

MEMO# 20310

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Kentucky Supreme Court Declines to Review Constitutionality of State's Taxation of Out-of-State Municipal Bonds

©2006 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. [20310] August 23, 2006 TO: FIXED-INCOME ADVISORY COMMITTEE No. 4-06 MONEY MARKET FUNDS ADVISORY COMMITTEE No. 2-06 TAX MEMBERS No. 30-06 RE: KENTUCKY SUPREME COURT DECLINES TO REVIEW CONSTITUTIONALITY OF STATE'S TAXATION OF OUT-OF-STATE MUNICIPAL BONDS The Kentucky Supreme Court has declined to review the Kentucky Appeals Court's decision in *Davis v. Department of Revenue*¹; the Appeals Court held that Kentucky's tax on interest income derived from bonds issued by states other than Kentucky is facially discriminatory in violation of the Commerce Clause.² The Kentucky statute exempts from Kentucky taxation interest income derived from bonds issued by Kentucky or its subdivisions; interest income derived from bonds issued by other states or their subdivisions is taxable. The Kentucky Supreme Court did not explain why it declined to review the case. State officials now must decide whether to seek United States Supreme Court review of the decision. If the Kentucky statute is invalidated, Kentucky could provide equal tax treatment to all municipal bonds by either taxing interest on all such bonds or providing tax-free treatment for all such bonds. In addition, refunds may be sought by Kentucky taxpayers who held out-of-state bonds. Lisa Robinson Associate Counsel 1 No. 2004-CA-001940-MR, January 6, 2006. Go to <http://opinions.kycourts.net/coa/2004-ca-001940.pdf> to read the case. 2 See Institute Memorandum (19632) to Fixed-Income Advisory Committee No. 2-06, Money Market Funds Advisory Committee No. 1-06 and Tax Members No. 4-06, dated January 26, 2006.