouped together when there is insufficient data to form a separate determination for each. Id. As a result, figures are higher than needed in some rural areas and lower than needed in some urban areas. Id.

123. Although originally included in the House bill, the Conference agreement deleted all income requirements. H.R. CONF. REP. No. 1479, 96th Cong., 2d Sess. 172, reprinted in 1980 U.S. CODE CONG. & AD. NEWS 5903, 5926.

124. See Table I, supra note 84, for a survey of state income limitations.
income\textsuperscript{125} or as an absolute dollar figure.\textsuperscript{126} Sometimes there is an additional limitation on the amount of net assets that a borrower may own.\textsuperscript{127} This figure is usually adjusted depending upon the size of the family.\textsuperscript{128}

IV. The Sunset Provision

The most controversial provision of the Mortgage Subsidy Bond Tax Act is its "sunset provision." \textsuperscript{129} As of January 1, 1984, the sunset provision eliminates the tax-exempt status of all single-family mortgage revenue bonds.\textsuperscript{130} Unless Congress takes action to extend or repeal the provision all single-family housing bonds, with the exception of veterans' bonds, issued after that date will be taxable securities.

The Supreme Court has specifically prohibited federal taxation of interest income paid on state and municipal bonds.\textsuperscript{131} Therefore, the constitutionality of any single-family bond regulation under the Mortgage Subsidy Bond Tax Act is questionable, since those bonds which do not comply with its provisions are subject to taxation.\textsuperscript{132} The focus

\textsuperscript{125} See, e.g., California Housing Finance Agency, Preliminary Official Statement 12 (Oct. 1, 1982) (for a one person household, 120% of the median county income, for two and three person households, 135% of the median and 150% for four persons or more); Wisconsin Housing Finance Authority, Preliminary Official Statement 14 (Dec. 1, 1982) (net worth); North Carolina Housing Finance Agency, Official Statement 10 (Nov. 12, 1981).

\textsuperscript{126} See Table I, supra note 84.


\textsuperscript{128} See, e.g., Arkansas Housing Development Agency, Official Statement 14 (July 27, 1982) ($2,000 added for each dependent); Connecticut Housing Finance Authority, Official Statement 11 (Sept. 10, 1982) (income limits range from $24,000 to $40,200 depending on family size).


\textsuperscript{130} Id. See notes 19-20 supra and accompanying text.

\textsuperscript{131} See discussion at notes 147-72 infra and accompanying text.

\textsuperscript{132} See Keohane, The Mortgage Subsidy Bond Tax Act of 1979: An Unwarranted Attack on State Sovereignty, 8 Fordham Urb. L.J. 483, 492-505 (1980). The author contends that the regulation of mortgage subsidy bonds is unconstitutional. In addition, the article takes the position that amendments to § 103 of the Internal Revenue Code limiting exemptions for IDBs and arbitrage bonds are unconstitutional. Id. at 505; 1981 Hearing, supra note 1, at 181-84 (statement of A.L. McNitt, Administrator of Nevada Housing Division) (the State of Nevada feels that there is sufficient probability that the Act is unconstitutional).
of this section, however, is on the constitutionality of the sunset provision and whether Congress has the power to completely eliminate single family mortgage revenue bonds.\textsuperscript{133} Even if the possibility exists that some regulation of single family bonds is constitutionally justifiable,\textsuperscript{134} it does not necessarily follow that the power of regulation may be exercised in such a manner as to eliminate the tax-exempt status of all single family mortgage revenue bonds. In order to determine whether Congress possesses the authority to eliminate these bonds, it is necessary to examine the constitutional doctrine of intergovernmental tax immunity.

A. Development of the Doctrine of Intergovernmental Tax Immunity

The concept of governmental tax immunity was introduced by the Supreme Court to protect federal instrumentalities from state taxation.\textsuperscript{135} In \textit{McCulloch v. Maryland},\textsuperscript{136} the Court held that a state may not tax those means employed by the national government to execute

\begin{itemize}
\item \textsuperscript{133} A discussion of whether any regulation of single-family mortgage revenue bonds is constitutionally justifiable, or alternatively, the extent to which regulation might be permitted, is beyond the scope of this Comment.
\item \textsuperscript{134} Recent decisions of the Supreme Court recognize that there may be situations where "the nature of the federal interest advanced may be such that it justifies state submission" to federal regulation. Hodel v. Virginia Surface Mining and Reclamation Ass'n, 452 U.S. 264, 288 n.29 (1981); National League of Cities v. Usery, 426 U.S. 833, 852-53 (1976) ("The limits imposed upon the commerce power when Congress seeks to apply it to the states are not so inflexible as to preclude temporary enactments by the federal government tailored to combat a national emergency."); Fry v. United States, 421 U.S. 542, 548 (1975) (federal Act temporarily freezing the wages of state and local government employees was constitutional as "an emergency measure to counter severe inflation that threatened the national economy"). Furthermore, since the Mortgage Subsidy Bond Tax Act was enacted by representatives from the 50 states, the operation of the political process would be relevant to any judicial review of the proper scope of a state's immunity from federal taxation. Although in a commerce clause context, the Supreme Court rejected the notion that the operation of the political process precludes the judicial review of a federal regulation imposed upon the operation of states as states, \textit{National League}, 426 U.S. at 841 n.12, perhaps the Court will not be as quick to accommodate challenges to federal regulations in the area of intergovernmental tax immunity. In \textit{Massachusetts v. United States}, 435 U.S. 444 (1978), the Court stated that: "The Congress, composed as it is of members chosen by state constituencies, constitutes an inherent check against the possibility of abusive taxing of the states by the National Government." \textit{Id.} at 456.
\item \textsuperscript{135} See notes 137-38 \textit{infra} and accompanying text.
\item \textsuperscript{136} 17 U.S. (4 Wheat.) 316 (1819).
\end{itemize}
its vested constitutional powers. The Court in this decision relied heavily upon the supremacy clause of the United States Constitution.

Collector v. Day expanded this doctrine of governmental immunity establishing a reciprocal state immunity from federal taxation, co-extensive with that enjoyed by the national government. The Court noted that the existence of states as sovereign entities predated the adoption of the Constitution. The instrument assumes that states will continue to exist and to perform their traditional sovereign functions. Without limitations on the power of the national government to tax, the Court feared that the ability of states to perform their traditional sovereign functions could be destroyed. Although the Constitution contains no express prohibition against intergovernmental taxation, the immunity of state and federal governments from taxation by each other has been upheld as a necessary implication of the Constitution.

137. Id. at 436. If states could tax the instruments employed by the federal government to carry out its powers, they could paralyze its essential activities. Id. at 436-37. State governments in their zeal to represent their constituency might use taxing power to operate to the disadvantage of the national government whose interests they do not represent. Id. at 428-31.

138. Id. at 433-36. The supremacy clause states: "This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby. . . ." U.S. Const. art. VI, § 2.


139. 78 U.S. (11 Wall.) 113 (1870). The Supreme Court held that the salary of a State judge was immune from federal income taxation.

140. "[T]he 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." Id. at 124.

141. Id. at 126.

142. Id. at 124-26.

143. Id. at 126-28. "The power of taxation contains the power to destroy." Id. at 127. This concept was introduced in McCulloch, 17 U.S. (4 Wheat.) at 431.

144. "[T]he exemption rests upon necessary implication, and is upheld by the great law of self-preservation; as any government, whose means employed in conducting its operations, if subject to the control of another and distinct government, can exist only at the mercy of that government." Collector v. Day, 78 U.S. (11 Wall.) at 127; see McCulloch, 17 U.S. (4 Wheat.) at 426.
As the doctrine of intergovernmental tax immunity developed, an initially expansive scope of governmental immunity was extended by the Court to activities that were intimately connected with the exercise of a governmental power or the performance of a governmental duty. During the most expansive period of the doctrine's development, immunity was accorded to individuals and private interests standing in close relationship with one government if the tax of another government resulted in any economic burden being passed on to the non-taxing sovereign. Intergovernmental tax immunity was later narrowed as will be discussed in the next two subsections of this Comment.

B. The Scope of Immunity for Governmental Obligations

Some of the earliest decisions in the area of intergovernmental tax immunity established the principle that governmental obligations issued by one sovereign were not taxable by the other. In Weston v. City Council, the Court held that a city's personal property tax imposed on federal obligations was unconstitutional. "The tax on...
MORTGAGE REVENUE BONDS

government stock is thought by this court to be a tax on the contract, a tax on the power to borrow money on the credit of the United States. . . .” 149 Later, in Merchantile Bank v. New York, 150 a reciprocal tax immunity was extended to state and municipal obligations. The Court stated in dictum that state bonds were not taxable by the federal government. 151

Shortly thereafter, the Court decided the pivotal case regarding the tax immunity of interest earned on state and municipal obligations. In Pollock v. Farmers’ Loan & Trust Co., 152 the Supreme Court held that the United States government could not tax the interest paid on state and municipal bonds. 153 Adopting an approach of form over substance, 154 the Court determined that a tax imposed upon these securities was a tax upon their source (the state), and therefore repugnant to the Constitution. 155

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 state or their instrumentalities exists in relation to a tax on income from their securities. . . .[T]axation on interest therefrom would operate on the power to borrow before it is exercised. . . .[T]he tax in question is a tax on the power of the States and their instrumentalities to borrow money, and consequently repugnant to the Constitution. 156

In addition to this determination, Pollock invalidated a part of the first income tax law which provided for the levying of taxes upon rents and income from real estate. 157 The tax was imposed in violation of the constitutional rule of apportionment. 158 To overcome this obstacle of apportionment, Congress enacted the sixteenth amendment, which gave the federal government the right to tax income “from whatever

149. Id. at 469.
150. 121 U.S. 138 (1887).
151. Id. at 162.
152. 157 U.S. 429 (1895).
153. Id. at 586.
154. Id. at 581.
155. Id. at 586. The Court followed the rationale used in a series of previous decisions which had held that taxes imposed upon various individuals and activities were actually taxes upon their source. Id. at 581-82.
156. Id. at 585-86.
157. Id. at 583, aff’d on reh’g, 158 U.S. 601 (1895).
158. Id.
source derived." Some representatives of state and local governments opposed passage of the amendment because they feared that it would provide the federal government with the power to tax interest paid on the bonds they issued. In response to this opposition, several members of Congress publicly stated that the amendment did not increase the scope of the federal government's tax power. Subse-

159. The sixteenth amendment states that: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. Const. amend. XVI.

Prior to the passage of the sixteenth amendment, Congress' power to tax was already unlimited and complete. Pacific Co. v. Soule, 74 U.S. (7 Wall.) 443 (1868). "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, import duties, 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." Id. at 446 (emphasis deleted). Accord Nicol v. Ames, 173 U.S. 509, 515 (1899); Veazie Bank v. Fenno, 75 U.S. (8 Wall.) 533, 540 (1869). Notwithstanding this full and complete power, however, the Supreme Court consistently recognized the fact that the Federal government was prohibited from taxing the property and revenues of instrumentalities of a State. Pollock v. Farmers' Loan & Trust Co., 157 U.S. 429 (1895) (federal government may not tax interest from municipal securities); Merchantile Bank v. New York, 121 U.S. 138, 162 (1887) (bonds issued under the authority of the State of New York are not taxable by the United States); United States v. Railroad Co., 84 U.S. (17 Wall.) 322, 332 (1873) (a municipal corporation is a part of the sovereign power of the state, and may not be subjected to federal taxation upon its revenues); Collector v. Day, 78 U.S. (11 Wall.) 113, 124 (1870) (Congress has no power to levy a tax upon the income of state judges); McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 429 (1819) (subtracted from the Constitution's full grant of power of taxation is the right of the separate sovereignities to perform their functions as such).

160. Governor Hughes of New York was perhaps the most vociferous opponent of the amendment. He feared that it would bestow upon Congress the power to tax income paid to holders of state and municipal bonds. 45 Cong. Rec. 2245 (1910) (quoting Gov. Hughes' address before the New York Legislature).

161. "My own judgement is that the words . . . [from whatever source derived] neither add to nor take away from the power of the Government to reach the incomes of the country. . . ." 45 Cong. Rec. 1699 (1910) (statement of Sen. Brown, who sponsored the sixteenth amendment in Congress); "To construe the proposed amendment so as to enable us to tax the instrumentalities of the State would do violence to the rules laid down by the Supreme Court for a hundred years, wrench the whole Constitution from its harmonious proportions and destroy the object and purpose for which the whole instrument was framed." Id. at 1698 (statement of Sen. William Borah of Idaho).

The objection made to the amendment is that this will confer upon the National Government the power to tax incomes derived from bonds issued by the States. . . . I do not find in the amendment any such meaning or effect. I do not consider that the amendment in any degree whatever will enlarge the taxing power of the National Government or will have any effect except to relieve the exercise of that taxing power from the requirement that the tax shall be apportioned among the several States.
sequent decisions by the Court confirmed this view and emphasized that the amendment was enacted to deal only with the apportionment problem created by the *Pollock* decision.\(^{162}\)

A series of cases, decided after *Pollock*, have struck down thinly disguised income taxes imposed by one sovereign upon the debt securities of another.\(^{163}\) In *Northwestern Mutual Life Insurance Co. v. Wisconsin*,\(^{164}\) the Court invalidated a three percent license fee tax on every dollar of interest earned from United States bonds as a direct imposition upon the bonds themselves.\(^{165}\) In *National Life Insurance Co. v. United States*,\(^{166}\) the Court rejected a method of taxing life insurance companies which effectively negated the advantage of municipal bond ownership.\(^{167}\) The taxing method had reduced the company's allowable reserve deductions by the amount of income the company derived from exempt securities.\(^{168}\) As a result, the company's tax burden was the equivalent of what it would have been had it owned no tax-exempt bonds.\(^{169}\) The Court in *National Life* articulated

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\(^{162}\) Evans v. Gore, 253 U.S. 245, 261 (1920) ("In other words, the purpose of the [Sixteenth] Amendment was to eliminate all occasion for such an apportionment because of the source from which the income came, a change in no wise affecting the power to tax but only the mode of exercising it."); Eisner v. Macomber, 252 U.S. 189, 206 (1920) (the sixteenth amendment "did not extend the taxing power to new subjects, but merely removed the necessity which otherwise might exist for an apportionment among the States of taxes laid on income"); Brushaber v. Union Pac. R.R. Co., 240 U.S. 1, 17-18 (1916) ("It is clear on the face of this text that [the sixteenth amendment] does not purport to confer power to levy income taxes in a generic sense . . . the whole purpose of the Amendment was to relieve all income taxes when imposed from apportionment.").


\(^{164}\) 275 U.S. 136 (1927).

\(^{165}\) Id. at 141. See also Macallen Co. v. Massachusetts, 279 U.S. 620, 634 (1929) (amendment removing excise tax exemption for United States bond income is invalid); Long v. Rockwood, 277 U.S. 142, 145 (1928) (royalties received from patents issued by the United States are immune from state taxation).

\(^{166}\) 277 U.S. 508 (1928).

\(^{167}\) Id. at 519.

\(^{168}\) Id. at 516.

\(^{169}\) Id. at 519.
the principle that “[o]ne may not be subjected to greater burdens upon his taxable property solely because he owns some that is [tax] free.” 170

In a similar decision, the Court in Missouri v. Gehner171 held that a state could not compensate for lost revenues by denying insurance companies that held tax-exempt government securities the full value of deductions granted other companies who were not holders.172

1. Limitations on the Scope of the Immunity

The Pollock decision was the Supreme Court’s last opportunity to consider directly the taxability of interest paid on state and municipal obligations. Other more recent decisions have applied the immunity doctrine in the area of indirect municipal bond taxation,173 but none have considered the taxability of interest paid on these obligations. One of the earliest cases to uphold the indirect taxation of government obligations was Flint v. Stone Tracy.174 In Flint, the Court upheld a federal franchise tax, imposed on private businesses, that included the use of income from state and municipal obligations to measure the amount of business transacted within the state.175 The Court recognized that although a direct ownership tax placed upon tax-exempt property was invalid, a privilege tax may be measured by a corporation’s property, even though part of that property is derived from sources that are not taxable.176

Another series of cases decided shortly after Pollock upheld taxes on the transfer of ownership of state and municipal obligations. Willcuts v. Bunn177 held that profits from the sale of these obligations were taxable, regardless of their governmental character, because a tax on gains imposed no burden upon a state’s borrowing power.178 The

170. Id.
171. 281 U.S. 313 (1930).
174. 220 U.S. 107 (1911).
175. Id. at 165.
176. Id. at 162-64. See also Home Ins. Co. v. New York, 134 U.S. 594 (1890) (upholding state privilege tax measured by dividends of corporation’s capital stock which included investments in United States bonds).
177. 282 U.S. 216 (1931).
178. Id. at 227-29. The Court stated that “[t]he power to tax is no less essential than the power to borrow money, and, in preserving the latter, it is not necessary to
Court stated that before the power of Congress to tax could be denied, the burden placed upon the state's borrowing power must be "real, not imaginary; substantial, not negligible." 179

In Denman v. Slayton,180 the Court upheld an Internal Revenue Code provision eliminating interest expense deductions for money borrowed to finance tax-exempt securities.181 The Court distinguished Denman from its earlier decision in National Life on the grounds that the tax in Denman did not impose any increased burden upon the purchaser "solely because he was the recipient of interest from tax-free securities . . ." 182 Denman merely prevented a person who was purchasing tax-exempt securities with taxable income from escaping taxation from both sources.183

In 1965, the Supreme Court in United States v. Atlas Insurance Co.184 upheld provisions in the Life Insurance Company Income Tax Act of 1959185 that allocated the tax-exempt interest on policy reserves between life insurance companies and their policy holders.186 This had the effect of increasing the insurance company's share of taxable

cripple the former by extending the constitutional exemption from taxation . . . where no direct burden is laid upon the governmental instrumentality. . . ." Id. at 225. The Court found the sale of bonds by their owners after issuance to be a distinct transaction from the issuance of the bonds and, therefore, not inseparably connected with the exercise of state borrowing power. Id. at 227-29.

179. Id. at 234. The transaction in question in Wilcutts was a transfer of title and not a transaction made on behalf of the state. Id. at 229. This case was consistent with earlier decisions by the Court allowing each sovereign to place a transfer tax on obligations of the other passing by legacy. See Greiner v. Llewellyn, 258 U.S. 384 (1922) (federal estate tax valid as applied to municipal bonds included in an estate); Plummer v. Coler, 178 U.S. 115 (1900) (upheld New York inheritance tax imposed upon bequest of United States bonds). In these instances the subject of taxation is the transfer and the property is only a convenient measuring device. See Comment, Intergovernmental Tax Immunities: An Analysis and Suggested Approach to the Doctrine and its Application to State and Municipal Bond Interest, 15 VILL. L. REV. 414, 421 (1970).

181. Id. at 519-20. In a later decision, the Court referred to this as the principle that tax-exempt financing must "pay its own way." United States v. Atlas Life Ins. Co., 381 U.S. 233, 247 (1965). This was a reference to the prohibition on the practice of deducting from federal income tax interest payments on money borrowed to finance tax-free obligations.

182. 282 U.S. at 519.
183. Id. at 520. The Court pointed out that an individual with an income of $10,000 from taxable securities could, by purchasing exempt securities with borrowed money and paying $10,000 interest thereon, escape taxation upon revenues from both sources. Id.

186. 381 U.S. at 247.
income. As a result, the Company was prevented from obtaining both the full benefit of the tax-exempt income and a full deduction for policy reserves. The Court held that the tax burden imposed by the Act was permissible since purchasers of tax-exempt securities “are [not] constitutionally entitled to reduce their tax liability and to pay less tax per taxable dollar than those owning no such securities.”

In each of the cases discussed in this section, the Court never wavered from its holding in Pollock. Any burden placed upon a government issuer as a result of the imposition of taxes was indirect and did not increase its cost of borrowing funds. Therefore, the taxes imposed placed no direct burden upon a sovereign’s borrowing power, before that power was exercised. Accordingly, none of these decisions provide authority for a direct tax upon income derived from single-family mortgage revenue bonds, which would obstruct state and local borrowing power before it is exercised. Indeed, these decisions support a prohibition of such a tax.

C. The Scope of Immunity for Other State Activities

The Supreme Court has been more active in narrowing the scope of intergovernmental tax immunity in other areas of governmental activity. These decisions are of limited relevance to this discussion since they neither descend from the principle set forth in Pollock, nor involve in any respect the taxation of governmental obligations. Nevertheless, the decisions are examined in order to ascertain to what extent, if any, they have eroded the scope of intergovernmental tax immunity. Has the doctrine degenerated to a point where the taxation of interest paid on single-family revenue bonds is constitutionally permissible?

1. Upon Whom Does the Burden Fall?

One traditional limitation on the scope of immunity has been imposed when individuals or private interests, rather than states, are the main beneficiaries of tax immunity. Prior to the decisions discussed in this section, the Court had provided immunity whenever a tax imposed by one sovereign would increase expenses realized by the

187. Id. at 238.
188. Id. at 251.
189. Id.
190. See Keohane, supra note 132, at 499. The decisions discussed in this Section do not address the issue of taxation of state or municipal bonds. The extent to which they are relevant to the exercise of a state’s borrowing power is uncertain. Id.
other.\textsuperscript{191} This standard was replaced by one which evaluates whether a particular tax falls directly upon the government by measuring the degree to which the tax imposes an economic burden upon the sovereign.

In \textit{James v. Dravo Contracting Co.},\textsuperscript{192} the Court upheld a two percent tax imposed by West Virginia upon the gross receipts collected by a private contractor from the federal government. The fact that the tax increased the cost to the federal government did not alone invalidate it.\textsuperscript{193} In \textit{Helvering v. Gerhardt},\textsuperscript{194} the immunity extended to governmental salaries\textsuperscript{195} began to recede as the Court denied a federal tax exemption to the employees of the Port Authorities of New York and New Jersey.\textsuperscript{196} The Court stated that the advantage derived by the state from this exemption was too speculative and uncertain to support a claim of constitutional immunity from taxation.\textsuperscript{197} The decision recognized that some burdens must pass between sovereigns, and focused upon the degree of burden placed upon the non-taxing sovereign.\textsuperscript{198} For immunity to extend to a private person dealing with the government, the resulting tax burden placed upon the state must be substantial.\textsuperscript{199}

\textsuperscript{191} See notes 145-46 \textit{supra} and accompanying text.
\textsuperscript{192} 302 U.S. 134 (1937).
\textsuperscript{193} \textit{Id.} at 160. The Court acknowledged the existence of a delicate balance between the freedom to perform essential governmental functions and unduly restricting the power to tax. \textit{Id.} at 150.
\textsuperscript{194} 304 U.S. 405 (1938).
\textsuperscript{196} 304 U.S. at 424. Shades of the supremacy doctrine reappeared as Justice Stone stated that: "[A]ny allowance of a tax immunity for the protection of state sovereignty is at the expense of the sovereign power of the nation to tax. Enlargement of the one involves diminution of the other." \textit{Id.} at 416. The Court reasoned that when immunity is invoked by a private citizen, it operates to his benefit at the expense of the taxing sovereign. \textit{Id.} at 416-17.
\textsuperscript{197} \textit{Id.} at 421-22.
\textsuperscript{198} \textit{Id.} at 422. This doctrine was first set forth in \textit{Metcalf & Eddy v. Mitchell}, 269 U.S. 514, 523-24 (1926), where the Court held that the salaries of independent consultants derived from a contract with the state were not exempt from federal income tax.
\textsuperscript{199} \textit{Helvering v. Gerhardt}, 304 U.S. 405, 421 (1938) (see notes 194-98 \textit{supra} and accompanying text); \textit{Helvering v. Mountain Producers Corp.}, 303 U.S. 376 (1938) ("immunity from non-discriminatory taxation sought by a private person for his property or gains because he is engaged in operations under a government contract or
In *Graves v. New York ex rel. O'Keefe*, the Supreme Court overruled *Collector v. Day* by holding that the state may validly impose a tax on the salary of an employee of a congressionally created corporation. The Court stated that the uncertain economic tax burden placed upon the state did not justify a private individual being clothed in immunity.

*Graves* also rejected the theory used by the *Pollock* Court that a tax on income is a tax on its source. Some advocates of the complete abolition of municipal tax-exemptions suggest that this finding extends to the taxation of interest derived from those obligations. It is their contention that since *Graves* determined that a tax on income is not a tax on its source, it therefore follows that a tax on income from interest paid on state and municipal obligations would not be a direct tax upon its source—the state. Rather, the tax would be imposed upon the individual bondholders. *Graves* has particular significance to those who urge reversal of the *Pollock* principle, because the deci-

lease cannot be supported by merely theoretical conceptions of interference with the functions of government" ). *Id.* at 386.


201. 78 U.S. (11 Wall.) 113 (1870).

202. *Graves*, 306 U.S., at 484-86. *Graves* also overruled other earlier cases which had held that the salary of an officer of one government or its instrumentality is immune from taxation by the other. See note 195 supra. The Court stated that:

So much of the burden of a non-discriminatory general tax upon the incomes of employees of a government . . . as may be passed on economically to that government . . . is but the normal incident of the organization within the same territory of two governments, each possessing the taxing power. The burden . . . is one which the Constitution pre-supposes . . .

*Id.* at 487.

203. *Id.* at 486.

204. *Id.* at 486. See *Pollock* v. Farmers' Loan & Trust Co., 157 U.S. 429, 585-86 (1895) (discussed at notes 154-58 supra and accompanying text). Supreme Court decisions prior to *Graves* had determined that immunity of the source does not necessarily extend immunity to income derived from that source. *New York ex rel. Cohn v. Graves*, 300 U.S. 308, 312-16 (1937) (state may tax income received from rents on lands situated in another state); *Hale v. State Bd. of Assessment and Review*, 302 U.S. 95, 108 (1937) (excise tax not laid upon bonds but on an aggregate of occupations and investments); *United States Glue Co. v. Town of Oak Creek*, 247 U.S. 321 (1918) (state tax upon income from interstate commerce is constitutional).

205. Ratchford, *Intergovernmental Tax Immunities in the United States*, 6 NAT'L TAX J. 305, 323, 327 (1953) (contending that, since the theory of "a tax on income as a tax on its source" is no longer tenable, the Supreme Court, if confronted with the issue today, would be likely to sustain the taxability of interest from state and municipal obligations); Kirby, *State and Local Bond Interest*, in HOUSE COMM. ON WAYS AND MEANS, 86TH CONG., 1ST SESS., 1 TAX REVISION COMPRENDIUM 679, 682-83 (Comm. Print 1959) (with the theory used in *Pollock* gone, practically nothing remains to support the tax-exempt status of state and municipal obligations).
sion reversed a similar principle based upon a long line of precedent which had established that the income received by officials of one sovereign was not taxable by the other.\textsuperscript{206}

In 1941, the Court, in \textit{Alabama v. King & Boozer},\textsuperscript{207} upheld a state sales tax paid by contractors working under a cost-plus-fixed-fee contract with the federal government. Although the burden of the tax was passed on to the federal government, the Court applied a "legal incidence" test to determine whether the state or federal government should bear the cost of the tax.\textsuperscript{208} Under Alabama state law, the "legal incidence" of the sales tax was to fall on the contractor and not the federal government because the contractor was legally obligated to pay the debt.\textsuperscript{209}

Commentators have also suggested that \textit{King & Boozer} is damaging to the immunity enjoyed by state and municipal obligations since it allows the additional burden of a governmental tax to be passed through to the non-taxing sovereign.\textsuperscript{210} In determining who would

\begin{footnotes}
\item[206] See notes 195-96 supra and accompanying text. One commentator, arguing against the validity of \textit{Pollock} in light of \textit{Graves}, states that to impose a tax upon interest derived from state and local bonds would not discriminate against the income derived from these obligations. The imposition of such a tax would merely remove the exemption for bond income in the same way the Court in \textit{Graves} removed the exemption for governmental salaries. Ratchford, supra note 205, at 325.
\item[207] 314 U.S. 1 (1941).
\item[208] Id. at 9-14. Commentators often describe the approach taken by the Court in \textit{King & Boozer} as a legal incidence test which determines whether the imposition of a state sales tax falls directly upon the government or upon a private interest. See L. Tribe, \textit{American Constitutional Law} § 6-29, at 297-98 (1978); Note, \textit{The Taxability of State and Local Bond Interest by the Federal Government}, 38 U. Cin. L. Rev. 703, 708 (1969). The Court concluded that the imposition of the sales tax in question fell upon the purchaser, as defined by state law. \textit{King & Boozer}, 314 U.S. at 9-10. In a cash sale the purchaser was determined to be the person who ordered and paid for the goods. \textit{Id.} In a credit sale, the purchaser was the person obligated to pay. \textit{Id.} at 10.
\item[209] Id. at 2. "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." \textit{Id.} at 9.
\item[210] See Ratchford, supra note 205, at 327 (noting the trend by the Court away from the doctrine that taxes are unconstitutional merely because a burden is passed on to the government); Kirby, supra note 205, at 683 (although the withdrawal of
\end{footnotes}
bear the burden from the taxation of interest earned on single-family bonds, however, the "King & Boozer legal incidence test lacks logical support." 211 None of the burden of an income tax on state or local obligations would be realized by purchasers of single-family bonds. Bond purchasers would benefit from increased interest payments offered by issuers as compensation for the taxability of these bonds. The burden of the tax would fall directly on state and local governments in terms of increased borrowing costs which would have a strong impact on the continued viability of these programs. In order to compete for investors in the marketplace, yields offered by issuers of taxable single-family bonds would have to be substantially higher than the yields offered on securities that are tax-exempt.212

Also, Gerhardt and O'Keefe suggest that for a finding of immunity not only must the burden imposed upon the government be direct, but also the benefit derived from the exemption must be provable.213 The benefit of tax-exemption realized by state and local government issuers in terms of reduced borrowing costs is statistically provable by computing the differential between the yields offered on taxable bonds and those paid on bonds that are tax-exempt. Using this comparison, one can see that the burden imposed upon issuers by the taxation of single-family bonds would be neither speculative nor uncertain.

Finally, the burden imposed by the sales tax in King & Boozer was negligible compared with that which would be imposed by the taxation of interest paid on single-family bonds. Nothing in King & Boozer precludes the invalidation of a tax which imposes a severe burden on the government.214 A tax placed on single-family bonds would impose a far more substantial burden than the one in Boozer. Increased

the exemption for interest would increase the borrowing costs of state and local governments, the burden would be nondiscriminatory).

211. See Note, supra note 208, at 708 (generally criticizing the logic behind the legal incidence test). See also L. Trube, supra note 208, § 6-29, at 397 ("extraneous circumstances make King & Boozer's use of the legal incidence test less than a compelling precedent").

212. See notes 9-10 supra and accompanying text.

213. See notes 194-204 supra and accompanying text. The burden may not be speculative or uncertain.

214. The court in Graves, 306 U.S. at 480-81, also supported this position and cautioned against the imposition of taxes which would interfere with the performance of governmental functions. Even though the Court rejected the theory that a tax on income is a tax on its source, the Court stated that "the only possible basis for implying a constitutional immunity from state income tax on the salary of an employee of the national government or of a governmental agency is that the economic burden of the tax is in some way passed on so as to impose a burden on the national government tantamount to an interference by one government with the other in the performance of its functions." Id. at 481.
borrowing costs may very well preclude states from providing single-family mortgage financing.²¹⁵

2. Proprietary Functions

Another early exception to the doctrine of intergovernmental tax immunity was recognized for proprietary activities conducted by states for monetary gain.²¹⁶ These cases generally distinguish between essential or traditional governmental functions and proprietary ones.²¹⁷

²¹⁵ See note 21 supra. The logic of using statistical data to measure the burden placed upon state and local government issuers by the imposition of federal taxation is supported by the Supreme Court’s decision in National League of Cities v. Usery, 426 U.S. 833 (1976). In National League, the Court made extensive use of statistical data to measure and demonstrate the financial burden that would be placed upon states by the imposition of a federal minimum wage standard on state employers. Id. at 846-48. The Court held that insofar as the 1974 amendments to the Fair Labor Standards Act sought to regulate the wages and work hours of state employees, they “operate to directly displace the States’ freedom to structure integral operations in areas of traditional governmental functions.” Id. at 852. The Court feared that the increased expense imposed by the standard would prevent states from supplying citizens with traditional governmental services. Id. at 849-51.

²¹⁶ South Carolina v. United States, 199 U.S. 437 (1905) (see text accompanying notes 218-20 infra); Allen v. Regents, 304 U.S. 439 (1938) (see text accompanying notes 221-22 infra); Helvering v. Powers, 293 U.S. 214 (1934); Ohio v. Helvering, 292 U.S. 360 (1934) (see note 219 infra).

²¹⁷ Two recent decisions of the Court provide insight into the issue of traditional functions in the context of conflicting interests between the federal commerce clause power and state sovereignty. In National League of Cities v. Usery, 426 U.S. 833 (1976) the Supreme Court stated that traditional governmental functions include: “such areas as fire prevention, police protection, sanitation, public health, and parks and recreation.” Id. at 851. The list provided by the Court was not exhaustive. Id. at 851 n.16. In United Transp. Union v. Long Island R.R. Co., 102 S. Ct. 1349 (1982) the Long Island Railroad’s employees union sought a declaratory judgment that the Railway Labor Act, and not the State Taylor Law, would govern the resolution of a labor dispute between the union and the railroad. The Supreme Court held that Congress’ acknowledged authority to regulate labor relations in the railroad industry does not so impair a state’s ability to carry out its constitutionally preserved sovereign function as to endanger its “separate and independent existence.” Id. at 1356. The Court rejected the argument that operation of a railroad engaged in interstate commerce was an integral part of traditional state activities. Id. at 1354. The decisions are relevant to this analysis only to the extent that they define the activities which will constitute essential state functions. The extent to which these holdings are applicable to questions of intergovernmental tax immunity is uncertain. The Court specifically qualified its decision in National League by stating that a different result might occur “if Congress seeks to affect integral operations of state governments by exercising authority granted it under other sections of the Constitution. . . .” National League of Cities v. Usery, 426 U.S. 833, 852 n.17 (1976); see Hodel v. Virginia Surface Mining & Reclam. Ass’n, Inc., 452 U.S. 264, 287 n.28 (1981).
In South Carolina v. United States,\footnote{218} the Court upheld federal license taxes that were imposed upon a state liquor monopoly. The fact that a state was participating in an activity normally conducted by private enterprise did not eliminate that state activity from the taxing power of the federal government.\footnote{219} The Court expressed concern that states, by extending the scope of their functions, could destroy the power of the national government to collect taxes.\footnote{220} In Allen v. Regents of the University System of Georgia,\footnote{221} the issue was whether the federal government could impose an admissions tax on athletic activities conducted by a state university. The Court held that although the public educational system was essential to the state, a nondiscriminatory tax laid on admissions to athletic events would not violate the doctrine of immunity.\footnote{222}

Although the tax burdens in South Carolina and Allen fell directly upon the state, it was the essential characteristics of the functions affected that were given primary consideration by the Court. In each instance, the activity burdened by the tax was one that could have been conducted by private enterprise, not one which was essential for the state to carry on as a government entity.

The proprietary functions doctrine was modified somewhat in New York v. United States.\footnote{223} New York State claimed that bottling mineral water for sale was a "usual, traditional and essential governmental function."\footnote{224} The Court rejected the above strict proprietary functions test\footnote{225} as inflexible and suggested a new standard of evaluation for state activities.

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  \item 218. 199 U.S. 437 (1905).
  \item 219. id. at 463. See Helvering v. Powers, 293 U.S. 214, 227 (1934) (salary of a trustee of a state railway company not exempt from federal income taxation); Ohio v. Helvering, 292 U.S. 360, 369 (1934) (federal excise tax may be imposed upon state liquor monopoly).
  \item 220. 199 U.S. at 455-57.
  \item 221. 304 U.S. 439 (1938).
  \item 222. id. at 452.
  \item 223. 326 U.S. 572 (1946).
  \item 224. id. at 574. The Court stressed the recent shift in emphasis towards limitations on immunity. id. at 581. The decision recognized a need for some taxation between sovereigns since the spheres of both national and state governments had expanded into new fields of activity unknown by the founding fathers. id. at 579.
  \item 225. id. at 583. Earlier in the decision, the Court had expressed its dissatisfaction with the current standard. "To rest the federal taxing power on what is 'normally' conducted by private enterprise in contradiction to the 'usual' governmental functions is too shifting a basis for determining constitutional power and too entangled in expediency to serve as a dependable legal criterion." id. at 580.
\end{itemize}
Although mortgage lending is a taxable activity normally conducted by private enterprise, it does not necessarily follow that state and local single-family mortgage subsidy bond programs are taxable proprietary functions. They are distinguishable from that line of cases on two grounds. First, these programs are not activities conducted for the purpose of monetary gain. Second, to the extent that these programs provide loans to persons who could not otherwise afford a conventional mortgage loan, they do not supplant an otherwise taxable activity being conducted by private enterprise. Accordingly, single-family mortgage bond programs are not taxable as a proprietary function.

V. Conclusion

Periodic increases in interest rates and a tight money supply have prevented private enterprise from supplying adequate housing for persons of low and moderate incomes. At the same time, the federal government has eliminated much of the housing subsidies that had previously enabled HFAs to be active in the construction of multi-family rental housing. As a result, state housing finance agencies

226. Id. at 582. The extent to which this test revised the Court's philosophy of the proprietary function doctrine is uncertain. All justices taking part in the decision agreed that not all of the former immunity was gone. Id. at 584 (Rutledge, J., concurring); id. (Stone, J. concurring) (joined by Justices Reed, Murphy and Burton); id. at 586 (Douglas, J., dissenting, joined by Black, J., dissenting); id. at 590. At least six of the nine justices explicitly disagreed with language in the majority opinion that suggested that Congress might impose any tax upon states that was not discriminatory. “[W]e are not prepared to say that the national government may constitutionally lay a non-discriminatory tax on every class of property and activities of States and individuals alike.” Id. at 586 (Stone, J., concurring) (joined by Justices Reed, Murphy and Burton); “If . . . any federal tax on any state activity were sustained unless it discriminated against the State, then a constitutional rule would be fashioned which would undermine the sovereignty of the states as it has been understood throughout our history.” Id. at 592 (Douglas, J., dissenting, joined by Black, J. dissenting).

227. See Keohane, supra note 132, at 502 (mortgage loan program is not profit-making enterprise). The Act provides that any excess profit earned by the issuer must be paid to the federal government or to bond-holders. See notes 62-63 supra and accompanying text.

have been forced to place an increased emphasis on their single-family mortgage programs in order to provide affordable housing for their low and moderate income citizens.

The vast majority of state courts have determined that the use of mortgage revenue bonds to finance housing for its citizens serves a public purpose and justifies the issuance of public debt.\textsuperscript{229} State legislatures have determined that the activities of state housing finance agencies serve an essential governmental function.\textsuperscript{230} Single-family bonds are an integral element of the formula prescribed by state


legislatures to remedy critical housing shortages. Due to changes in our society, economy, and political philosophy, these bonds have become no less essential than those used in multi-family programs.

The decisions to prohibit the federal government from taxing the income derived from state and municipal obligations was last proclaimed by the Supreme Court in 1895, yet its vitality remains intact. This exemption has been one of the most enduring features of our income tax law since 1913. Recently, a trend has developed toward restricting the use of tax-exempt financing for certain purposes. The constitutionality of all these restrictions is questionable. It appears certain, however, that the sunset provision of the Mortgage Subsidy Bond Tax Act, which provides for the elimination of tax-exempt single-family revenue bonds, is unconstitutional.

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