

**MEMO# 2382**

December 13, 1990

# **INSTITUTE RULING REQUEST ON CALIFORNIA PASS-THROUGH TREATMENT OF U.S. TERRITORY AND AGENCY OBLIGATIONS**

- 1 - December 13, 1990 TO: TAX MEMBERS NO. 55-90 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 17-90 RE: INSTITUTE RULING REQUEST ON CALIFORNIA PASS-THROUGH TREATMENT OF U.S. TERRITORY AND AGENCY OBLIGATIONS

As we recently informed you, California enacted a "technical amendment" to section 17145 of the California Taxation and Revenue Code this fall which could be interpreted to deny pass-through treatment for interest paid on territorial and federal agency obligations. These obligations pay interest exempt from state tax when held directly by an individual investor, but are not considered by California to be "obligations of the United States." (See Institute Memorandum to Tax Members No. 49-90 and Money Market Members - One Per Complex No. 16-90, dated November 21, 1990.) Denial of pass-through treatment for the interest paid on these bonds would effectively repeal another amendment made earlier this year to section 17145 which was expressly intended to permit such interest to flow through an investment company exempt from California tax. (See Institute Memorandum to Tax Members No. 20-90 and Money Market Members - One Per Complex No. 8-90, dated June 15, 1990.) In the attached letter to the California Franchise Tax Board, the Institute has requested a ruling that interest paid on territorial and federal agency obligations which is exempt from California tax when paid directly to an individual investor will not be excluded from pass-through treatment as an exempt interest dividend merely because the territorial and federal agency obligations are not considered by California to be "obligations of the United States." The Franchise Tax Board's staff has acknowledged that the technical amendment passed this fall was not intended to deny pass-through treatment to territorial and federal agency obligations and that they are drafting a technical correction to reverse the error made by the previous technical amendment. We have requested our ruling because (1) it is unlikely that the technical correction could be enacted before 1990 tax information would be reported to shareholders and (2) if the Board does not intend to apply section 17145 to preclude - 2 - territorial and federal agency obligations interest from being eligible for exempt-interest dividend treatment, that information should be disseminated through a published ruling. We will keep you informed of developments. Keith D. Lawson Associate General Counsel Attachment KDL:bmb

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.