

MEMO# 6451

December 13, 1994

SUPREME COURT RULES REPO INCOME IS NOT EXEMPT FEDERAL OBLIGATION INTEREST

1 See Institute Memorandum to Accounting/Treasurers Members No. 8-94, Closed-End Fund Members No. 7-94, Members - One Per Complex No. 17-94 and Tax Members No. 8-94, dated March 9, 1994. 2 See Institute Memorandum to Board of Governors No. 53-94, Accounting/Treasurers Committee No. 32-94, Closed-End Fund Committee No. 16-94 and Tax Members No. 27-94, dated June 17, 1994. December 13, 1994 TO: BOARD OF GOVERNORS No. 123-94 TAX MEMBERS No. 50-94 ACCOUNTING/TREASURERS MEMBERS No. 42-94 CLOSED-END FUND MEMBERS No. 43-94 MEMBERS - ONE PER COMPLEX No. 94-94 RE: SUPREME COURT RULES REPO INCOME IS NOT EXEMPT FEDERAL OBLIGATION INTEREST

Earlier this year, the U.S. Supreme Court granted the State of Nebraska's petition to hear the Loewenstein case, which involved Nebraska's taxation of mutual fund dividends derived from repurchase agreements ("repos") backed by U.S. Government obligations.¹ A brief filed by the State of California and 21 other states urged the Court to hold that federal law does not prohibit the state taxation of dividends derived from federal obligation interest. Because acceptance of California's argument would have jeopardized state "pass-through" treatment for federal obligation interest, treatment that the Institute has succeeded in obtaining in all 50 states, the Institute filed an amicus curiae brief.² The attached Supreme Court opinion upholds Nebraska's taxation of repo income. In a narrow opinion, the Court determined that the fund dividends were not derived from U.S. Government obligations, but instead represented interest on loans collateralized by U.S. Government obligations. In holding that the income was taxable because it was not derived from U.S. Government obligations, the Court necessarily rejected California's argument and thus sustained the Institute's position on pass-through treatment. We will keep you informed of developments. Catherine L. Heron Vice President & Senior Counsel Attachment