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SEP 23 '63

September 18, 1963

Hon. Kenneth B. Keating
U. S. Senator
Senate Office Building
Washington, D. C.

Dear Senator Keating:

A recent decision was handed down by the United States District Court for the Northern District of Oklahoma in the Atlas Life Insurance Co. case that, if extended, could have a disastrous effect on the marketability of State and local governmental securities. The effect could be that governmental bonds, historically tax-exempt, would be taxed. Local governments, as a result could be pushed to the brink of bankruptcy by being forced to pay higher interest rates on their borrowings.

The complaint of the Atlas Life Insurance Company was that it was required to pay more tax on its other income from taxable sources solely because it received income in the form of interest from state and municipal securities.

This decision involves an interpretation of the complex life insurance company tax provisions, as contained in the Life Insurance Company Tax Act of 1959, but more important than this is the fact that the decision goes to the very heart of the constitutional tax immunity of state and local governmental securities from federal taxation.

Judge Bohanon, the presiding Judge, agreed with the Government attorneys that Congress, in enacting the Life Insurance Income Tax Act of 1959, expressed its intent to approving the complex taxing formula contained in the bill rather than by inserting the so-called exclusion clause. However, when the bill was being considered by Congress, the Treasury Department insisted that the bill did not propose to tax municipal bond interest. Congress, however, felt uneasy about the bill's municipal bond provisions and inserted a clause which provided that "----- if it is established in any case that the application of the definition of taxable investment income under this subsection results in the imposition of tax on any wholly tax-exempt interest----adjustment shall be made to the extent necessary to prevent such imposition."

Hon. Kenneth B. Keating

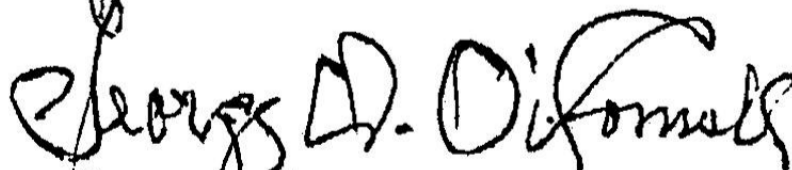
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It seems obvious that Congress had no intention of taxing municipal bond interest and yet the Treasury Department in applying the 1959 Law, ignoring the exclusion clause, requires life insurance companies to divide tax-exempt interest income between the company and the policyholders and allows the company to deduct only its share from net investment income. Thus, if the policyholders' share is determined to be seventy-five percent, then the company may exclude only twenty-five percent of its total tax-exempt interest income in arriving at its taxable base.

I repeat should the concept, as embodied in Judge Bohanon's opinion, be extended to individuals and commercial banks, it could have disastrous effects on the marketability of municipal bonds because in order for the securities to be attractive to buyers an exorbitant rate of interest would have to be paid by the municipalities which in turn would mean higher debt service that would have to be met through increased real estate taxes or increased revenues from other sources such as sales taxes.

In conclusion, I urge you to seek revision of the 1959 Life Insurance Income Tax Law for the purpose of removing therefrom any ambiguity as to the intent of Congress in regards to the traditionally tax-exempt status of municipal bond interest.

Very truly yours,



George D. O'Connell, Comptroller