

**MEMO# 2201**

September 21, 1990

# **MARYLAND HIGH COURT AFFIRMS PASS-THROUGH OF FEDERAL OBLIGATION INTEREST**

- 1 - September 21, 1990 TO: MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 12-90  
TAX MEMBERS NO. 38-90 RE: MARYLAND HIGH COURT AFFIRMS PASS-THROUGH OF  
FEDERAL OBLIGATION INTEREST

The Maryland Court of Appeals (the State's highest court) has affirmed, in part, a lower court ruling that held the State's attempt to tax mutual fund dividends derived from federal obligation interest to be a violation of federal law. The attached case thus effectively overrules legislation enacted last year by Maryland while this case was pending which permitted pass-through treatment if at least 50 percent of the fund's interest income was derived from federal obligations (see Institute Memorandum to Tax Members No. 20-89 and Money Market Fund Chief Executive Officers No. 5-89, dated July 3, 1989). The Court of Appeals held the State's attempts to tax dividends of mutual funds derived from interest on federal obligations to be a violation of the federal law prohibition on the direct or indirect state taxation of federal obligations. Thus, all dividends received by a Maryland shareholder of a mutual fund are exempt from state tax to the extent that the dividends are derived from interest on federal obligations, regardless of the percentage of the fund's holdings in federal obligations. The Court of Appeals did, however, reverse the lower court's decision that exempted from tax dividends derived from repurchase agreements involving federal obligations. We will keep you informed of further developments. David J. Mangefrida, Jr.  
Assistant General Counsel Attachment