

NOTE: Where it is feasible, a syllabus (headnote) will be released, as is being done in connection with this case, at the time the opinion is issued. The syllabus constitutes no part of the opinion of the Court but has been prepared by the Reporter of Decisions for the convenience of the reader. See *United States v. Detroit Lumber Co.*, 200 U. S. 321, 337.

SUPREME COURT OF THE UNITED STATES

Syllabus

NEBRASKA DEPARTMENT OF REVENUE *v.* LOEWENSTEIN

CERTIORARI TO THE SUPREME COURT OF NEBRASKA
No. 93-823. Argued October 11, 1994—Decided December 12,
1994

Respondent, a Nebraska resident, owns shares in mutual funds (Trusts) that earn some of their income by participating in "repurchase agreements" (repos) involving federal debt securities. In such a transaction, the party holding the securities (Seller-Borrower) transfers them to the Trusts in return for a specified amount of cash. At a later date, the Trusts deliver the securities back to the Seller-Borrower, who credits to the Trusts an amount equal to the cash transfer plus interest at an agreed-upon rate that bears no relation to the yield on the underlying securities. Ultimately, the Trusts' interest income is distributed to respondent in proportion to his shares in the Trusts. After petitioner issued a Revenue Ruling concluding that interest income from repos is subject to Nebraska's income tax, respondent brought this declaratory judgment action in state court, asking that the Revenue Ruling be declared invalid as contrary to the Supremacy Clause and to 31 U. S. C. §3124(a), which, in relevant part, exempts from state taxation interest on "obligations of the United States Government." The court granted the relief, and the Nebraska Supreme Court affirmed.

Held:

1. Nebraska's taxation of the income respondent derived from the repos does not violate §3124(a). Pp. 4-11.

(a) For purposes of §3124(a), the interest income earned by the Trusts is interest on loans from the Trusts to the Seller-Borrower, not interest on federal securities; in this context, the securities are merely collateral for these loans. Several features of the repos lead to this conclusion: (1) at a repo's commencement, the Trusts pay the Seller-Borrower a fixed sum of money, which is repaid with interest at a rate bearing no relation to either the coupon interest paid or discount interest

accrued on the federal securities during the term of the repo; (2) the Trusts may liquidate the securities should the Seller-Borrower default on the debt, but, like a lender, they must pay to the Seller-Borrower any proceeds in excess of the amount of the debt plus expenses, and may recover any deficiency from the Seller-Borrower; (3) the market value of the securities must be maintained at 102% of the original payment amount, with the Seller-Borrower delivering cash or additional securities if the value falls below 102%, and the Trusts returning securities if the value exceeds 102%; and (4) the Seller-Borrower may, during the term of the repo, substitute federal securities of equal market value for the securities initially involved in the transaction. The fact that the Trusts take ``delivery'' of the federal securities at the repo's commencement also is consistent with understanding the repos as loans, since ``delivery'' perfects the Trusts' security interests in their collateral. Pp. 4-9.

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(b) Respondent's two objections to this interpretation of §3124(a) are unpersuasive. It does not matter that the Trusts and Seller-Borrower characterize the repos as sales and repurchases, since the substance and economic realities of the transactions show that the Trusts receive interest on cash they have lent to the Seller-Borrower. Cf. *Frank Lyon Co. v. United States*, 435 U. S. 561, 582. And, contrary to respondent's argument, this case does not involve the construction or validity of the Nebraska income tax statute's add-back rule. Pp. 9-11.

2. Nebraska's taxation of income from repos involving federal securities does not violate the Supremacy Clause. Respondent has pointed to no statute, revenue ruling, or other manifestation of Nebraska policy that treats "state" repos differently from "federal" repos for tax purposes. Nor does the taxation at issue make it more difficult and expensive for the Federal Government to finance the national debt. Expert testimony referred to by respondent has no relevance to this case, and respondent has shown no "obvious and appreciable" injury to the Government's borrowing power as a result of Nebraska's taxation of the Trusts' repo income, see *Rockford Life Ins. Co. v. Illinois Dept. of Revenue*, 482 U. S. 182, 190, n. 10. Pp. 12-14.

244 Neb. 82, 504 N. W. 2d 800, reversed and remanded.

THOMAS, J., delivered the opinion for a unanimous Court.