

No. 1103

SUPREME COURT OF THE DISTRICT OF COLUMBIA

TAX DIVISION

JOSEPH M. BURTON  
CLERK OF  
SUPREME COURT OF THE  
DISTRICT OF COLUMBIA  
TAX DIVISION

THE FIRST NATIONAL BANK  
OF WASHINGTON,

JUL 19 1978

Petitioner

FILED

v. : Docket No. 2180  
2192  
DISTRICT OF COLUMBIA, 2318

Respondent

OPINION AND ORDER

Petitioner appeals from a denial of claims for refund of taxes paid. The petitioner is a national banking association organized under the laws of the United States with its principal executive office in the District of Columbia. The taxes in controversy are "gross earnings" taxes of the District of Columbia pursuant to section 47-1701, District of Columbia Code, 1967 ed.

Facts

On or about July 28, 1970, the bank filed its report of gross earnings for fiscal year 1971, which report covered income received by the bank for the period July 1, 1969, to June 30, 1970. In its said report, as it had consistently done in prior years, the bank claimed exclusion of interest received on U. S. Treasury and U. S. agency securities from the gross earnings base on which the tax is assessed. In its said report, as it had consistently done in prior years, the bank claimed exclusion of interest on FNMA securities, treating such securities as U. S. agency securities. (P., Docket No. 2180).

Pursuant to that report, the bank received a bill for first-half taxes due in September, 1970, in the amount of \$61,957.32, which amount was paid on or before September 30, 1970. On or about February 1, 1971, the bank received a letter from the District of Columbia Government advising that the bank's report of gross earnings had been adjusted to include interest received by the bank on FNMA securities, Federal Land Banks securities, and Federal

Home Loan Bank securities, and that a "corrected bill" would be submitted. (P., Docket No. 2180). Pursuant to the foregoing, on or about February 5, 1971, the bank received a revised bill for first-half taxes for fiscal year 1971, claiming an additional amount of taxes due of \$27,913.07, including a penalty of \$1,329.19. Additionally, the bank received a bill for second-half taxes due in March, 1971, in the amount of \$88,541.20 (originally only \$61,957.32 would have been payable). The total deficiency assessed for fiscal year 1971 was therefore \$54,496.95, including a penalty of \$1,329.19. (P. Docket No. 2180).

By letter dated March 25, 1971, from counsel to the bank to the Department of Finance and Revenue, the bank protested the above deficiency assessment. (P., Docket No. 2180). On March 31, 1971, (as per letter dated March 31, 1971, from William C. Matis, Comptroller), the bank paid \$61,957.32, representing second-half taxes conceded to be due for fiscal year 1971, but withheld \$26,583.88 shown on the revised bill for second-half taxes, pending a response to petitioner's March 25 letter. (P. Docket No. 2180.)

By letter dated April 5, 1971, from the District of Columbia Government to the Bank's counsel, the respondent advised that it agreed with the bank's position that interest on Federal Land Banks securities and Federal Home Loan Bank securities is not taxable as gross earnings, but reiterated its view that interest on FNMA securities is taxable, based upon its interpretation of Public Law 90-448, 90th Congress. (P., Docket No. 2180). On or about April 9, 1971, the bank received a second revised bill for fiscal year 1971, eliminating tax on interest of Federal Land Bank securities and Federal Home Loan Bank securities and eliminating the penalty, but including tax on interest on FNMA securities, and indicating a deficiency for fiscal year 1971 of \$32,733.32. (P., Docket No. 2180). Said amount was paid under protest on or about August 27, 1971. (P., Docket No. 2180).

A claim for refund as to said amount, with interest, was filed on or about August 27, 1971. (P., Docket No. 2180). The claim for refund was denied by undated letter received from the Director of Finance and Revenue by the bank's counsel on November 11, 1971. (P., Docket No. 2180). A petition appealing from the denial of the refund claim was filed with the Superior Court of the District of Columbia, Tax Division, on February 24, 1972.

On August 31, 1971, the bank filed its report of gross earnings for fiscal year 1972, covering earnings for the period July 1, 1970, to June 30, 1971. In its report, the bank claimed exclusion of interest received on U. S. Treasury and U. S. agency securities (including securities of FNMA.) P., Docket No. 2192). Pursuant to its said report, the bank received a tax bill for first-half taxes due for fiscal year 1972 in the amount of \$72,401.65, which amount included tax on interest received by the bank on FNMA securities. (P., Docket No. 2192).

The said amount of \$72,401.65 was paid on September 30, 1971. Of the said amount, \$10,379.38 was paid under protest. (P., Docket No. 2192). A claim for refund of \$10,379.38, with interest, (claiming an overpayment for the first half of fiscal year 1972), was filed on or about October 15, 1971. (P., Docket No. 2192). The claim for refund filed October 15, 1971, was denied by letter from the Department of Finance and Revenue, received by counsel for the bank on November 11, 1971. (P. Docket No. 2192).

A petition appealing from denial of the claim for refund filed on October 15, 1971 was filed with the Superior Court of the District of Columbia, Tax Division, on February 24, 1972. Since the tax for the entire year 1972 had not been paid at the time the petition was filed, motion was made by petitioner and granted by this Court for voluntary dismissal without prejudice for such portion of the petition as related to fiscal year 1972.

The bank received a tax bill for second-half taxes due for fiscal year 1972 in the amount of \$72,401.65, of which \$10,379.38 included tax on interest received by the bank on FNMA securities.. (P., Docket No. 2192). The second half bill for fiscal year 1972 of \$72,401.65 was paid on March 31, 1972. Of this amount, \$10,379.48 was paid under protest. (P., Docket No. 2192.)

A claim for refund of \$10,379.38, with interest, was filed on April 3, 1972, claiming an overpayment of taxes for the second-half of fiscal year 1972. This claim was never acted upon by respondent, and on July 31, 1972, the bank filed an amended claim for refund of \$20,758.75 claiming an overpayment of taxes with interest for the entire fiscal year 1972. (P., Docket No. 2192).

The amended claim for refund was denied by letter of August 2, 1972 from the Director for Assessment Administration, District of Columbia Department of Finance and Revenue. (P., Docket No. 2192). Petition appealing from the denial of the amended refund claim was filed on October 2, 1972.

The tax with respect to fiscal year 1973 was paid by the petitioner under protest on September 29, 1972, and on March 30, 1973. A claim for refund of \$18,556.68, with interest (overpayment of taxes for fiscal year 1973), was filed on August 15, 1974. The claim for refund has not been acted upon by the respondent. (P., Docket No. 2318).

#### Conclusions of Law

##### A. Jurisdiction

Respondent contends this court lacks jurisdiction to consider this petition due to the running of the statute of limitations in case No. 2192.<sup>1/</sup> D. C. Code 47-2403 provides for a six-month

<sup>1/</sup> The following cases were consolidated in this action. Respondent contends that petitioner is barred in the other cases as well because they raise the same issues as in No. 2192.

limitation period after denial of claim for refund within which suit must be filed in Superior Court of the District of Columbia. Petitioner's first claim for refund was filed on October 15, 1971 which was denied on November 11, 1971. At the time of the refund claim, only a portion of the year's taxes had been paid. D. C. Code 47-2403 requires the payment of all of the tax based on the questioned assessment for the entire tax year in issue before the Court can acquire jurisdiction. District of Columbia v. Berenter, 466 F.2d 367 (1972), 151 U.S. App. D. C.196. Petitioner's motion for voluntary dismissal without prejudice was granted by this court for such portion of the petition as related to fiscal year 1972. Petitioner filed another refund claim on April 3, 1972 and an amended claim on July 31, 1972 which were denied on August 2, 1972. Suit was filed on October 2, 1972.

Respondent contends the running of the statute began on November 11, 1971 when the first refund claim was denied, therefore barring this action. Petitioner claims it began on August 2, 1972 when the entire year's refund claim was denied. The court agrees with petitioner and finds jurisdiction to consider the petition.

B. Tax Status of FNMA Securities

FNMA securities are not exempt from state and local taxes pursuant to a specific congressional exemption. This being the case, respondent contends the primary issue is whether FNMA securities are "obligations of the United States" within the meaning of 31 U.S.C. §742, as delineated in Smith v. Davis, 323 U.S. 111 (1944) and, therefore, constitutionally exempt from taxation by the District of Columbia.

Petitioner contends constitutional issues are irrelevant and the sole question is whether the intent of Congress as set forth in the Committee Report to Public Law 80-116, considered in conjunction with long established administrative practice of respondent shows that securities of Federal agencies and instrumentalities are exempt from the D. C. gross receipts tax imposed on banks.

Petitioner also raises the question whether respondent's arguments are timely. Petitioner claims that respondent did not raise the above arguments at the hearing and, therefore, should be estopped from raising them now. Finding that the petitioner is not prejudiced by submission of respondent's arguments, the Court will consider the arguments in ruling on the petition.

On the question of whether it is necessary to determine if these securities are the type of credit instrumentalities which are constitutionally exempt from state and local taxation, the Court agrees with petitioner that it is not. Petitioner does not contend that FNMA securities are constitutionally exempt from the D. C. gross receipts tax. The Congress has a special relationship with the District of Columbia, i.e., it exercises exclusive power to legislate for the District of Columbia. This relationship is delineated in Nield v. District of Columbia, 71 App. D. C. 306, 110 F.2d 246.

Power to legislate for the District of Columbia is expressly delegated by the Constitution. Article I, Section 8, clause 17, gives to Congress power "To exercise exclusive legislation in all cases whatsoever, over such District (not exceeding ten miles square) as may, by cession of particular states, and the Acceptance of Congress, become the Seat of the Government of the United States, \*\* [emphasis added] That delegation is sweeping and inclusive in character to the end that Congress may legislate within the District for every proper purpose of government. Within the District of Columbia, there is no division of legislative powers such as exists between the federal and state governments. Instead there is a consolidation thereof, which includes within its breadth all proper powers of legislation. Subject only to those prohibitions of the Constitution which act directly or by implication upon the federal government, Congress possesses full and unlimited jurisdiction to provide for the general welfare of citizens within the District of Columbia by any and every act of legislation which it may deem conducive to that end. In fact, when it legislates for the District, Congress acts as a legislature of national character, exercising complete legislative control as contrasted with the limited power of a state legislature, on the one hand, and as contrasted with the limited sovereignty which Congress exercises within the boundaries of the states, on the other. at 309-311 [emphasis added]

Respondent cites Smith v. Davis, 323 U.S. 111 (1944) which delineates the type of credit instrumentalities which are recognized as constitutionally exempt from state and local taxation. However, the court in Davis, supra was only concerned with the issue of whether an open account against the United States was an instrumentality of the United States and hence immune from state or county taxation.

In the instant case, we are concerned with the District of Columbia tax on gross earnings on interest received from FNMA securities. Because Congress has the exclusive power to legislate for the District of Columbia, the Court is not concerned with the constitutional parameters for state and local tax exemptions on federal securities. The Court must base its determination on the Congressional intent as it applies to these particular securities.

In order to determine whether Congress intended interest on FNMA securities to be exempt from the District of Columbia tax on gross earnings the court must determine whether FNMA is a federal instrumentality, which in turn, has the power to issue tax exempt federal securities. This court concurs with the court's finding in Federal National Mortgage Ass'n v. Lefkowitz, 390 F. Supp. 1364 (1975) which holds that FNMA is in fact a federal instrumentality.

First of all, we find in plaintiff's favor on the threshold question to the Supremacy Clause claim, i.e., we find that FNMA is in fact a federal instrumentality. A glance at the federal legislation involved, 12 U.S.C. § 1716 et seq., leaves little doubt that Congress intended FNMA to be recognized as a federal instrumentality. As mentioned above, FNMA is subject to the general regulatory power of the Secretary of Housing and Urban Development. 12 U.S.C. § 1723a(h). The Secretary of the Treasury also has specific regulatory power over certain of FNMA's financial transactions, and is authorized to purchase and hold as much as two billion dollars in obligations issued by FNMA. See 12 U.S.C. § 1719. Furthermore, Congress has exempted FNMA from having to qualify to do business in any state, 12 U.S.C. § 1723a(a), and has

cloaked FNMA with immunity from state taxation (with the exception of real estate taxes), 12 U.S.C. §1723a(c)(1). It is clear that FNMA performs a significant governmental function in its secondary mortgage market operations, see 12 U.S.C. §§1716(a), 1917(a)(1), and that the federal government has an extensive interest and involvement in mortgage market assistance. at 1368

There has been some question about the status of FNMA since its reorganization in 1968 pursuant to Public Law 90-448.<sup>2/</sup> The Internal Revenue Service, in a letter dated May 6, 1971 (see Exhibit A attached), ruled that notwithstanding the partition of FNMA in 1968 the association remained an instrumentality of the United States. The ruling refers to legislative history which shows the Congressional intent to keep the special relationship between FNMA and the Federal Government. Specifically, the Congressional intent is manifested by the following:

"The new FNMA would be a Government-sponsored private corporation, regulated by the Secretary (of Housing and Urban Development) and would have a status analogous to that of the Federal land banks and the Federal home loan banks." U. S. Code Congressional and Administrative News, 90th Congress, 2nd Session, 1968 2 pg. 2943-2944.

"...that the Secretary of Housing and Urban Development shall have general regulatory powers over the Federal National Mortgage Association and shall make such rules and regulations as shall be necessary and proper to insure that the purposes of this title are accomplished. No stock, obligation, security, or other instrument shall be issued by the corporation without the prior approval of the Secretary."

. . .

(t)he secretary may require that a reasonable portion of the corporation's mortgage purchases be related to the national goal of providing adequate housing for low and moderate income families . . ." Section 802(ee) of the Housing and Urban Development Act of 1968.

<sup>2/</sup> By amendments made in 1968, FNMA was partitioned into two separate entities, one to be known as Government National Mortgage Association (GNMA), the other to retain the name FNMA. GNMA remained in the Government, and FNMA became entirely privately owned by retiring the Government-held stock.

In a memorandum from the Senior Vice-President and General Counsel of FNMA, James E. Murray entitled "Status of FNMA Debentures and Discount Notes as 'Federal Agency Securities'", September 1, 1972 (see Exhibit B attached) concludes:

"The legislative history of the Housing and Urban Development Act of 1968, which enabled FNMA to become entirely privately owned, indicates clearly that Congress intended that FNMA nonetheless retain a special relationship to the Federal Government."

The court also notes that FNMA v. Lefkowitz, supra was decided in 1975 after reorganization. The court finds that FNMA retained its status as a federal instrumentality after 1968.

Next, a determination must be made as to whether Congress intended FNMA to issue tax exempt federal securities. In the same I.R.S. letter ruling of May 6, 1971, referred to above and attached hereto, the Director of the Income Tax Division briefly outlined the history of FNMA and held that FNMA securities are government securities, and while not guaranteed by the United States, are supported by the corporation's statutory authority to borrow from the United States Treasury which entitles them to tax exempt status.

The memorandum from the Vice-President and General Counsel of FNMA also concluded that FNMA securities are Federal Agency Securities, stating:

"Since the 1968 enactment, the Congress has on several occasions clearly indicated that FNMA's obligations are still considered to be Federal agency securities. In reporting a bill which would allow commercial banks to invest part of their required reserves in obligations "issued by Federal Agencies," the House of Representatives Banking and Currency Committee stated FNMA's obligations were included.<sup>6</sup> In reporting bills to allow FHA reserve funds to be invested in obligations of "any agency of the United States," both Banking and Currency Committees of the Congress described that language as "including, for these purposes, the Federal National Mortgage Association."<sup>7</sup> (See Exhibit B attached)

Following the I.R.S. and FNMA reasoning, the court finds that Congress authorized FNMA to issue tax exempt government securities.

Finally, it has been established that interest and dividends received by banks and building associations on securities and obligations issued by the Federal Government and its agencies and instrumentalities is not includable in gross earnings for purposes of determining the tax payable under Section 47-1703, D. C. Code 1951, which section levies a tax upon the gross earnings of banks in the District of Columbia. This ruling was made by a letter issued by Chester H. Gray, Corporation Counsel, District of Columbia, dated April 12, 1961. (Exhibit C, attached). This opinion overturned a previous ruling by the Corporation Counsel after clarification from Congress concerning an amendment to section 4 of the Public Debt Act of 1941, which reads as follows:

NEED FOR THE LEGISLATION

Section 4(a) of the Public Debt Act of 1941, as amended by the Public Debt Act of 1942, provides that "interest upon obligations and dividends, earnings, or other income from shares, certificates, stock, or other evidences of ownership, and gain from the sale or other disposition of such obligations and evidences of ownership issued on or after the effective date of the Public Debt Act of 1942 by the United States or any agency or instrumentality thereof shall not have any exemption, as such, and loss from the sale or other disposition of such obligations or evidences of ownership shall not have any special treatment, as such, under Federal tax acts now or hereafter enacted."

The Corporation Counsel for the District of Columbia has construed the words "Federal tax acts" to include the Act of July 1, 1902 (32 Stat. 619) which imposes an annual tax upon the gross earnings of banks in the District of Columbia. The effect of such a construction, if followed by the District government, would be to require the inclusion of income from Federal securities held by such banks in their gross earnings subject to tax.

The legislative history of section 4 of the Public Debt Act of 1941, as originally enacted or as amended by the Public Debt Act of 1942, indicates no intent to permit taxation of Federal securities by other jurisdictions than the Federal Government. It is the opinion of your committee, therefore, that any ambiguity in this respect in the existing language of the section should be eliminated.

LIMITED EFFECT OF THE PUBLIC DEBT ACT

The Public Debt Act of 1941 made no change in the taxable status of Federal obligations under State or local law, nor any change in the taxable status of State or local obligations under Federal law.

The views of the Treasury Department and of the Board of Commissioners of the District of Columbia on the bill are expressed in the following letters addressed to the chairman of your committee:

Treasury Department  
Washington 25, May 5, 1947

...  
Government of the District of Columbia  
Washington 4, D. C., May 9, 1947

Hon. Harold Knutson,  
Chairman, Committee on Ways and Means,  
House of Representatives, Washington 25, S. C.

My Dear Mr. Knutson: The Commissioners have for report H. R. 2872, Eightieth Congress, a bill to amend further section 4 of the Public Debt Act of 1941, as amended, and clarify its application, and for other purposes.

This bill further amends subsection 1 of section 4 of the Public Debt Act of 1941, as amended, by striking out the words "Federal tax acts now or hereafter enacted" and inserting in lieu thereof the words "the Internal Revenue Code, or laws amendatory or supplementary thereto." The purpose of this amendment is to preclude, beyond question, the taxation of the interest on obligations of the United States under the provisions of the statute levying upon banks in the District of Columbia a tax upon gross earnings (sec. 47-1701, D. C. Code, 1940 ed.).

In the case of District of Columbia v. Riggs National Bank ((decided in 1929), 58 App. D.C. 349, 30 Fed. (2) 873), it was held that, under the then-existing statutes exempting obligations of the United States from taxation, the District of Columbia had no authority to include the interest therefrom in computing, for the purpose of taxation, the gross earnings of banks. However, on March 28, 1942, section 4 of the Public Debt Act was amended to provide that obligations of the United States issued after the effective date of the amendment should not have any exemption as such "under the Federal tax acts now or hereafter enacted." The Corporation Counsel of the District has recently held that, since the statute under which the District of Columbia levies taxes upon banks is an act of Congress, it is a Federal tax act within the meaning of the Public Debt Act and that the obligations issued by the United States after the effective date of such amendment are subject to District taxation. The Comptroller of the Currency and the general counsel for the Treasury Department have advised the commissioners there was no intent on their part, in drafting the 1942 amendment to the Public Debt Act, to make the obligations of the United States and the income therefrom subject to taxation exempt under the Internal Revenue Code. This amendment makes clear the intent and the Commissioners have no objection to the passage of this bill.

The Commissioners have been advised by the Bureau of the Budget that there is no objection on the part of that office to submission of this report to the Congress.

Respectfully,

JOHN RUSSELL YOUNG,  
President, Board of Commissioners

After reviewing the legislative history, Corporation Counsel concluded:

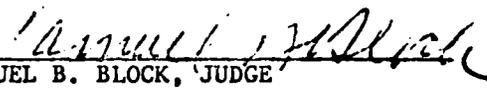
In view of the legislative history of Public Law 116, 80th Congress, I am constrained to conclude, under all the circumstances, that my opinion of April 12, 1961, was incorrect, and that interest and dividends received by banks and building associations on securities and obligations issued by the Federal Government and its agencies and instrumentalities is not includable in gross earnings for purposes of determining the tax payable under section 47-1703, D. C. Code, 1951. It follows that interest and dividends received on securities and obligations issued by state, county, and municipal governments and their instrumentalities is likewise not includable in gross earnings for purposes of tax under section 47-1703.

The tax in question involves securities issued and purchased both prior to and after reorganization. Apparently, the District of Columbia is not relying on the reorganization of FNMA for their change of policy regarding the tax status of interest on FNMA securities.<sup>3/</sup> Nonetheless, the Court feels it is unnecessary to decide whether the established administrative practice of the District of Columbia concerning tax assessment on FNMA securities is dispositive in this case. The Congressional intent is clear, interest on obligations and securities of the United States are not taxable under the provisions of section 47-1703, D. C. Code, 1967 ed. The Congressional intent is also clear that securities issued by FNMA are tax exempt securities of the U. S. Government. Therefore, petitioner's refund is granted.

Wherefore, it is, this 18<sup>th</sup> day of July, 1978, hereby,  
ORDERED, that petitioner's appeal from denial of claim for refund is granted. It is further,

ORDERED, that counsel shall calculate the amount of the judgment and interest and the same shall be approved by the court.

BY THE COURT:

  
SAMUEL B. BLOCK, JUDGE

Copies to counsel

3/ In a letter dated April 5, 1971, the government based its denial of tax refund on FNMA reorganization in 1968. However, the government in its response to this petition, does not rely on the reorganization of FNMA but claims FNMA securities are not obligations of the United States and they are not entitled to tax exemptions, or exempt pursuant to specific Congressional enactment.

Copies Served:

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7/20/78