

MEMO# 2267

October 18, 1990

NORTH CAROLINA ALLOWS FULL PASS-THROUGH OF FEDERAL OBLIGATION INTEREST

- 1 - October 18, 1990 TO: MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 15-90 TAX MEMBERS NO. 45-90 RE: NORTH CAROLINA ALLOWS FULL PASS-THROUGH OF FEDERAL OBLIGATION INTEREST _____ The

Institute is pleased to inform you that North Carolina has reinterpreted its income tax statutes to allow interest on federal obligations to retain its tax-exempt character when passed-through as a dividend to mutual fund shareholders. Prior to 1989, mutual fund dividends attributable to federal obligation interest were not taxed by North Carolina. (See Institute Memorandum to Members - One Per Complex No. 61-88, Tax Members No. 61-88, Unit Investment Trust Members No. 70-88, Closed-End Fund Members No. 58-88, and Accounting/Treasurers Committee No. 45-88, dated December 12, 1988.) Last year, North Carolina altered the method by which mutual fund dividends were taxed, eliminating the subtraction from federal taxable income of ordinary income dividends from mutual funds that were derived from interest on federal obligations and replacing it with a dividend tax credit of up to \$300. (See Institute Memorandum to Money Market Fund Chief Executive Officers No. 12-89 and Tax Members No. 51-89, dated December 26, 1989.) The attached information release states that federal law prohibits the taxation of dividends which represent direct obligations of the federal government. Prior administrative material inconsistent with this revised position is rescinded, although no effective date is given. In addition, the release requires funds to provide shareholders with the amount of dividends eligible for the exclusion, not merely a percentage based on the assets of the fund. - 2 - The release makes no change in the treatment of mutual fund dividends attributable to interest income from obligations of states other than North Carolina; these dividends remain taxable. We will keep you informed of further developments. David J. Mangefrida, Jr.
Assistant General Counsel Enclosure