MEMO# 1971

June 15, 1990

CALIFORNIA EXPANDS PASS-THROUGH OF FEDERAL OBLIGATION INTEREST

June 15, 1990 TO: TAX MEMBERS NO. 20-90 MONEY MARKET MEMBERS - ONE PER COMPLEX NO. 8-90 RE: CALIFORNIA EXPANDS PASS-THROUGH OF FEDERAL OBLIGATION INTEREST ____ The attached California statute, effective June 1, 1990, amends section 17145 of the Taxation and Revenue Code to permit a fund to pay dividends derived from interest on federal obligations free of state tax if, at the close of each quarter of its taxable year, at least 50% of the value of its total assets consists of obligations the interest on which, if received directly by an individual, would be exempt from tax under the Constitution or laws of the United States or California. Under prior law, this pass-through treatment was available, with respect to federal obligation interest, only for "obligations of the United States" which paid interest excludable from state tax under the Constitution or laws of the United States. The California Franchise Tax Board took the position that pass-through treatment was unavailable under the old statute with respect to many obligations, such as Puerto Rican obligations and obligations of certain government agencies, the interest on which would not have been taxable if received directly by an individual. (See Institute Memorandum to Members- One Per Complex No. 43-89, Closed-End Fund Members No. 71-89, Tax Members No. 49-89, Unit Investment Trust Members No. 72-89 and Accounting/Treasurers Members No. 7-89, dated December 20, 1989). In addition, prior law required that the 50% threshold be calculated with respect to either California obligations or U.S. obligations before the interest income attributable to both could be passed through. Under the new law, California and U.S. obligations can be aggregated to determine whether the 50% threshold has been satisfied. We will keep you informed of developments. David J. Mangefrida, Jr. Assistant General Counsel Attachment