

MEMO# 3564

March 5, 1992

TENNESSEE REVENUE COMMISSIONER ANNOUNCES END OF PASS-THROUGH OF TENNESSEE OBLIGATION INTEREST AS OF APRIL 1, 1992

March 5, 1992 TO: UNIT INVESTMENT TRUST COMMITTEE NO. 11-92 MEMBER COMPLEXES WITH TENNESSEE-ONLY TAX-EXEMPT FUNDS RE: TENNESSEE REVENUE COMMISSIONER ANNOUNCES END OF PASS-THROUGH OF TENNESSEE OBLIGATION INTEREST AS OF APRIL 1, 1992 _____ The Tennessee Commissioner of Revenue, Joe Huddleston, has announced in the attached letter to a member of the Tennessee State Senate that as of April 1, 1992, the Department of Revenue will no longer allow a deduction from dividend and interest income under the Hall Income Tax for dividends of investment companies and distributions of unit investment trusts (both considered "dividends" under the Hill Income Tax) derived from interest on Tennessee obligations. The law currently provides for a pass-through of the exempt character of that interest where the investment company or UIT is 75 percent or more invested in Tennessee municipal obligations. Huddleston announced that he is taking this action in response to a letter from the state Attorney General reaffirming a 1990 Attorney General opinion that the exemption from tax of Tennessee obligations, but not federal obligations, violates the United States Constitution because it impermissibly discriminates in favor of Tennessee obligations and against obligations of the United States. As you know, 31 U.S.C. section 3124 prohibits states from directly or indirectly taxing federal obligations. Despite this, Tennessee is one of three states which continues to tax dividends derived from federal obligations. You may recall that in 1990 Huddleston had asked the Legislature to repeal the exemption for Tennessee obligations in order to cure the unconstitutional discrimination against federal obligations. At that time, the Institute testified that such a repeal would be ineffective to cure the basic problem, because Tennessee would continue to violate federal law by taxing federal obligation interest whether or not it allowed a pass-through for its own obligation's interest. The Legislature at that time voted down the proposed legislation. (See Institute Memorandum to Board of Governors No. 28-90, Money Market Members - One Per Complex No. 5-90, SEC Rules Members No. 31-90, State Securities Members No. 9-90, Tax Members No. 17-90 and Unit Investment Trust Members No. 20-90, dated April 18, 1990.) - 1 - A bill is currently under consideration in the Tennessee state legislature which would extend the exemption from the Hall Income Tax for dividends derived from Tennessee obligations to dividends derived from federal obligations. Passage of the bill would deprive Huddleston of his rationale for refusing to allow the exemption for dividends derived from Tennessee obligations. The Institute will be

meeting tomorrow in Nashville with our local counsel and representatives of the Tennessee Bankers Association, who also support this legislation, to coordinate a strategy to obtain the bill's passage. It is anticipated that the strategy will include a grass-roots campaign designed to get Tennessee residents to contact their state Senators and Representatives to urge passage of the legislation. We understand that the bill has substantial support in the Legislature. However, the bill would result in a revenue loss to the state of approximately \$3.5 million. Popular support for the legislation is thus very important. A hearing on the bill will be held on March 23, 1992, at which the Institute will testify. The Institute will be writing to the Unit Investment Trust Committee again next week after the strategy has been settled upon at tomorrow's meeting and asking each member to write to its Tennessee unitholders or shareholders urging them to contact state legislators in favor of the legislation. At that time, the Institute will also provide a fact sheet and talking points which can be used in the letter. The Institute also is gathering data to be used in our presentations to the state. It would be very helpful if we could obtain from any committee member to whom we have not already spoken any information you may have on the number of Tennessee- only municipal bond UITs sponsored by each committee member, if any, their assets and the number of unit holders. Please call the undersigned at (202) 955-3521 with this information or if you have any questions. The information also may be faxed to (202) 659-1519. We will keep you informed of developments. David J. Mangefrida Jr. Assistant Counsel - Tax Attachments

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