NOTES

TAXING POLICE BRUTALITY BONDS

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In view of decades of devastating police violence and efforts to reform policing, this Note points to two concurrent phenomena that result in the federal tax code granting benefits to the wealthiest taxpayers who lend to municipalities for police brutality settlements. The first phenomenon is cities electing to issue bonds to satisfy these costly payouts. These bonds have been coined "police brutality bonds." The second phenomenon is the tax benefit to investors in the top tax brackets for collecting interest from municipal bonds—compared to like private bonds. This Note argues that the federal tax code should not allow wealthy taxpayers to receive tax benefits from funding police brutality bonds. Further, since tax exemption of municipal bonds is a form of federal subsidy, this Note argues that a federal subsidy for police brutality bonds is inappropriate given the legislative intent and economic justification behind tax exemption.

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INTRODUCTION

In the summer of 2020, jarring footage of a Minneapolis police officer murdering George Floyd, an unarmed Black man, sparked demonstrations across 140 cities.[1] Protestors in Minneapolis called for the police officers responsible for Mr. Floyd's death to be fired and prosecuted.[2] And in July of that summer, Mr. Floyd's family filed a civil suit against the city of Minneapolis and the police officers, alleging a deprivation of Mr. Floyd's rights.[3] The lawsuit settled for $27 million in March 2021.[4]

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1. See Derrick Bryson Taylor, George Floyd Protests: A Timeline, N.Y. Times (Nov. 5, 2021), https://www.nytimes.com/article/george-floyd-protests-timeline.html (on file with the *Columbia Law Review*); Catherine Thorbecke, Derek Chauvin Had His Knee on George Floyd's Neck for Nearly 9 Minutes, Complaint Says, ABC News (May 29, 2020), https://abcnews.go.com/US/derek-chauvin-knee-george-floyds-neck-minutes-complaint/story?id=70961042 [https://perma.cc/6YRK-GREC] ("Video of Chauvin pinning Floyd to the ground with his knee pressed into Floyd's neck went viral earlier this week, sparking widespread protests across the country that have taken a violent turn in Minnesota as outrage mounts.").

2. See Eli Newman, Detroit Police, NAACP Call for Murder Charges Over Death of George Floyd, WDET (May 28, 2020), https://wdet.org/2020/05/28/detroit-police-naacp-call-for-murder-charges-over-death-of-george-floyd/ [https://perma.cc/3JLT-GZBZ].

3. See Complaint at 27–38, Schaffer v. Chauvin, No. 0:20-cv-01577-SRN-TNL (D. Minn. filed July 15, 2020), 2020 WL 3988441 (alleging three violations of 42 U.S.C. § 1983 (2018) for the murder of George Floyd).

4. Steve Karnowski & Amy Forliti, Floyd Family Agrees to $27M Settlement Amidst Ex-Cop's Trial, AP News (Mar. 12, 2021), https://apnews.com/article/minneapolis-pay-27-million-settle-floyd-family-lawsuit-52a395f7716f52cf8d1fbeb411c831c7 [https://perma.cc/5SFY-V2X9].

This story—one of police action resulting in devastating human consequences and costing a city a large settlement payout—is not uncommon. The city of Louisville, Kentucky, settled with Breonna Taylor's family for $12 million in September 2020.[5] The city of Cleveland, Ohio, settled with Tamir Rice's family for $6 million in 2016.[6] The city of St. Anthony, Minnesota, settled with Philando Castile's mother for $3 million in 2017.[7] And New York City settled with Eric Garner's family for $5.9 million in 2015.[8]

Cities have several ways to raise money when they need to satisfy large police brutality payouts. They might have insurance to cover the costs.[9] Alternatively, they can pay from the city's general fund or the city police department's budget.[10] Or they could sell bonds—coined "police brutality bonds."[11] When investors buy bonds, they typically have to pay federal income taxes on the interest proceeds. Municipal bonds, however, produce tax-exempt interest. As a result of the exemption and the economics of the bond market, investors in the top tax bracket tend to receive more interest on municipal bonds, such as police brutality bonds, than they would after-tax on corporate bonds.[12] Therefore, the Internal Revenue Code (the Code) enables the wealthiest individuals to benefit from the suffering of victims of police brutality.

This Note demonstrates how the Code allows such a tax benefit and why the benefit is worrisome. It then considers proposals on how to eliminate the benefit. In Part I, this Note will demonstrate how and why

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5. Taylor was shot to death by police officers acting on a no-knock warrant. A Look at Big Settlements in US Police Killings, AP News (Mar. 12, 2021), https://apnews.com/article/shootings-police-trials-lawsuits-police-brutality-2380f38268a504ae689ad5b64b5de2e7 [https://perma.cc/C97E-9APB].

6. Rice, a twelve-year-old boy, was fatally shot by a Cleveland, Ohio, police officer. Eric Heisig, Tamir Rice Estate's Multi-Million Dollar Settlement Approved by Probate Court, Cleveland.com (Nov. 30, 2016), https://www.cleveland.com/court-justice/2016/11/tamir_rice_estates_multi-milli.html [https://perma.cc/69DF-Z6R3].

7. Castile was fatally shot by a St. Anthony, Minnesota, police officer. Sarah Horner, Philando Castile Family Reaches $3M Settlement in Death, Twin Cities Pioneer Press (June 26, 2017), https://www.twincities.com/2017/06/26/philando-castile-family-reaches-3m-settlement-in-death/ [https://perma.cc/E6VX-X4Q5].

8. Garner was killed by a police chokehold. J. David Goodman, Eric Garner Case Is Settled by New York City for $5.9 Million, N.Y. Times (July 13, 2015), https://www.nytimes.com/2015/07/14/nyregion/eric-garner-case-is-settled-by-new-york-city-for-5-9-million.html (on file with the *Columbia Law Review*).

9. See, e.g., Horner, supra note 7 ("The settlement . . . will be paid through the city's coverage with the League of Minnesota Cities Insurance Trust."); see also infra note 40 and accompanying text.

10. See infra notes 40, 159 and accompanying text.

11. Alyxandra Goodwin, Whitney Shepard & Carrie Sloan, Action Ctr. on Race & the Econ., Police Brutality Bonds: How Wall Street Profits From Police Violence 3 (2020), https://acrecampaigns.org/wp-content/uploads/2020/06/ACRE_PBB_2020_2.pdf [https://perma.cc/42QW-VQ67].

12. See infra section II.A.

municipalities face large judgments and settlements for police brutality,[13] how municipalities fund these payouts, including by issuing bonds,[14] and how interest on those bonds is tax exempt.[15] In Part II, this Note will show how the Code sanctions a tax benefit for the richest investors for funding police brutality bonds, which is normatively problematic and emblematic of uninformed investing.[16] Moreover, because tax exemption is a form of federal subsidy, this Note argues that the use of tax-exempt bonds for police brutality payouts is inconsistent with the legislative intent and economic justification for tax exemption on municipal bonds interest.[17] In Part III, this Note will explore ways to limit this tax benefit using existing provisions of the Code.[18]

I. FEDERAL TAX EXEMPTION FOR INTEREST ON POLICE BRUTALITY BONDS

To satisfy police brutality payouts, some cities systematically issue bonds, the interest on which is tax exempt for the bondholder. Section I.A considers how municipalities find themselves facing costly settlements and judgments for police brutality. Section I.B illustrates why interest on municipal bonds is tax exempt by briefly exploring the history of tax exemption on municipal bond interest and showing that police brutality bonds do not qualify for one of the exceptions to tax exemption in the Code.

A. *Lawsuits Against Cities and Their Police Departments for Police Brutality*

When police action results in physical harm or death, victims or their families may sue the police officers, their police departments, and the municipality. Section I.A.1 first defines police brutality and then discusses the federal and state causes of action under which victims can sue. Section I.A.2 shows how these lawsuits can result in costly payouts and how some municipalities have issued bonds to satisfy these payouts.

1. *Plaintiffs' Cause of Action in Police Brutality Cases.* — The term "police brutality" can cover a wide range of abuse or discrimination by police, including excessive force, wrongful search and seizure, false arrest or wrongful imprisonment, and sexual harassment or abuse.[19] Under this definition (and even under a narrow one), it is hard to know the overall incidence of police brutality, given the lack of uniformity and consistency

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13. See infra sections I.A.1–.2.

14. See infra section I.A.2.

15. See infra section I.B.

16. See infra section II.A.

17. See infra section II.B.

18. See infra Part III.

19. This Note adopts this definition of police brutality, as it is consistent with the formulation used by the Action Center on Race and the Economy (ACRE) in its report on cities issuing bonds to fund police brutality payouts. See Goodwin et al., supra note 11, at 9, 19, 20, 25 (describing various forms of police brutality).

in data collection.[20] Yet the information that is available is troubling. Police are responsible for more than a thousand deaths each year and tens of thousands more injuries.[21] Police use of excessive force, particularly against Black and Hispanic men, is prominent.[22] In fact, police violence is the sixth-leading cause of death for young Black men.[23]

Despite these devastating results, it is rare for law enforcement officers to face accountability for violence by being convicted of a crime. The decision to charge officers is up to local prosecutors, who are in a difficult or compromised position because they rely heavily on the police for their ongoing work.[24] Additionally, prosecutors may face political

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20. See Amelia Thomson-DeVeaux, Laura Bronner & Damini Sharma, Cities Spend Millions on Police Misconduct Every Year. Here's Why It's So Difficult to Hold Departments Accountable., FiveThirtyEight (Feb. 22, 2021), https://fivethirtyeight.com/features/police-misconduct-costs-cities-millions-every-year-but-thats-where-the-accountability-ends/ [https://perma.cc/5RUW-B7RZ] [hereinafter Thomson-DeVeaux et al., Cities Spend Millions] ("Shoddy, confusing, or incomplete record-keeping combined with a host of other local factors to make it nearly impossible for us to conclude if anything was changing in any given city—much less whether those shifts were for better or worse."); see also David Dante Troutt, *Screws*, *Koon*, and Routine Aberrations: The Use of Fictional Narratives in Federal Police Brutality Prosecutions, 74 N.Y.U. L. Rev. 18, 102 (1999) ("Definitions of police brutality are multiple and sometimes contradictory, and statistics are rarely standardized.").

21. See GBD 2019 Police Violence US Subnational Collaborators, Fatal Police Violence by Race and State in the USA, 1980–2019: A Network Meta-Regression, 398 Lancet 1239, 1239–43 (2021) (estimating 1,240 police-caused fatalities in 2018); Ted R. Miller, Bruce A. Lawrence, Nancy N. Carlson, Delia Hendrie, Sean Randall, Ian R.H. Rockett & Rebecca S. Spicer, Perils of Police Action: A Cautionary Tale From US Data Sets, 23 Inj. Prevention 27, 28 (2017) (finding that police killed or injured more than 55,000 people in 2012).

22. See Jeffrey Fagan & Alexis D. Campbell, Race and Reasonableness in Police Killings, 100 B.U. L. Rev. 951, 961 (2020) ("[A]cross several circumstances of police killings and their levels of objective reasonableness, Black suspects are more than twice as likely to be killed by police than are suspects from other racial or ethnic groups . . . ."); GBD 2019 Police Violence US Subnational Collaborators, supra note 21, at 1245 (finding that non-Hispanic Black men were 3.5 times more likely to be killed by police than white men and Hispanic men were 1.8 times more likely than white men). But see Roland G. Fryer, Jr., An Empirical Analysis of Racial Differences in Police Use of Force, 127 J. Pol. Econ. 1210, 1213–14 (2019) (finding large racial differences in nonlethal use of force, but no racial differences in officer-involved shootings).

23. Morgan Sherburne, Police: Sixth-Leading Cause of Death for Young Black Men, Univ. Mich. Inst. for Soc. Rsch. (June 1, 2020), https://isr.umich.edu/news-events/news-releases/police-sixth-leading-cause-of-death-for-young-black-men-2/ [https://perma.cc/U4UG-57JW] ("Police use-of-force—which includes asphyxiation, beating, a chemical agent, a medical emergency, a Taser, or a gunshot—trails accidental death, suicide, other homicides, heart disease and cancer as a leading cause of death for young black men, who have the highest risk of being killed by police.").

24. John V. Jacobi, Prosecuting Police Misconduct, 2000 Wis. L. Rev. 789, 803–04 ("When they are asked to prosecute one of these allies, prosecutors face 'an impossible conflict of interest between their desire to maintain working relationships and their duty to investigate and prosecute police brutality.'" (quoting Alexa P. Freeman, Unscheduled Departures: The Circumvention of Just Sentencing for Police Brutality, 47 Hastings L.J. 677, 719 (1996))).

pressure not to prosecute.[25] Philip M. Stinson, professor of criminal justice, estimates that between 2005 and 2010, only 110 law enforcement officers were charged with murder or manslaughter, with only 42 being convicted.[26]

But accountability is still possible: Victims of police brutality can file civil claims. The relevant federal statute is 42 U.S.C. § 1983,[27] which allows individuals to file claims for damages for violations of federal rights such as illegal seizures,[28] use of excessive force,[29] or wrongful convictions.[30] Under § 1983, victims can sue individual officers[31] as well as police departments and cities.[32] Police brutality victims typically have

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25. Id.

26. Amelia Thomson-DeVeaux, Nathaniel Rakich & Likhitha Butchireddygari, Why It's So Rare for Police Officers to Face Legal Consequences, FiveThirtyEight (June 4, 2020), https://fivethirtyeight.com/features/why-its-still-so-rare-for-police-officers-to-face-legal-consequences-for-misconduct/ [https://perma.cc/HKZ4-GTJZ] (last updated Sept. 23, 2020) (describing Professor Philip M. Stinson's dataset on prosecutions of police officers).

27. The statutory language reads as follows:

> Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress . . . .

42 U.S.C. § 1983 (2018).

28. "The right of the people to be secure in their persons, houses, papers, and effects, against unreasonable searches and seizures, shall not be violated . . . ." U.S. Const. amend. IV. See, e.g., Soldal v. Cook County, 506 U.S. 56, 72 (1992) (holding that a complaint alleging that law enforcement officers dispossessed homeowners of their mobile home sufficiently stated a cause of action under § 1983 as unlawful seizure within the meaning of the Fourth Amendment).

29. See, e.g., Graham v. Connor, 490 U.S. 386, 394 (1989) ("Where, as here, the excessive force claim arises in the context of an arrest or investigatory stop of a free citizen, it is most properly characterized as one invoking the protections of the Fourth Amendment . . . ."); Russo v. City of Cincinnati, 953 F.2d 1036, 1044 (6th Cir. 1992) ("The use of excessive or unreasonable force by police officers in the exercise of their authority gives rise to a § 1983 cause of action." (citing Tennessee v. Garner, 471 U.S. 1 (1985))).

30. See, e.g., Roberts v. City of Fairbanks, 947 F.3d 1191, 1198 (9th Cir. 2020) (showing how a plaintiff could recover damages under § 1983 claim for unconstitutional conviction or imprisonment); Spadaro v. City of Miramar, 855 F. Supp. 2d 1317, 1340 (S.D. Fla. 2012) ("To plead a claim for malicious prosecution under section 1983, a plaintiff must establish (1) the elements of the common law tort of malicious prosecution and (2) a violation of his fourth amendment right to be free from unreasonable seizures.").

31. In 1961, the Supreme Court held that the phrase "under color of law" in § 1983 covers even police officer actions that are unauthorized by state law, state custom, or state usage. See Monroe v. Pape, 365 U.S. 167, 172, 187 (1961).

32. See Monell v. Dep't of Soc. Servs., 436 U.S. 658, 701 (1978) (holding that municipal liability is available under § 1983). Individual police officers are frequently indemnified by cities anyway. Joanna C. Schwartz, Police Indemnification, 89 N.Y.U. L. Rev. 885, 912 (2014) [hereinafter Schwartz, Police Indemnification] (finding that police officers financially

causes of action under state tort laws as well.[33] For example, in Maine, a claim of excessive force is a subset of the assault and battery common law tort.[34]

2. *Funding Police Brutality Judgments or Settlements.* — Filing a § 1983 claim or a state claim can result in a judgment for the police brutality victim or a settlement directly with the municipality.[35] In the aggregate, cities pay hundreds of millions of dollars in settlements or judgments for these claims each year.[36] One analysis found that the thirty-one cities with the highest police-to-civilian ratios in the country paid more than $3 billion to settle police misconduct lawsuits over a ten-year period.[37] Meanwhile, New York City separately reported paying $97.3 million in fiscal year 2019 in settlements or judgments for personal injury "police action" claims.[38] Between 2011 and 2020, the city paid close to a billion dollars for these claims.[39]

The question then becomes how municipalities pay out these sizable sums. Professor Joanna C. Schwartz has found that cities take one of three approaches: paying directly from the city's budget (self-insurance), purchasing private liability insurance, or participating in public entity risk

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contributed to settlements or judgments in approximately 0.41% of the 9,225 civil rights cases brought against law enforcement in which plaintiff received financial compensation in the forty-four largest jurisdictions studied between 2006 and 2011).

33. See Arturo Peña Miranda, "Where There Is a Right (Against Excessive Force), There Is Also a Remedy": Redress for Police Violence Under the Equal Protection Clause, 65 UCLA L. Rev. 1678, 1742 (2018) ("The common law equivalent of an excessive force claim is a trespass for battery suit, which redressed bodily hurts. The vast majority of states, if not all, still protect this common law equivalent of excessive force . . . ." (footnote omitted)); see also Deville v. Marcantel, 567 F.3d 156, 172 (5th Cir. 2009) ("Louisiana's excessive force tort mirrors its federal constitutional counterpart."); Robinson v. Solano County, 278 F.3d 1007, 1016 (9th Cir. 2002) ("Most of the state law claims arise from the allegation that the individual officers used excessive force, and California denies immunity to police officers who use excessive force in arresting a suspect."); Thompson v. City of Indianapolis, 208 F. Supp. 3d 968, 977 (S.D. Ind. 2016) ("If a police officer uses unnecessary or excessive force, the officer may commit the torts of assault and battery.").

34. Richards v. Town of Eliot, 780 A.2d 281, 292 n.8 (Me. 2001).

35. See, e.g., Off. of the N.Y.C. Comptroller, Claims Report: Fiscal Year 2020, at 13 (2021), https://comptroller.nyc.gov/wp-content/uploads/documents/Claims-Report-FY-2020.pdf [https://perma.cc/R8F2-AVH8] ("Resolving meritorious claims pre-litigation results in substantial financial savings to the City while allowing the New York City Law Department to allocate resources to more complex or difficult cases."); see also supra notes 4–8.

36. Zusha Elinson & Dan Frosch, Cost of Police-Misconduct Cases Soars in Big U.S. Cities, Wall St. J. (July 15, 2015), https://www.wsj.com/articles/cost-of-police-misconduct-cases-soars-in-big-u-s-cities-1437013834 (on file with the *Columbia Law Review*) (finding that the ten cities with the largest police departments paid out a quarter of a billion dollars in 2014 alone).

37. See Thomson-DeVeaux et al., Cities Spend Millions, supra note 20.

38. Off. of the N.Y.C. Comptroller, supra note 35, at 13–14; see also id. at 34 (defining police action claims as those "result[ing] from alleged improper police action, such as false arrest or imprisonment, excessive force or assault, or failure to provide police protection").

39. Id. at 46 tbl.3.

pools with other municipalities in the state.[40] Smaller and mid-sized cities are more likely to use risk pools and private insurance.[41] Some cities, however, have lost insurance coverage due to an excessive number of claims.[42]

Among those who self-insure, some municipalities issue bonds to satisfy police brutality payouts, as researchers at the Action Center on Race and the Economy (ACRE) have reported.[43] When municipalities issue bonds, they are borrowing money on which they have to pay interest.[44] They can sometimes borrow directly from a private purchaser (e.g., a bank) acting on behalf of a small group of investors.[45] More commonly, however, municipalities sell these bonds to financial institutions acting as underwriters, who then resell the bonds on the primary or secondary municipal bond market to investors.[46] Households and nonprofit organizations make up the plurality of municipal bond investors.[47]

The purposes for which police brutality bonds are issued can vary, according to the ACRE researchers. Some cities use bonds when their insurance will not cover all of the payout.[48] Other municipalities use brutality bonds to replenish money for projects that were defunded in order to pay out settlements.[49]

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40. Joanna C. Schwartz, How Governments Pay: Lawsuits, Budgets, and Police Reform, 63 UCLA L. Rev. 1144, 1162 (2016) [hereinafter Schwartz, How Governments Pay].

41. Id. at 1170; see also Amy Forliti, Philando Castile's Family Reaches $3M Settlement in Death, AP News (June 26, 2017), https://apnews.com/article/d89912f174fa4f7ebec977629216adc1 [https://perma.cc/DG6R-UPCC] ("The League of Minnesota Cities Insurance Trust is a cooperative in which Minnesota cities contribute premiums into a jointly owned risk pool that is used to pay claims.").

42. Schwartz, How Governments Pay, supra note 40, at 1191.

43. See, e.g., Goodwin et al., supra note 11, at 8 (estimating that in Chicago, for example, settlements and judgments totaled $709.3 million between 2008 and 2017, on top of which the city has to pay interest of another billion dollars).

44. To be sure, the majority of long-term municipal bond issuances are for education, transportation, and utilities. See IRS, Pub. 5439, Municipal Bonds, Calendar Year 2019 (2022), https://www.irs.gov/pub/irs-pdf/p5439.pdf [https://perma.cc/TB8Z-WQ6S].

45. Randle B. Pollard, Who's Going to Pick Up the Trash?—Using the Build America Bond Program to Help State and Local Governments' Cash Deficits, 8 Pitt. Tax Rev. 171, 187 (2011).

46. Id.

47. Mun. Sec. Rulemaking Bd., Trends in Municipal Bond Ownership 1 (2021), https://www.msrb.org/sites/default/files/2022-09/MSRB-Brief-Trends-Bond-Ownership.pdf [https://perma.cc/U2VU-S8W4] (finding that individual investors account for 45.2% of all municipal bond holdings in 2020).

48. Goodwin et al., supra note 11, at 5 ("The small Pennsylvania city of Bethlehem settled a wrongful death lawsuit for $7.89 million in 2004. Its insurance paid for only $500,000, and the city issued $7.39 million in bonds to pay for the rest.").

49. Id. at 9 ("New Haven, CT's city council voted to fund a $9.5 million settlement by raiding city funds, including bond funds intended for a bridge renovation project. The city plans to issue new bonds in 2018 to replenish the raided funds." (footnote omitted)).

Some municipalities use these bonds as an "emergency option" to satisfy large, unexpected increases in payouts."[50] For example, in 2009, a federal jury directed a $2 million verdict against the city of Canton, Ohio, on behalf of the estate of a man killed by four city police officers.[51] The city decided to issue a $1.8 million note to pay a portion of the claim, which it is still repaying at a rate of $100,000 a year.[52] Since that 2010 payout, however, Canton has had three other police misconduct settlements, costing $148,000 total, which it paid with money from its general fund.[53]

The ACRE researchers also noted that some municipalities use police brutality bonds habitually.[54] They define the habitual use of bonds as when the city's yearly budgetary allotment for settlement expenses is insufficient so often "that it is fair to say cities are knowingly not setting aside enough money to pay these costs and anticipating that they will move money from other areas of the budget, borrow the money, or both."[55] For example, from 2012 to 2014, Chicago budgeted about $16 million a year for settlements or judgments but actually paid about $52 million for police-related payouts each year.[56]

B. *Tax Exemption for Interest on Brutality Bonds*

When states and cities issue bonds, they pay interest to the bondholder, who generally does not have to pay federal income tax on that interest. Since the inception of federal income taxation, there have been two major inquiries as to the treatment of municipal bond interest. The first inquiry, which section I.B.1 will explore, relates to the constitutional question of whether the federal government has the power to tax municipal bond interest. The second inquiry, which section I.B.2 will explore, relates to what should constitute a tax-exempt municipal bond statutorily. Section I.B.3 demonstrates that police brutality bonds do

50. Id. ("In 2010, the City of Canton, OH issued $1.8 million in notes to pay a jury judgment in a federal case after a man died following a beating by police.").

51. Peter Krouse, Federal Jury Orders City of Canton to Pay $2 Million for Fatal Arrest of Shawn Pirolozzi, Cleveland.com (May 20, 2009), https://www.cleveland.com/metro/2009/05/federal_jury_orders_city_of_ca.html [https://perma.cc/NY5T-LCXB].

52. Kelly Byer, What Do Law Enforcement Lawsuits Around Stark County Cost?, CantonRep.com (July 19, 2020), https://www.cantonrep.com/story/news/local/2020/07/19/what-do-law-enforcement-lawsuits-around-stark-county-cost/113371192/ [https://perma.cc/8CF2-2JQT] (finding that as of 2020, the city still had $800,000 left to pay out on the note).

53. Id. (reporting that the city has a $125,000 deductible before its insurer begins to pay).

54. Goodwin et al., supra note 11, at 9 ("Since 2008, Milwaukee has authorized about $26.1 million in borrowing to pay for police settlements and judgments, at interest rates of up to 5 percent. Milwaukee authorized borrowing for settlements or judgments in eight of the ten years between 2008 and 2017." (footnote omitted)).

55. Id. at 8.

56. Id. at 14.

not fit into the exceptions for tax exemption, so the interest on those bonds is tax exempt.

1. *Constitutional Dimensions.* — Tax exemption on municipal bond interest was thought to be required by the Constitution when the Supreme Court first considered the question in 1895. In *Pollock v. Farmers' Loan & Trust Co.*, the Court held that a federal tax on the interest on municipal bonds was "repugnant to the constitution."[57] The Court was swayed in part by a finding of undue federal influence on state borrowing—that such a tax "would operate on the [municipality's] power to borrow before it is exercised, and would have a sensible influence on" its contracts.[58] Further, the Court found that because a state government could not tax "the powers, the operations, or the property of the United States, nor the means which they employ to carry their powers into execution," the United States could not tax an instrumentality or property of a state.[59]

A century later, in *South Carolina v. Baker*, the Court recognized that a number of cases decided after *Pollock* undermined or contradicted its underlying reasoning that the burden of federal tax on interest on the states necessitates immunity.[60] It cited one such case, *Alabama v. King & Boozer*,[61] in which the Court upheld a state sales tax imposed on a government contractor even though the federal government was ultimately responsible for the financial burden of the tax:[62]

> 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. So far as a different view has prevailed, we think it no longer tenable.[63]

South Carolina v. Baker effectively foreclosed the opportunity for a Tenth Amendment argument against federal taxation on state bond interest.[64] To be sure, in the Court's most recent anticommandeering case, *Murphy v. NCAA*, the Court expanded its Tenth Amendment

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57. 157 U.S. 429, 586 (1895).

58. Id.

59. Id. at 584.

60. 485 U.S. 505, 521–24 (1988). For example, in *Helvering v. Mountain Producers Corp.*, 303 U.S. 376 (1938), "the Court upheld the constitutionality of a federal tax on net income a corporation derived from a state lease." *Baker*, 485 U.S. at 522.

61. 314 U.S. 1 (1941).

62. *Baker*, 485 U.S. at 520–21.

63. Id. (internal quotation marks omitted) (quoting *King & Boozer*, 314 U.S. at 8–9).

64. See id. at 511–12; Daniel Knepper, Note, Eliminating the Federal Subsidy in *Kelo*: Restricting the Availability of Tax-Exempt Financing for Redevelopment Projects, 94 Geo. L.J. 1635, 1646 (2006) ("After *Baker*, no doubt remained about Congress's authority to limit the tax exemption, or remove it entirely, for municipal bonds."). But see Maxwell A. Miller & Mark A. Glick, The Resurgence of Federalism: The Case for Tax-Exempt Bonds, 1 Tex. Rev. L. & Pol. 25, 57–58 (1997) (noting "a clear resurgence of federalism protection" means that weak reasoning in *Baker* "will not stand if the constitutionality of the tax exemption for state and local bonds is put squarely before the Court").

jurisprudence by striking down a federal statute *prohibiting* certain state action, whereas previous cases had only struck down federal statutes requiring affirmative actions by states.[65] But the Court distinguished *Baker* first by noting that federal taxation of state bond interest would likely only have an indirect effect on state bond issuance. And even if "removal of the tax exemption was tantamount to an outright prohibition of the issuance of bearer bonds,"[66] removing tax exemption for state bonds "would simply treat state bonds the same as private bonds," and the "anticommandeering doctrine does not apply when Congress evenhandedly regulates an activity in which both States and private actors engage."[67] So despite the resurgence of Tenth Amendment concerns on the Supreme Court,[68] tax exemption for municipal bond interest continues not to be constitutionally mandated.

2. *Codifying What Qualifies as a Tax-Exempt Municipal Bond.* — In the 1920s and 1940s, there were several proposals in Congress to tax interest on municipal bonds, none of which were successful.[69] During the Great Depression, however, municipalities began issuing bonds—industrial development bonds (IDBs)—to help private entities raise money at lower borrowing costs.[70] And in 1968 came Congress's first attempt to deny tax exemption for these private-use bonds.[71]

Jumpstarting reform was an announcement from the Treasury Department in March 1968 that it would issue regulations essentially

65. Murphy v. NCAA, 138 S. Ct. 1461, 1478 (2018) ("It was a matter of happenstance that the laws challenged in *New York* and *Printz* commanded 'affirmative' action as opposed to imposing a prohibition. The basic principle—that Congress cannot issue direct orders to state legislatures—applies in either event." (referring to Printz v. United States, 521 U.S. 898 (1997); New York v. United States, 505 U.S. 144 (1992))).

66. Id.

67. Id.

68. See Robert Schapiro, The Disappearance and Unfortunate Revival of the Tenth Amendment, Nat'l Const. Ctr., https://constitutioncenter.org/the-constitution/amendments/amendment-x/interpretations/129 [https://perma.cc/5G9V-DYRF] (last visited Feb. 16, 2023) (noting that the revival of the Court's attention to federalism began in the 1990s).

69. See Michael Livingston, Reform or Revolution? Tax-Exempt Bonds, the Legislative Process, and the Meaning of Tax Reform, 22 U.C. Davis L. Rev. 1165, 1170–71 & n.10 (1989) ("The exemption for municipal bond interest was simple enough as long as these bonds were used for 'traditional' public purposes—schools, roads, governmental operations, etc.").

70. Id. at 1171 ("For example, a county might lend bond proceeds to a company to construct a new factory (alternatively, the county might build the factory and lease it to the company)."); see also Stan Provus, CDFA Spotlight: The Basics of Industrial Development Bonds, Council of Dev. Fin. Agencies (July 7, 2006), https://www.cdfa.net/cdfa/cdfaweb.nsf/0/BE597705BA591F2588257936005F06C3 [https://perma.cc/4T6M-HF36] ("Through a 1936 Mississippi industrial development program termed 'Balance Agriculture with Industry', the state authorized the first U.S. industrial revenue bonds. These bonds were issued by the city of Durant for the construction of a Realsilk Hosiery Mill factory." (citation omitted)).

71. See Livingston, supra note 69, at 1173, 1178.

prohibiting tax exemption for IDBs.[72] These proposed regulations prompted strong reactions in Congress.[73] Senators opposed to taxing IDB interest argued that those bonds encouraged businesses to relocate to their states and particularly encouraged economic growth in rural areas.[74] Others favored taxation on the basis that tax exemption for IDBs was a federal subsidy to private businesses, not local governments, and that IDBs were increasing interest rates for municipalities overall.[75] In the end,

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72. See generally Staff of Comm. of Conf. on H.R. 15414, 90th Cong., Revenue and Expenditure Control Act of 1968: Explanation of the Bill H.R. 15414 as Agreed to in Conference 13–14 (Conf. Comm. Print 1968) [hereinafter Conference Committee Explanation, H.R. 15414] (noting that the Treasury Department published proposed regulations on March 23, 1968). At the time, the Treasury Department recognized how tax exemption for IDB interest was inconsistent with its unfavorable position toward arbitrage bonds. See Lynn Kawecki, IRS, An Historical Perspective of Small Issue Bonds 10, https://www.irs.gov/pub/irs-tege/part1b02.pdf [https://perma.cc/ZP5X-QTQT] (last visited Jan. 25, 2023) ("In both cases, the issuer acted as a conduit for an investment, taking no risk or responsibility for payment on the bonds.").

Moreover, the Treasury Department was concerned about rising interest rates for municipalities for traditional government purposes. In hearings before the Senate Committee on Finance, then-Assistant Secretary Stanley Surrey reportedly "noted that about one-third of the total annual tax exempt issuances involved the use of industrial development bonds to fund businesses. The lion's share of these issuances was comprised of very large issuances for the benefit of large corporations." Id. at 11. "The end result of flooding the market with private funding was an increased cost to governments of funding traditional governmental projects such as roads and schools." Id.

73. See 114 Cong. Rec. 5763 (1968) (statement of Rep. Long) ("I rise today to protest, in the strongest possible terms, attempts by the administration and the Internal Revenue Service in particular to circumvent the Congress on the matter of increased Federal taxes."); id. at 5791–92, 5924 (statement of Rep. Long) (further explaining these objections); id. at 6013 (statement of Sen. Curtis) ("It is proposed that tax-free revenue bonds issued by States and their subdivisions for industrial expansion become taxable not by law enacted by Congress, but by edict of the Treasury Department. Nothing could be more preposterous, outrageous, and brazen."); cf. id. at 5873 (statement of Sen. Metcalf) ("The Treasury's action is a vital step toward eliminating these private corporate bonds from the tax-exempt bond market.").

74. See id. at 6938–39 (statement of Sen. Monroney) ("These bonds have been a vital part of the life-force of nonurban industrial establishment, particularly in Oklahoma, where the new ruling would block the creation of 16,000 new jobs now for non-urban Oklahomans."); see also id. at 7026–27 (statement of Rep. Hamilton) ("In many rural areas of America these industrial development bonds have provided small industries with their only access to vital funds."). Per Representative Jack Edwards of Alabama,

> Industrial development bonds have been the deciding factor in the decision of many industries to go forward with building plans. New jobs have been created and in many cases the poor people of this Nation have left the welfare rolls and become productive citizens. Why then should the Internal Revenue Service propose to remove tax-exempt status from these job-producing industrial development bonds?

Id. at 5924 (statement of Rep. Edwards).

75. See id. at 7681 (statement of Sen. Proxmire) ("There is no element of municipal bonds that has grown more rapidly than [IDBs] . . . . [A]s the supply increases, the interest rate will rise[,] . . . [so] financing investment for health and school services will be penalized because interest rates on bonds to finance the services will . . . rise."). Senator Fritz Hollings

Congress came up with a compromise that provided a number of exceptions for the types of municipal bonds that qualified as private use,[76] such as bonds that were used to fund residential rental property or convention or trade show facilities. But despite the legislative effort to reduce private use of tax-exempt municipal bonds, the bill's numerous exceptions led to the prodigious growth in the volume of tax-exempt bonds for private businesses.[77]

The next attempt to reduce the use of tax-exempt bonds for private use came nearly two decades later with the Tax Reform Act of 1986.[78] At the time, the Joint Committee on Taxation explained Congress's concern in creating the new law:

> Congress was concerned with the large and increasing volume of tax-exempt bonds being issued under prior law. The effects of this increasing volume included an inefficient allocation of capital; an increase in the cost of financing *traditional governmental activities*; the ability of higher-income persons to avoid taxes by means of tax-exempt investments; and mounting revenue losses.
>
> At the same time, Congress recognized the important cost savings that tax-exempt financing could provide for State and local governments, in a period marked by reductions in direct Federal expenditures for such purposes. To the extent possible, Congress desired to restrict tax-exempt financing for private activities without affecting the ability of State and local governments to issue bonds for traditional governmental purposes.[79]

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provided the example of Summerville, South Carolina, which "issued $800,000 of school bonds, 5-percent bonds, full faith and credit," and "there was not a bidder." Id. at 7685–86 (statement of Sen. Hollings). "This is what will happen to small communities when they begin to transfer to industry their non-taxable status. They will not be able to provide for the schools. They will not be able to provide for the sewerage. They will not be able to provide for water systems." Id. For more perspectives, see generally id. at. 7678–703, 8147–62.

76. See Conference Committee Explanation, H.R. 15414, supra note 72, at 14–18 (explaining the exceptions).

77. See Livingston, supra note 69, at 1175–77; see also Staff of Joint Comm. on Tax'n, 99th Cong., General Explanation of the Tax Reform Act of 1986 (H.R. 3838, 99th Congress; Public Law 99-514), at 1151 (Comm. Print 1987) [hereinafter Joint Committee Explanation, Tax Reform Act] ("Between 1975 and 1985, the volume of long-term tax-exempt obligations for private activities (including tax-exempt IDBs, student loan bonds, mortgage revenue bonds, and bonds for use by certain nonprofit charitable organizations) increased from $8.9 billion to $116.4 billion . . . .").

78. Livingston, supra note 69, at 1230 (noting that the 1986 Act tried to phase down private activity bond issuance, including by introducing a volume cap, arbitrage rules, and stricter targeting rules).

79. Joint Committee Explanation, Tax Reform Act, supra note 77, at 1151 (emphasis added).

The Tax Reform Act of 1986 provided the framework for tax exemption for municipal bonds that remains largely in force today.[80] The next subsection discusses how the Act's provisions apply to police brutality bonds.

3. *Police Brutality Bonds and the Code Today.* — To start, 26 U.S.C. § 103 states that interest earned on state and local bonds is tax exempt.[81] The two exceptions to tax exemption are found in § 141 (nonqualifying private activity bonds) and § 148 (arbitrage bonds).[82] Police brutality bonds do not fit the definition of either exception, so interest received by holders is tax exempt.

Police brutality bonds do not meet the definition of § 141's "private activity bonds."[83] To fall under the exemption, a bond has to qualify as private loan financing[84] or have more than 10% of its proceeds used for private business.[85] Of course, police brutality bonds do not fund private loans; they fund judgments or settlements, the beneficiaries of which are not required to pay the municipalities back.[86] Additionally, proceeds from police brutality bonds are not used in a trade or business; they are used by the municipalities to satisfy judgments and settlements.[87]

Police brutality bonds are also not arbitrage bonds. Section 148 defines "arbitrage bonds" as bonds for which the proceeds "are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly—to acquire higher yielding investments, or to replace funds which were used directly or indirectly to acquire higher yielding investments."[88] But since police brutality settlements and judgments do not produce any yield, police brutality bonds clearly do not fit this exception either; therefore, they do produce tax-exempt interest.

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80. Knepper, supra note 64, at 1645 ("The 1986 revisions provided the statutory framework largely still in place today.").

81. 26 U.S.C. § 103(a) (2018) ("Except as provided in subsection (b), gross income does not include interest on any State or local bond.").

82. See id. § 103(b).

83. See id. § 141.

84. Treas. Reg. § 1.141-5(a) (2023) (meeting the private loan financing test if "more than the lesser of 5 percent or $5 million of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than governmental persons").

85. 26 U.S.C. § 141(b)(1) (qualifying "if more than 10 percent of the proceeds of the issue are to be used for any private business use"). In addition, these bonds have to satisfy the private security or payment test. See Treas. Reg. § 1.141-4(a).

86. See 26 U.S.C. § 141(c).

87. See id. § 141(b)(6)(A).

88. Id. § 148(a). A "classic example" of arbitrage is a municipality issuing a bond at a 10% tax-exempt rate for 20 years, investing those bond proceeds in a 20-year treasury bond with a rate of 12%, and pocketing the 2% difference every year. See William L. Gehrig, Vanessa Lowry & Linda D'Onofrio, The Fundamentals of Municipal Bonds 47 (2016) ("Whenever the investment rate of return on such proceeds is expected to be greater than the interest rate on the borrowing, the issuer has traditionally had to be concerned about potential 'arbitrage.'").

II. ISSUES WITH THE TAX EXEMPTION FOR BRUTALITY BONDS

This Part demonstrates in section II.A how top-bracket taxpayers receive a tax benefit from investing in municipal bonds, which means they receive that benefit from investing in police brutality bonds. Section II.A also discusses why this result is normatively problematic and emblematic of uninformed investing in the municipal bond market. Then, section II.B explores the other problem with tax-exempt brutality bonds—that they are the result of a federal subsidy. Section II.B explains why a federal subsidy to settle police brutality settlements does not comport with the legislative intent or economic justification for tax exemption.

A. *A Tax Benefit to Wealthy Investors*

When companies or local governments want to raise money, they can sell—or "issue"—bonds to investors and will have to pay back this debt with interest over time. As a starting point, interest rates on private bonds are typically higher than interest rates on municipal bonds of like term and credit rating. But, as this Part will show, because of the tax exemption for municipal bond interest, as the interest rate of a municipal bond becomes closer to that of a comparable private bond, the gain from investing in municipal bonds increases. The result is that the type of investor for whom investing in municipal bonds is tax advantageous are taxpayers in top tax brackets.[89] Section II.A.1 explains why a tax benefit to wealthy investors from brutality bonds is normatively problematic and section II.A.2 shows how it is also emblematic of uninformed investing.

As law students in a basic Federal Income Taxation course learn, interest rates for municipal bonds are lower than interest rates for comparable corporate bonds[90] because investors will not need to pay a portion of their interest proceeds from municipal bonds toward federal tax.[91] For example, an investor who has a federal income tax rate of

89. See infra notes 92–95 and accompanying text. In fact, municipal bond holdings are heavily concentrated among the wealthiest taxpayers: In 2013, the top 0.5% of Americans by wealth held 42.0% of all municipal bonds. Peter Olson & David Wessel, A Smaller Share of Americans Owns Municipal Bonds. Does That Matter?, Brookings (Aug. 18, 2016), https://www.brookings.edu/blog/up-front/2016/08/18/a-smaller-share-of-americans-owns-municipal-bonds-does-that-matter/ [https://perma.cc/XY2G-YUQ9].

90. Council of Econ. Advisors, Annual Report 486 tbl.B–42 (2023), https://www.whitehouse.gov/wp-content/uploads/2023/03/ERP-2023.pdf [https://perma.cc/K7NC-A3PP] (showing that interest rates for high-grade municipal bonds have been lower than interest rates for triple-A corporate bonds since 1952 (the first year of data in the table)).

91. Grant A. Driessen, Cong. Rsch. Serv., RL30638, Tax-Exempt Bonds: A Description of State and Local Government Debt 1 (2018), https://crsreports.congress.gov/product/pdf/RL/RL30638/17 [https://perma.cc/75MS-2BBX] [hereinafter Driessen, Tax-Exempt Bonds] (explaining why the tax liability on taxable corporate bonds allows tax-exempt municipal bonds to have lower interest rates).

40%[92] and has purchased a corporate bond returning 10% interest would have an after-tax return of 6% interest on that bond. Accordingly, an investor would be indifferent when faced with a corporate bond returning 10% (taxed at 40%) and a municipal bond returning 6% (taxed at 0%) because after tax, the investor's earnings are identical (the "implicit" tax rate[93] on this municipal bond would be 40%). Municipalities would thus want to issue bonds with interest rates at least a little higher than 6% to entice that investor, which is obviously lower than the 10% rate on the corporate bond.

But municipal bond interest rates are not set simply based on the tax rate of top-bracket taxpayers. They are driven more broadly by supply of and demand for municipal and taxable bonds.[94] As supply of municipal bonds increases (or demand for municipal bonds decreases), their interest rates rise. For example, when the supply of municipal bonds is high, it is possible that there are not enough investors like the above 40% tax-rate investor to buy all of these bonds. In that case, the interest rate would need to increase from 6% to attract investors in other tax brackets—those at the 35% and 30% federal income tax rates—who require a higher tax-exempt bond rate to correspond to their after-tax income from a taxable bond.

To attract the 30% tax-rate investors, the interest rate on the municipal bond would need to rise above 7%—that is, the interest that they would receive on a comparable corporate bond. Holders of a tax-exempt municipal bond with 7% interest have an implicit tax rate of 30%.

92. The highest tax bracket rate in 2022 is 37%, followed by 35% and 32%. See IRS, IR-2021-219, IRS Provides Tax Inflation Adjustments for Tax Year 2022 (Nov. 10, 2021), https://www.irs.gov/newsroom/irs-provides-tax-inflation-adjustments-for-tax-year-2022 [https://perma.cc/N9BH-9N8X]. But for simpler math to explain the economic concepts, this Note uses round numbers, such as 40%, 35%, and 30%.

93. The implicit tax rate is the tax rate inferred from the interest rate. Here, a 40% implied tax rate on 10% interest would result in an after-tax return of 6%.

94. Driessen, Tax-Exempt Bonds, supra note 91, at 2. "Demand for tax-exempt bonds depends upon the number of investors, their wealth, statutory tax rates, and alternative investment opportunities." Id. "Supply depends upon the desire of the state and local sector for capital facilities and their ability to engage in conduit financing (issuing state or local government bonds and passing the proceeds through to businesses or individuals for their private use)." Id. Naturally, "[a]lmost all of the factors which influence demand and supply are affected by federal tax policy and fiscal policy." Id.

Take, for example, the Tax Cuts and Jobs Act of 2017, which placed limitations on the deductibility of interest for businesses, resulting in the decrease in long-term domestic debt and declines in new debt issuances. Richard D. Carrizosa, Fabio B. Gaertner & Daniel P. Lynch, Debt and Taxes? The Effect of TCJA Interest Limitations on Capital Structure 1, 21, 23 (2020) (unpublished manuscript), https://ssrn.com/abstract=3397285 [https://perma.cc/4QTA-GL2D]. Additionally, the Federal Reserve's interventions may have an impact. For example, in 2021, there was an increase in taxable municipal bonds, in part because the Federal Reserve facilitated low interest rates to mitigate the economic impact of the COVID-19 pandemic. Thomas Luke Spreen & Ed Gerrish, Taxes and Tax-Exempt Bonds: A Literature Review, 36 J. Econ. Survs. 767, 778 (2021) ("Low interest rates diminish the value of the tax exemption to investors, increasing the appeal of taxable bonds.").

For holders at the top tax bracket, however, that implicit tax rate of 30% on these bonds is lower than their actual tax rate of 40%. That 10% difference is tax-free income beyond what an investor would receive on a corporate bond and what this Note refers to as the tax benefit from investing in municipal bonds.

The prior example shows that when the interest rates rise on municipal bonds much beyond what is necessary to attract just the top tax bracket investors, those investors reap more and more of the tax benefit—an outcome that incentivizes the wealthiest investors to prefer tax-exempt municipal bonds. In comparison, the municipal bond rate would have to be at least 8% to get an investor at the 20% tax rate level to notice.[95]

This theoretical advantage to wealthy investors can be seen in practice, in part because of the ever-increasing supply of municipal bonds. Professor Christine Sgarlata Chung characterizes the fiscal nature of local and state governments as facing a consistent pressure to spend: to finance infrastructure projects and schools, pay out pensions, and pursue many other local government functions.[96] At the same time, municipalities deal with "constrained" revenue sources, such as grant money and local taxes, in addition to borrowing.[97] As a result, in 2020, there were approximately fifty thousand issuers of municipal securities and approximately one million different municipal securities outstanding.[98]

In recent years, the difference between tax-exempt bonds and like taxable bonds has been relatively low, as measured by the yield spread—the difference between the interest on tax-exempt bonds and taxable bonds of like term and risk. Municipalities receive more savings when the yield spread is greater.[99] The yield spread today is much lower than it was decades ago.[100] In 1985, the yield spread between AAA corporate bonds and "high grade" municipal bonds was 2.19%.[101] In comparison, the yield

95. Of course, people at lower tax rate levels may not have the capital to invest in bonds.

96. See Christine Sgarlata Chung, Government Budgets as the Hunger Games: The Brutal Competition for State and Local Government Resources Given Municipal Securities Debt, Pension and OBEP Obligations, and Taxpayer Needs, 33 Rev. Banking & Fin. L. 663, 683 (2014).

97. Id. at 674.

98. Mun. Sec. Rulemaking Bd., Muni Facts 1–2 (2022), https://www.msrb.org/sites/default/files/2022-09/MSRB-Muni-Facts.pdf [https://perma.cc/UP48-UVAC]. In comparison, there are approximately 43,000 corporate bonds. Id. at 2.

99. Id.

100. Steven Maguire & Jeffrey M. Stupak, Cong. Rsch. Serv., RL30638, Tax-Exempt Bonds: A Description of State and Local Government Debt 2 (2015) ("Since 1980, the spread between tax-exempt and taxable bonds has declined as underlying interest rates have declined.").

101. Council of Econ. Advisors, supra note 90, at 486 tbl.B–42 (reporting the AAA corporate bond interest rate as 11.37% and the high-grade municipal bond interest rate as 9.18% in 1985). The difference between the corporate bond and municipal bond interest rates is, therefore, 2.19%.

spread was 0.22% in 2022, suggesting that the top-bracket taxpayers investing in these municipal bonds are receiving large tax benefits by retaining more interest.[102]

Moreover, research has generally shown that the yield difference between taxable bonds and municipal bonds has produced low implicit tax rates at longer maturities.[103] Scholars estimate the implicit tax rate on long-term municipal bonds to be around 20% or 25%—a 12- or 17-point difference for investors in the top tax bracket.[104] Once again, these figures suggest that wealthy taxpayers are currently receiving large tax-free benefits from holding municipal bonds.

1. *Normatively Problematic.* — Combining the phenomena of (1) municipalities issuing bonds to satisfy police brutality payouts and (2) top-tax-bracket investors receiving tax benefits from buying municipal bonds reveals a troubling result: The Code allows wealthy investors to reap potentially large tax-free benefits from funding police brutality. This is normatively problematic: The most advantaged in our society—top-bracket taxpayers—benefit from the harms to some of the least advantaged—victims of police violence and their families.[105] Moreover, the wealthiest taxpayers tend to be white, whereas there is a higher prevalence

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102. Id. (reporting that in 2022, the AAA corporate bond interest rate was 4.07% and the high-grade municipal bond interest rate was 3.85%). The difference between the corporate bond and municipal bond interest rates was, therefore, 0.22%.

103. See Dario Cestau, Burton Hollifield, Dan Li & Norman Schürhoff, Municipal Bond Markets, 11 Ann. Rev. Fin. Econ. 65, 68–69 (2019) (providing a literature review of scholars trying to explain low implicit tax rates at longer maturities); Konul Amrahova Riegel, Solving the Muni Puzzle: Who Benefits From Tax Exemption of Government Debt?, 49 Pub. Fin. Rev. 71, 75–77 (2021) ("[The] difference between the theoretical and empirical values of the implied marginal tax rate seems to suggest that tax-exempt issuers may be significantly overpaying in interest costs."). Because the difference is not prevalent at shorter maturities, scholars refer to this phenomenon as a "puzzle" and have produced a number of theories as to the cause. E.g., Riegel, supra, at 72; see also Grant A. Driessen, Cong. Rsch. Serv., RL31457, Private Activity Bonds: An Introduction 5 n.18 (2022), https://crsreports.congress.gov/product/pdf/RL/RL31457/25 [https://perma.cc/Y25Y-PZU4] ("One explanation is that the tax treatment of tax-exempt bonds and taxable bonds is not symmetrical through the yield curve. The lower tax rate for capital gain income plays a role in this phenomena."). The maturity length refers to the number of years it will take to repay the loan, and a long-term maturity is typically ten years or more. James Chen, Term to Maturity in Bonds: Overview and Examples, Investopedia, https://www.investopedia.com/terms/t/termtomaturity.asp [https://perma.cc/BQ7U-LGFB] (last updated Aug. 5, 2022) ("Generally, the longer the term to maturity is, the higher the interest rate on the bond will be and the less volatile its price will be on the secondary bond market.").

104. Riegel, supra note 103, at 72, 97 (finding, however, a much smaller difference of 0–2%).

105. Just the facts that investors receive interest and underwriters receive fees for police brutality bonds have received criticism for this reason. See Goodwin et al., supra note 11, at 27 ("[N]either banks and other firms, nor private investors, should be allowed to continue to make a profit from police violence."). This Note does not focus on this critique because that would involve other, unrelated economic analysis to the point being made here.

of police brutality against Black and Hispanic Americans.[106] So, not only is this phenomenon symptomatic of existing structural racial inequities, but also it exacerbates those inequities because it tends to increase the wealth of largely white bondholders.

One might wonder, then, why this Note is focused on brutality bonds but not other types of judgments and settlements facing municipalities. Seemingly, any type of judgment facing a city that is funded by tax-exempt bonds could create a similar normative problem. The focus of this Note, however, is pragmatically driven: There is evidence showing the *systematic* use of tax-exempt bonds to fund police brutality payouts.[107] And while there are one-off examples of cities issuing bonds for other types of large settlements,[108] evidence of systematic use for these other types of bonds has yet to be produced.

There may be several reasons for this lack of evidence. One is that municipalities are not required to disclose the specific usage of bonds.[109] Therefore, whether cities are using bonds to fund other types of payouts is not easily discernible. Another reason, however, could be that cities face large payouts from police action due to the routine indemnification of police officers in civil suits pursuant to state or local law and policy,[110] and the same cannot be said for other types of municipal employees. As a prerequisite, state and local governments that indemnify their employees, police or otherwise, require that the action at the center of the lawsuit

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106. See supra notes 21–22 and accompanying text; see also Emily A. Shrider, Melissa Kollar, Frances Chen & Jessica Semega, U.S. Census Bureau, P60-273, Income and Poverty in the United States: 2020, at 3 fig.1 (2021), https://www.census.gov/content/dam/Census/library/publications/2021/demo/p60-273.pdf [https://perma.cc/YWS7-Q8PK] (reporting that the 2020 median household income was $74,912 for white, non-Hispanic Americans and $45,870 for Black Americans).

107. See Goodwin et al., supra note 11, at 11 (noting that some cities "habitually rely[] on borrowing to pay settlement and judgment costs that predictably exceed the city's dedicated funding year after year").

108. See, e.g., Sophie Alexander, Bond Sales by Cities Borrowing to Pay for Lost Court Fights Jump, Bloomberg (July 30, 2018), https://www.bloomberg.com/news/articles/2018-07-30/bond-sales-jump-by-cities-borrowing-to-pay-for-lost-court-fights (on file with the *Columbia Law Review*) (reporting that Dallas issued $58.7 million to finance four legal settlements over police and firefighter pay).

109. See infra section II.A.2. In fact, even to seek out the usage of municipal bonds for police brutality payouts, the researchers at ACRE had an arduous journey. See Goodwin et al., supra note 11, at 6 ("There is a striking lack of transparency and disclosure around cities' reliance on borrowing . . . . Most cities in our sample were unable, or unwilling, to provide a full accounting of how much they are spending on borrowing for settlements and judgments.").

110. Schwartz, Police Indemnification, supra note 32, at 890–91; see also Richard Frankel, Regulating Privatized Government Through § 1983, 76 U. Chi. L. Rev. 1449, 1506 n.240 (2009). Professor Stephen Rushin has also found that a "significant number of contracts require the municipality to indemnify officers in cases of civil judgments" in an empirical study of police union contracts from 178 municipalities between 2014 and 2016. See Stephen Rushin, Police Union Contracts, 66 Duke L.J. 1191, 1221 (2017).

fall within the "scope of employment."[111] Given the nature of policing[112] in relation to other types of local government work,[113] it seems unlikely that a municipality will be faced with indemnifying non-police employees in costly lawsuits, at least ones based on physical injury.[114] Beyond injury, it is also not certain that employees will be indemnified for other bad acts.[115] Additionally, although § 1983 might seem to provide an avenue for suing municipalities directly, it is not easy to hold municipalities liable through § 1983 because federal courts have developed rigorous standards for a successful claim.[116] For all these reasons, a sizable portion of cities' settlement and judgment costs most likely arise from police action.

2. *Uninformed Investing*. — Another area of concern is the lack of transparency inherent in municipal bond investing, which can prevent investors from knowing how their money is being used. To start, there are no direct federal requirements on municipal issuers regarding disclosure.[117] In fact, a 2012 report from the U.S. Government

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111. Aaron L. Nielson & Christopher J. Walker, Qualified Immunity and Federalism, 109 Geo. L.J. 229, 273 n.245 (2020) ("All of these indemnification statutes also exclude any actions by an employee that fall outside the course or scope of employment.").

112. The "nature of policing" refers to police officers' ability and opportunity to use force. See Overview of Police Use of Force, Nat'l Inst. Just. (Mar. 5, 2020), https://nij.ojp.gov/topics/articles/overview-police-use-force [https://perma.cc/8YW5-4SGS] ("Broadly speaking, the use of force by law enforcement officers becomes necessary and is permitted under specific circumstances, such as in self-defense or in defense of another individual or group.").

113. See Mark Micheli, The 10 Most Common Jobs in Government, Gov't Exec. (Apr. 5, 2013), https://www.govexec.com/management/2013/04/10-most-common-jobs-government/62287/ [https://perma.cc/K8XJ-UCPE] (showing that the most common types of municipal government jobs, besides police, are in education or are functionally administrative).

114. For example, it would be hard to imagine how a bodily injury caused by a teaching assistant would be within their "scope of employment."

115. See, e.g., Wright v. City of Danville, 675 N.E.2d 110, 119 (Ill. 1996) (holding that the city had no duty to indemnify attorneys' fees incurred in the former commissioners and corporation counsel's unsuccessful defense because their criminal conduct was outside scope of their employment).

116. See Matthew J. Cron, Arash Jahanian, Qusair Mohamedbhai & Siddhartha H. Rathod, Municipal Liability: Strategies, Critiques, and a Pathway Toward Effective Enforcement of Civil Rights, 91 Denv. U. L. Rev. 583, 585–88 (2014) (describing the standard under § 1983 for municipal liability and showing how it is burdensome); Joanna C. Schwartz, Municipal Immunity, 108 Va. L. Rev. (forthcoming 2023) (manuscript at 23) (UCLA Sch. of L., Pub. L. & Legal Theory Rsch. Paper No. 23-02), http://ssrn.com/abstract=4324582 [https://perma.cc/K872-72AJ] (conducting a study on the success of *Monell* claims in federal court and finding that fewer than one in five survive motions to dismiss or motions for summary judgment).

117. U.S. Gov't Accountability Off., GAO-12-265, Municipal Securities: Overview of Market Structure, Pricing, and Regulation 14 n.28 (2012), https://www.gao.gov/assets/gao-12-265.pdf [https://perma.cc/YR9G-863P] ("Instead, the municipal securities disclosure regime is based on a combination of indirect disclosure obligations established through broker-dealers' role as underwriters in primary market issuances and voluntary issuer

Accountability Office found that "municipal issuers' disclosures are sometimes outdated and incomplete."[118] There could, however, be state requirements for disclosure. Some states, such as Florida and Illinois, require full disclosure, approved by state regulators, for all tax-exempt debt issued.[119] Others have no disclosure requirements.[120] A plurality of states, including New York and California, have disclosure requirements only for certain types of municipal debt.[121]

It can be difficult for investors to know that municipal bonds are being used to fund police brutality payouts. Some investors might not want to invest in a bond used for this specific purpose.[122] For a concrete example, take the Cleveland Foundation. After discovering police brutality bonds in its portfolio in 2020, the Foundation made the decision to sell its holdings of those bonds, reasoning that, "Although this divestiture is a small statement in dollars, we hope that it will lead to a conversation inspiring other investment managers to screen their own portfolios and encourage

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disclosures."). Congress exempted municipal bond issuers from the reporting requirements placed on other types of bonds by the Securities Exchange Act of 1934. Neil O'Hara, Sec. Indus. & Fin. Mkts. Ass'n, The Fundamentals of Municipal Bonds 225 (6th ed. 2012). To be sure, municipal issuers are subject to antifraud laws and regulations, prohibiting "any untrue statement of a material fact" in bond disclosures. Todd Meierhenry, Dodd–Frank Act and Its Impact on the Municipal Issuers, Underwriters, and Advisors, 63 S.D. L. Rev. 565, 571 (2019).

118. See U.S. Gov't Accountability Off., supra note 117, at 13–14 & n.28 ("Market participants have expressed frustration regarding the resulting lack of uniformity in the completeness and timeliness of issuer disclosures available in the municipal market, particularly in the secondary market.").

119. See Lisa M. Fairchild & Timothy W. Koch, The Impact of State Disclosure Requirements on Municipal Yields, 51 Nat'l Tax J. 733, 736–37 (1998).

120. Id. at 737 ("Nondisclosure states have the weakest disclosure practices within the municipal market. While issuers typically provide official statements, they frequently are not available until after investors purchase the bonds.").

121. Id. at 737–38 ("Many states require the filing and approval of official statements for a small subset of issues. In general, the type of bond (revenue or general obligation) or the type of issuer (local, state, or agency) determines whether regulators demand a particular form and content on an official statement.").

122. See, e.g., Paddy Hirsch & Stacey Vanek Smith, Judgement Bonds, NPR (Oct. 29, 2018), https://www.npr.org/transcripts/661823224 [https://perma.cc/B5JZ-3UVW] ("I would rather have an airport revenue bond or a water and sewer bond, in which it's an essential service no matter what happens. Judgment payments are not essential."); Caitlin Reilly, Investors Want Details on Bonds That Pay for Police Misconduct, Roll Call (July 1, 2020), https://www.rollcall.com/2020/07/01/investors-want-details-on-bonds-that-pay-for-police-misconduct/ [https://perma.cc/FD28-UKWU] ("You get to pick and choose what you invest in, but it isn't always clear . . . . If investors knew they were paying off judgments against police departments, I don't think they would buy the bonds." (internal quotation marks omitted) (quoting Eric Glass, portfolio manager for AllianceBernstein)).

To be sure, some in the industry are determined to solve the lack-of-information problem. Napoleon Wallace, a bond analyst, and his firm, Activest, plan to introduce a new rating system to help municipal bond investors consider "fiscal justice" before investing in a city's debt. See Stephen Gandel, 'Fiscal Justice Ratings' Fight Police Brutality With Finance, N.Y. Times (Oct. 16, 2021), https://www.nytimes.com/2021/10/16/business/dealbook/fiscal-justice-ratings.html (on file with the *Columbia Law Review*).

municipalities to put more of this burden on the liable officers and not the public."[123]

B. *A Federal Subsidy for Brutality Bonds*

Tax exemption of municipal bond interest is a form of federal subsidy because the federal government forgoes additional tax revenue from bondholders. A federal subsidy for brutality bonds is inconsistent with the legislative intent[124] and economic justification[125] behind the tax exemption provisions.

"Federal subsidy" might suggest that all of the benefit of tax exemption goes to the municipality, the issuer of the tax-exempt bonds. That's not the case, however, when some of the benefit is going to the bondholders.[126] To illustrate, imagine a private bond issued with 10% interest. A wealthy investor in the 40% tax bracket would receive 6% interest after-tax. Therefore, as previously explained, a municipality would need to issue its bond with only 6% interest to entice that investor because that investor does not need to pay tax on that bond's interest income.[127] In this situation, the benefit of the federal subsidy, the 4% loss in tax revenue that the government would have received from a taxable bond producing 10% interest, goes entirely to the municipality, which successfully attracts the investor without having to pay out the higher 10% interest rate.

If the interest rate on that municipal bond is 8%,[128] however, the investor is receiving 2% additional interest compared to the interest they would have received on a like private bond and the municipality is only saving 2% in interest. In this situation, the benefit of the federal subsidy is split, but the federal government still loses out on 4% of the additional interest income.[129] So, regardless of how much of the benefit of tax exemption actually goes to the municipality, the fact remains that the federal government forgoes additional tax revenue. In 2022, tax exemption on municipal bonds cost the federal government more than

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123. Social Impact Investing, Cleveland Found., https://www.clevelandfoundation.org/grants/impact-investing/ [https://perma.cc/9NU3-BXJJ] (last visited Nov. 6, 2021).

124. See infra section II.B.1.

125. See infra section II.B.2.

126. The previous section showed *why* municipalities do not always retain all of the benefit of tax exemption. See supra notes 92–98 and accompanying text.

127. See supra note 93 and accompanying text. To have the advantage over a comparable private bond, the municipality would actually need to issue its bond at an interest rate slightly higher than 6%.

128. See supra note 94 (explaining why interest rates on municipal bonds are not just a little higher than what the highest bracket investor would receive in interest after tax on a comparable private bond).

129. The point of comparison is still the private bond producing 10% interest, with 6% going to the investor and 4% going to the federal government as income tax.

$39 billion in tax collection.[130] That loss in tax revenue, because it is one that Congress chose to forgo after significant debate, becomes problematic when it is the result of brutality bonds.[131]

1. *Inconsistent With Legislative Intent.* — Tax exemption for police brutality bonds departs problematically from the legislative intent behind tax exemption. An inquiry into legislative intent regarding the taxation of municipal bond interest takes a circuitous route because, during the early history of municipal bonds, interest could not constitutionally be taxed,[132] and these bonds were used by and large "to finance traditional public uses such as roads and schools."[133] This history—presumed unconstitutionality of federal taxation and early nonproblematic use of municipal bonds—meant that there was no need for Congress to create distinctions on what types of municipal bonds qualified for tax-exempt interest.

Moreover, this early history does not indicate that Congress intended for a *presumption* of tax exemption for municipal bond interest in all cases. In fact, the cycles of problematic use of municipal bonds followed by reactive congressional reform in the twentieth century suggest otherwise: For instance, the rise of conduit financing (i.e., IDBs)[134] prompted the IRS and then Congress to enact exceptions to tax exemption in 1968.[135] Later, widespread private activity use of municipal bonds prompted Congress to enact further restrictions.[136]

Today, the Code does not deny tax exemption interest for any category of bonds that would include police brutality bonds, even though § 141 excludes certain private use bonds.[137] Nonetheless, given the

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130. See Off. of Tax Analysis, U.S. Dep't of the Treasury, Tax Expenditures tbl.3 (2023), https://home.treasury.gov/system/files/131/Tax-Expenditures-FY2024-update.pdf [https://perma.cc/4LGR-8HGA] (showing that the 2022 tax expenditure for "[e]xclusion of interest on public interest State and local bonds" was $38.6 billion).

131. To be precise about Congress's intent, brutality bonds are *more* problematic than other municipal bonds as Congress never intended for any of the benefit of tax exemption to go to investors for any type of municipal bond. The main reason for tax exemption on municipal bonds is to help state and local governments invest in costly projects that benefit their communities. See infra section II.B.1. When any of the benefit goes to investors, the municipality saves less and has to spend more on those projects. See infra section II.B.2. With brutality bonds, there is the problem that Congress did not intend for investors to benefit from tax-exempt municipal bonds *and* the problem that Congress would not have intended tax exemption for municipal bonds when they are used to fund police brutality payments. See infra sections II.B.1–.2.

132. See supra section I.B.1.

133. Knepper, supra note 64, at 1644.

134. Provus, supra note 70 (explaining that IDBs were "designed to draw or retain industry into communities for employment and economic benefits through the use of tax-exempt financing").

135. Livingston, supra note 69, at 1171–74 (showing how use of industrial development bonds prompted the IRS to create conditions for tax exemption, which prompted Congress to enact legislation).

136. Id. at 1177–79, 1187–93.

137. 26 U.S.C. §§ 103, 141 (2018).

legislative tendency toward reactive reform in this area, just because Congress has not specifically restricted tax exemption on police brutality bond interest does not mean that Congress *intends* for them to be exempt. Moreover, it would have been difficult for Congress to even contemplate the tax consequences of police brutality bonds until recently because their systematic use was first reported a few years ago.[138]

Furthermore, the prior tax reforms indicate that Congress likely would not have intended tax exemption on brutality bond interest, as police brutality payouts are not traditional government functions. Explaining the Tax Reform Act of 1986, the Joint Committee on Taxation said that municipalities "may issue tax-exempt bonds to finance general government operations and facilities, without regard to most of the restrictions (including volume limitations) that apply to bonds used to finance activities of nongovernmental persons."[139] It further defined "traditional governmental purposes" as "general government operations and the construction and operation of such governmental facilities as schools, roads, government buildings, and governmentally owned and operated sewage, solid waste, water, and electric facilities."[140] Police brutality payments do not aid in the construction or operation of government facilities, and it would be a stretch to consider them as being used for general government operations.

Police brutality bonds also do not provide the same benefits as qualifying private activity bonds. For qualifying private activity bonds, the Joint Committee reasoned, "Congress recognized that State and local governments can, in certain cases, achieve significant cost efficiencies through joint public-private partnerships that utilize private management skills to assist in the provision of governmental services."[141] With police brutality bonds, there are no private management skills or public–private partnerships being leveraged.

More evidence that Congress would not have intended for police brutality bonds to be tax exempt comes from analogizing to the statutory definition of private activity bonds in § 141, particularly the private loan financing test. The private loan financing test is met (and the bond interest therefore subject to taxation) if "more than the lesser of 5 percent or $5

138. ACRE's report was first published in 2018. Brooke Sweeney, Wall Street Is Making Millions off Police Brutality, Vice (June 24, 2020), https://www.vice.com/en/article/akzkze/how-wall-street-profits-from-police-brutality [https://perma.cc/DB67-NM2F].

139. Joint Committee Explanation, Tax Reform Act, supra note 77, at 1129.

140. See, e.g., id. at 1152 ("The Act retains the ability of qualified governmental units to issue tax-exempt debt for the financing of traditional governmental activities."). Additionally, the Treasury regulations define "essential government uses" as "improvements to utilities and systems that are owned by a governmental person and that are available for use by the general public (such as sidewalks, streets and street-lights; electric, telephone, and cable television systems; sewage treatment and disposal systems; and municipal water facilities)." Treas. Reg. § 1.141-5(d)(4)(ii) (2023).

141. Joint Committee Explanation, Tax Reform Act, supra note 77, at 1153.

million of the proceeds of the issue is to be used (directly or indirectly) to make or finance loans to persons other than governmental persons."[142] In enacting these provisions, "Congress believed that this diversion of governmental bond proceeds to nongovernmental users should be limited."[143] Obviously, police brutality settlements or judgments do not qualify under the private loan financing test as they are not loans—they are payments. Moreover, with police brutality bonds all—let alone more than 5%—of the benefit of bond proceeds goes to nongovernmental users. Therefore, diversion of tax-exempt municipal bonds to fund the police brutality payouts should be limited, in keeping with congressional intent.

Finally, even the most fervent proponents of widescale tax exemption for municipal bonds likely would not have supported the use of these bonds to satisfy police brutality settlements. Those proponents saw the highest value of these bonds to be the creation of jobs and economic growth, particularly in rural areas of the country, because they could encourage businesses to relocate or grow in those areas.[144] With police brutality bonds, there is no such economic growth—the bond proceeds are used for sunk costs. Moreover, police brutality generates immense negative externalities—to victims, families, and communities.[145] Accordingly, a federal subsidy to cities to settle police brutality claims is incredibly inappropriate, even in the most favorable reading of the legislative history.

2. *Not Aligned With Economic Justification.* — Police brutality bonds also do not align with the economic justification behind tax exemption. That justification is that the exemption—and the lower interest rates that come with it—encourage local governments "to provide the optimal amount of public services."[146] For instance, municipal bond issuances have been a major driver in improving infrastructure in the United States, financing approximately 72% of the nation's infrastructure projects between 2007 and 2016.[147] This is because efficient borrowing "enables local governments to synchronize the cost and benefit of capital expenditures over time,"[148] provides municipalities the ability "to enjoy the immediate benefits of capital improvement" they may not otherwise be able to by

142. Treas. Reg. § 1.141-5(a).

143. Joint Committee Explanation, Tax Reform Act, supra note 77, at 1152.

144. See supra notes 73–74 and accompanying text.

145. See Eleanor Lumsden, How Much Is Police Brutality Costing America?, 40 Univ. Haw. L. Rev. 141, 165–93 (2017) ("When people think of costs, they may consider the physical harm experienced by the 'victims,' people hurt or killed, or costs borne by particular communities. They may also consider the costs to the criminal justice system. The costs are in fact much broader.").

146. Driessen, Tax-Exempt Bonds, supra note 91, at 4.

147. Cestau et al., supra note 103, at 67.

148. S. Samuel Young, Market-Oriented Subnational Debt Regimes: Empowering the Developing World to Construct Infrastructure, 45 Vand. J. Transnat'l L. 917, 927 (2012). But cf. Miller & Glick, supra note 64, at 30 (explaining the argument that efficiency is *reduced* by tax-exemption).

relying only on current revenues,[149] and "reduce[s] the real cost of projects when there is inflation in labor and material costs without a correlative increase in technology or value."[150] Accordingly, the tax exemption on municipal bond interest is estimated to have saved state and local governments approximately $714 billion between 2000 and 2014.[151]

In contrast, police brutality payouts do not require the benefits of long-term borrowing because they are not capital improvements. Moreover, by having an overly broad statute that allows tax exemption on brutality bonds, the overall economic benefits of tax exemption to the municipalities are diminished because interest rates rise with the larger supply of bonds.[152]

III. ANALYSIS OF PROPOSALS FOR TAXING POLICE BRUTALITY BOND INTEREST

The solutions developed in this Part are directed at discouraging or preventing issuers—state and local governments—from issuing tax-exempt bonds if the proceeds will be used to fund police brutality payments. Eliminating the tax exemption for municipalities on brutality bonds will remove the tax benefit to wealthy taxpayers who fund police brutality bonds and the federal subsidy for police brutality payouts. Of course, there may be other approaches, such as disclosure requirements, and those approaches are not necessarily precluded by the solutions explored here.[153]

At the outset, note that removing tax exemption for brutality bonds would likely not inhibit cities' ability to pay police brutality payouts. The currently low yield spread[154] suggests that there would actually be little difference for cities borrowing at the tax-exempt rate and the corporate rate. Of course, those rates might change.[155] Nevertheless, there are

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149. Young, supra note 148, at 927.

150. Id. at 928.

151. Cestau et al., supra note 103, at 67.

152. See Joint Committee Explanation, Tax Reform Act, supra note 77, at 1151 ("As the total volume of tax-exempt bonds increases, the interest rate on the bonds must increase to attract investment from competing sources. The additional bond volume caused by nongovernmental use thus increases the cost of financing essential government services.").

153. A solution like this might look like a requirement that municipalities publicly disclose (1) their plans for the bond proceeds before they receive funds and (2) how they used the funds during and after their use. In fact, in 2020, Representative Gregory Meeks introduced legislation to amend the Securities Exchange Act of 1934 to require state and local governments to disclose when bonds may be used to pay for settlements or judgments in connection with police violence or civil rights abuses. See Disclose Police Brutality Bonds Act of 2020, H.R. 7261, 116th Cong. (2020).

154. See supra notes 101–102 and accompanying text.

155. There are ways that the federal government could keep interest rates low for municipalities using bonds to pay large judgments or settlements; however, it is unlikely that Congress would be interested in this, as these payouts appear contrary to the intent behind tax exemption, namely financing public goods. See supra notes 123–133 and accompanying

strategies cities can employ to soften the blow of large payouts on their budgets. For example, cities have been able to work out installment-style payment plans during settlement negotiations.[156] In fact, a majority of states allow for some form of periodic-payment plans for tort judgments.[157] So, if the municipalities currently have the wherewithal to borrow and pay interest on bonds for police brutality judgments, they should be able to pay even under a non-tax-exemption regime.

As a caveat, one might think that by eliminating tax exemption and thereby creating some inconvenience to municipalities in the way they fund police brutality payouts, they may feel some financial pressure to reform policing practices, creating a deterrence effect on police brutality itself. But given law enforcement's documented resistance to change,[158] this Note does not suggest that policing reform will be the likely outcome. In fact, Professor Schwartz's research has found that police agencies do not feel a financial burden even when they must satisfy police brutality payouts from their own budgets (as opposed to the cities' budgets).[159]

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text; see also Blaine G. Saito, Building a Better America: Tax Expenditure Reform and the Case of State and Local Government Bonds and Build America Bonds, 11 Geo. J.L. & Pub. Pol'y 577, 611 (2013) ("Such a policy shift, though, is generally thought of as unlikely under political science matters, barring a major systemic shock.").

That approach would be, in essence, the Build America Bonds program: Instead of relying on the market to provide lower interest rates to municipalities given their tax exemption status, the federal government is more directly responsible for the subsidy to the municipalities. See Nasiha Salwati & David Wessel, What Are Build America Bonds or Direct-Pay Municipal Bonds?, Brookings (Aug. 4, 2021), https://www.brookings.edu/blog/up-front/2021/08/04/what-are-build-america-bonds-or-direct-pay-municipal-bond/ [https://perma.cc/2RTB-KZYC] (last updated Sept. 17, 2021) (explaining the Build America Bonds program). This Note does not propose this approach as a solution because it permits a federal subsidy for police brutality payouts. See supra section II.B.

156. See, e.g., Alan Feuer & Jim Dwyer, City Settles Suit in Louima Torture, N.Y. Times (July 13, 2001), https://www.nytimes.com/2001/07/13/nyregion/city-settles-suit-in-louima-torture.html (on file with the *Columbia Law Review*) (paying the bulk of a settlement in one lump sum, but the rest "will be disbursed in $5,000 monthly installments over the course of at least 20 years"); Yvonne Wenger & Mark Puente, Baltimore to Pay Freddie Gray's Family $6.4 Million to Settle Civil Claims, Balt. Sun (Sept. 8, 2015), https://www.baltimoresun.com/news/crime/bs-md-ci-boe-20150908-story.html [https://perma.cc/73TT-VSVE] ("Under the proposed agreement, the city would pay $2.8 million during the current fiscal year and $3.6 million next year, the city said.").

157. Hanoch Dagan & Avihay Dorfman, Substantive Remedies, 96 Notre Dame L. Rev. 513, 554 (2020) (citing Roger C. Henderson, Designing a Responsible Periodic-Payment System for Tort Awards: Arizona Enacts a Prototype, 32 Ariz. L. Rev. 21, 27–29 (1990)).

158. See Wesley G. Skogan, The Commission and the Police, 17 Criminology & Pub. Pol'y 379, 380, 389 (2018) ("The unchanging institutional structure remains its most important reform."); Ryan Cohen, Note, The Force and the Resistance: Why Changing the Police Force Is Neither Inevitable, Nor Impossible, 20 U. Pa. J.L. & Soc. Change 105, 106 (2017) ("Countless attempts to implement seemingly promising reforms have been tried and abandoned.").

159. Schwartz, How Governments Pay, supra note 40, at 1192 ("Some law enforcement agencies pay millions of dollars from their budgets for settlements and judgments yet feel no financial consequences of these payments because they receive money during the

Section III.A considers how to amend current Code sections to exclude interest on police brutality bonds from tax exemption. Section III.B shows the benefits to those amendments, particularly how they would mitigate the problems identified in Part II. Lastly, section III.C addresses potential problems with both solutions.

A. *Solutions Within the Code*

There are two Code sections that define the types of municipal bonds whose interest is excluded from tax exemption. The first, as explored in section III.A.1, is § 148, which defines arbitrage bonds. The second, as explored in section III.A.2, is § 141, which defines private activity bonds. This section shows how Congress could amend § 148 and § 141 so that their application extends to police brutality bonds.

1. *A § 148-Like Solution.* — One solution could be modeled after § 148 of the Code, which defines arbitrage bonds as using tax-exempt bond proceeds to acquire "higher yielding investments" and excludes them from tax exemption.[160] The Code could similarly define and exclude police brutality bonds. For example:

> **Section [X]. Police brutality bonds.**
>
> **(a) Police brutality bond defined**
>
> For purposes of section 103, the term "police brutality bond" means any bond issued as part of an issue any portion of the proceeds of which are reasonably expected (at the time of issuance of the bond) to be used directly or indirectly—
>
> (1) to fund judgments or settlements against the issuer's police department or its officers under state tort claims or 42 U.S.C. § 1983, or
>
> (2) to replace funds which were used directly or indirectly to satisfy judgments or settlements against the issuer's police department or its officers under state tort claims or 42 U.S.C. § 1983.
>
> For purposes of this subsection, a bond shall be treated as a police brutality bond if the issuer intentionally uses any portion of the proceeds of the issue of which such bond is a part in a manner described in paragraph (1) or (2).

Of course, there are issues with enforcing § 148, which may illuminate issues with enforcing the modified version above. One issue comes from the language "reasonably expected" and "intentionally uses" in the statute,[161] which seems pretty favorable to municipalities. It would be difficult to meet such a subjective test, especially given that municipalities have multiple decisionmakers and a bureaucratic, multi-step process to make decisions. Nonetheless, there may be strong deterrence value from

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budgeting process for litigation payouts, overages are paid from central funds, and litigation savings are not enjoyed by the agencies.").

160. See 26 U.S.C. § 148 (2018).

161. Id. § 148(a).

the possibility of class action, which can arise from a municipality falsely asserting that the interest would be tax exempt when it knows the IRS would find the bond to be a police bond, so the interest would be taxable for the bondholders.[162] Fear of potential action from the SEC may also deter underwriters or bond counsel from aiding a municipality in duplicitously engaging in a brutality bond scheme.[163]

While there have been no empirical tests for efficacy of § 148, one may also look to major abuses of the provision since its adoption. One notable example is the yield-burning scandal of the late 1990s, which exposed a major gap in the application of § 148.[164] To refinance old debt when interest rates fell, municipalities often sold new bonds and placed proceeds into temporary escrow accounts, where they collected interest, which could not be higher than the interest the municipalities were paying on the bonds.[165] Therefore, underwriters sold the municipalities Treasury securities at inflated prices, which reduced the yield to meet the escrow requirements.[166] In response, the Treasury proposed and later adopted regulations that created a "rebuttable presumption that issuers purchase[d] open market Treasuries at fair market value only if the transaction [met] certain requirements."[167]

It may be worth noting that the IRS learned about the practice of yield burning from a whistleblower and not through an IRS monitoring procedure.[168] This may warrant some weight to the concerns about § 148's

162. See supra note 117 (describing the antifraud provision).

163. See Robert W. Doty, Municipal Finance Advising, Part I: Fiduciary Relationships of Municipal Finance Advisors with Their Issuer Clients, 33 Urb. Law. 225, 228 (2001) ("Multi-party responsibility for disclosure . . . is emphasized by circumstances in which the Commission has brought both issuers and professionals into the enforcement process for disclosure violations. Commonly, there have been more onerous, and at times far more severe, penalties against the professionals."); see also id. at 228 n.11 (providing examples).

164. Sharon R. King, Municipal Bond Investors Could Wind Up in an I.R.S. Crackdown, N.Y. Times (July 25, 1996), https://www.nytimes.com/1996/07/25/business/market-place-municipal-bond-investors-could-wind-up-in-an-irs-crackdown.html (on file with the *Columbia Law Review*) ("By some estimates, underwriters may have earned $2 billion to $3 billion of illegal profits from yield burning since the late 1970's.").

165. Id. ("By law, those accounts cannot generate a higher rate of interest than the rate on the newly issued bonds; if they do, the excess is considered to be arbitrage profit, and it must be rebated to the Federal Government."); see also Jeffrey J. Wick, Note, Yield Burning and Municipal Finance: A Primer, 18 Ann. Rev. Banking L. 533, 535 (1999).

166. Wick, supra note 165, at 536.

167. Id. at 542; Treas. Reg. § 1.148-5(d)(6) (2023). It should be noted that the current regulation now creates a rebuttable presumption that an investment not of the type traded on an established securities market was "acquired or disposed of for a price that is not equal to its fair market value." See Treas. Reg. § 1.148-5(d)(6)(i).

168. Michael Quint, Accuser in the Muni Bond Industry, N.Y. Times (Mar. 3, 1995), https://www.nytimes.com/1995/03/03/business/accuser-in-the-muni-bond-industry.html (on file with the *Columbia Law Review*) ("Mr. Lissack said he called officials in the Justice Department at the end of 1993 to alert them to some little-known practices in the municipal bond market.").

efficacy, particularly regarding its enforcement. But one way police brutality bonds differ from yield burning is perhaps the lack of incentive on the part of underwriters to aid municipalities to covertly secure tax exemption for those bonds. Whether those bonds are tax exempt or not, municipalities will need underwriters, so the underwriters will collect their fees regardless. In contrast, preventing arbitrage situations, like the yield-burning scandal, discourages municipalities from issuing certain types of bonds in the first place, depriving underwriters of their fees. Underwriters therefore have no incentive to encourage or participate in concealing the use of bonds to fund police brutality payouts, whereas they do have such an incentive in the arbitrage context.

Lastly, with § 148, there may be an issue with properly linking borrowing at a lower rate to lending at a higher rate.[169] Without such a link, it would be hard to qualify a bond as an improper "arbitrage" bond. Similarly, for the above modification of § 148, linking the use of bonds proceeds to police brutality payouts could hamper proper enforcement. This issue is addressed in section III.C.2.

2. *Expansion of § 141 to Include "Private Claimant".* — Another possible solution could be an expansion of § 141. A solution within § 141 would add another test to determine what constitutes a "private activity bond." For example, such an addition could look like:

> **(a) Private activity bond**
>
> For purposes of this title, the term "private activity bond" means any bond issued as part of an issue— . . .
>
> (3) which meets the private claimant test, where private claimant is defined as the beneficiary of a settlement or judgment against the issuer's police department or its officers under state tort claims or 42 U.S.C. § 1983.

One way to evaluate the efficacy of § 141, which was intended to reduce private use of tax-exempt municipal bonds,[170] is to consider the

169. See Gilbert E. Metcalf, Arbitrage and the Savings Behavior of State Governments 4 (Nat'l Bureau of Econ. Rsch., Working Paper No. 3017, 1989), https://www.nber.org/papers/w3017 [https://perma.cc/R6HD-35PC]. Professor Gilbert Metcalf provided the following example:

> Consider a state which historically has paid for bridge construction through tax revenues and raises a certain amount of taxes each year for "capital improvements." Then one year, it issues a bond for bridge repair and uses the bond proceeds to fix the bridge. The additional tax revenues that would have been used for bridge repair can now be invested in an unrestricted fashion. Clearly, with sufficiently sophisticated (or intricate) bookkeeping, it will be difficult for the IRS to prove that arbitrage is occurring.

Id.

170. Livingston, supra note 69, at 1182–83 (finding that the growth in the private activity bond market, resulting in huge revenue losses for the federal government, and criticisms of these bonds, such as raising borrowing costs for municipalities, made them "an irresistible target of reform legislation").

volume of private activity bonds over time relative to the growth of tax-exempt municipal bonds overall. The volume of private activity bonds has grown, but they make up a much smaller proportion of tax-exempt municipal bonds than they did prior to the enactment of the Tax Reform Act of 1986. In 1983, municipalities issued $62.4 billion in qualifying private activity bonds, making up 68% of all municipal bond issuances.[171] In 2017, municipalities issued about $142.5 billion of these bonds, but they only accounted for a quarter of tax-exempt municipal bonds.[172]

B. *Benefits of Both Solutions*

Both solutions largely address the current problems with the Code by denying tax exemption for police brutality bonds. They resolve the legislative history inconsistencies: Under either solution, the Code would seek to deny benefits from tax-exempt bonds going largely to private individuals or entities, something the framers of the 1986 Code sought to avoid.[173] And by having a less permissive statutory scheme, municipalities may enjoy lower borrowing costs on actual tax-exempt bonds being used for public goods or services projects, which is more in line with the economic justification.[174]

Moreover, both solutions promote a better expression of the law. Professor Cass R. Sunstein explained the expressive function of the law as "the function of law in 'making statements' as opposed to controlling behavior directly."[175] If either solution were adopted, the law would express that the federal government should not subsidize municipalities' police brutality payouts.

C. *Addressing Potential Issues With Both Solutions*

The resolution of some of the problems identified in Part II—uninformed investing and the normative problem of rich investors actually being able to receive a tax benefit from purchasing these bonds—will depend on how easily municipalities can work around these statutes. There may be issues with administrability and underenforcement, and as with the yield-burning example in section III.A.1, these problems can be

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171. Id. at 1182 n.57 (citing Joint Comm. on Tax'n, Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 930 (Comm. Print 1984)).

172. See Statistical Tables: All Municipal Bonds Reported on Form 8038 Series Returns, 2017, IRS, https://www.irs.gov/statistics/soi-tax-stats-tax-exempt-bond-statistics (on file with the *Columbia Law Review*).

173. See supra notes 140–143 and accompanying text.

174. See supra section II.B.2.

175. Cass R. Sunstein, On the Expressive Function of Law, 144 U. Pa. L. Rev. 2021, 2024, 2027 (1996) ("A society might identify the norms to which it is committed and insist on those norms via law, even if the consequences of the insistence are obscure or unknown.").

difficult to foresee. This section, however, tries to anticipate a few and addresses them.

1. *Covering "Police Brutality".* — Because there are many types of abuse that we classify as "police brutality,"[176] it is hard not to create ambiguity about what is covered under the statutes without naming specific causes of action. The above suggested statutes specify "state tort claims" and "42 U.S.C. § 1983." But, by being specific, it is possible that other causes of action for what we might also consider police brutality are not covered.

One way around this issue would be to focus the changes to the Code on the defendant rather than the cause of action—that is, by just specifying lawsuits "against the police department or its officers" or "against the municipality" without specifying the cause of action. But doing so would include a vast number of claims, such as employment discrimination, pension recovery, and motor vehicle accidents, which may warrant a subsidy.[177] At the same time, a broad statute might be called for, especially since paying out most kinds of settlements and judgments is not a traditional government function and could be normatively problematic.[178]

Another way to address this issue is by using "under police brutality claims" instead of "under state tort claims or 42 U.S.C. § 1983" and then defining police brutality claims in another section. In fact, that is the approach § 148 takes with the term "higher yielding investments."[179] Adoption of that approach here might look like:

> **(b) Police brutality claims**
>
> For purposes of this section—
>
> The term "police brutality claims" means any claim for abuse or discrimination by police, including, but not limited to, excessive force, wrongful search and seizure, false arrest or wrongful imprisonment, and sexual harassment or abuse.[180]

2. *Covering Obfuscated Uses.* — Another potential issue is whether either statute adequately addresses circumstances in which the police brutality payout is obscured, either because it is not clear for what purpose bond proceeds are being used or the bonds are falsely presented as being used for a legitimate, tax-exemption qualifying purpose. For example, the

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176. See supra note 19 and accompanying text.

177. See supra section II.A.1 (explaining why this Note is only focused on police brutality payouts).

178. This Note does not necessarily take a position on whether tax exemption should be allowed for other types of judgment obligation bonds. It does not foreclose the possibility that some judgment obligation bonds may warrant a subsidy, while others would not, based on norms or the legislative intent or economic justification behind tax exemption. A further analysis may be required for those other bonds, but this Note focuses on police brutality bonds given evidence of their systematic use.

179. 26 U.S.C. § 148(b) (2018) (defining a higher yield investment as "any investment property which produces a yield over the term of the issue which is materially higher than the yield on the issue").

180. See supra note 19 (adopting a definition consistent with ACRE's usage).

city of New Haven, Connecticut, satisfied a $9.5 million police brutality settlement with funds intended for a different purpose and then planned to issue new bonds to replenish those funds.[181] There is seemingly protection for this issue in the § 148-like solution, which includes the language: "to *replace* funds which were used directly or indirectly to satisfy judgments or settlements . . . ."[182]

A more incisive approach could nonetheless be employed. Municipal issuers could be required to certify bonds as having taxable interest "to the extent"[183] of their police brutality liability. So, for example, if in 2021, Chicago issued a $200 million bond and is facing police brutality payouts totaling $50 million that year, it would be *required* to certify that interest on $50 million of that bond is taxable.

There may be an issue if Chicago earnestly plans to satisfy these payouts from its general fund or some other non-bond method. In that scenario, the Code might provide a way around this provision. For example, it could require that municipalities prove by clear and convincing evidence that they are satisfying the police brutality payouts without the use of bond proceeds and not using the bond proceeds to replace funds used to satisfy the judgments. This solution puts the onus on issuers to prove the qualification of their bonds as opposed to on the IRS to spot abusive use of tax-exempt bonds. This is how § 103 could adopt restrictive language:

> **§ 103 - Interest on State and local bonds**
>
> **(a) Limitations on the exclusion of municipal bond interest**
>
> Gross income includes interest on any State or local bond to the extent of police brutality liability as defined by section [X] for the State or city during the calendar year, except as provided in subsection (b).[184]

Then, a separate code could incorporate the following language to define "police brutality liability" and "police brutality claims," as well as to show how municipalities can prove that they have satisfied their police brutality liability already:

> **Section [X]. Police brutality liability.**
>
> **(a) Police brutality liability**
>
> For the purposes of section 103, the term "police brutality liability" refers to the sum of all the settlements and judgments resulting from police brutality claims as defined in subsection (b).

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181. See supra note 49.

182. See supra section III.A.1.

183. This approach was inspired by discussion on improvements to 26 U.S.C. § 265(a)(2) from Professor Alex Raskolnikov's Spring 2021 course on Federal Income Taxation at Columbia Law School.

184. This solution keeps the current exceptions to tax exemption for interest on qualifying private activity bonds and arbitrage bonds.

(b) Police brutality claims

For purposes of this section—

The term "police brutality claims" means any claim for abuse or discrimination by police, including, but not limited to, excessive force, wrongful search and seizure, false arrest or wrongful imprisonment, and sexual harassment or abuse.

(c) Reducing police brutality liability

Upon clear and convincing evidence, the issuer's police brutality liability may be reduced by the amount paid from a non-tax-exempt bond method during the calendar year. If the issuer presents this evidence, it must also prove upon clear and convincing evidence that it does not intend to use new bond proceeds to replace directly or indirectly the amount paid for police brutality claims at issuance.

Reversing the overall exemption of interest on municipalities in § 103 to a limitation on interest to the extent of police brutality provides the most restriction on the tax exemption for police brutality bond interest. In doing so, the Code would better align with the legislative intent and economic justification behind tax exemption.[185] Investors would also be better informed that their investment would not be used to satisfy police brutality payouts. It also creates a better expression of the law—one that does not tolerate the use of tax-exempt bonds to fund police brutality.[186] And it disallows rich investors from receiving more on interest on these bonds than they would on corporate bonds.

These benefits, however, must be weighed against the possibility that this solution could be too stringent against overall tax exemption for municipal bond interest. States and cities would have to prove that their police brutality liability has been otherwise satisfied before issuing tax-exempt bonds, that is, bonds at a lower interest rate. This additional hurdle could create a bureaucratic hassle or otherwise discourage municipalities from issuing tax exempt debt. But the risk of that is seemingly low, considering the high demand for borrowing due to the inherent constraints on municipal budgets and increasing expenditures.[187]

CONCLUSION

Police brutality takes the lives of thousands and injures tens of thousands more each year. Young men of color, in particular, bear the brunt of this violence. Academics have examined the human costs of police brutality, its causes and prevalence in our cities, and ways to reform policing to reduce harm and improve accountability. Creating systemic change around any problem requires understanding who benefits from

185. See supra sections II.B.1–.2.

186. See supra note 175.

187. See supra note 96 and accompanying text.

the status quo and how. With police brutality, at a time when cities pay hundreds of millions—if not billions—of dollars in settlements and judgments each year, this Note showed how the richest taxpayers receive a tax benefit from funding those payouts and municipalities receive lower interest rates on their bonds. This Note also proposed concrete reforms policymakers could enact to eliminate those benefits.