

INFORMATION BULLETIN #19

INCOME TAX

MAY 2012

(Replaces Bulletin #19 dated January 2003)

DISCLAIMER: Informational bulletins are intended to provide nontechnical assistance to the general public. Every attempt is made to provide information that is consistent with the appropriate statutes, rules, and court decisions. Any information that is not consistent with the law, regulations, or court decisions is not binding on either the Department or the taxpayer. Therefore, the information provided herein should serve only as a foundation for further investigation and study of the current law and procedures related to the subject matter covered herein.

SUBJECT: Government Obligations

DIGEST OF CHANGES: Update listing of exempt and taxable federal obligations. Taxation of state and local bond interest issued by another state.

REFERENCES: IC 6-3-1-3.5

EFFECTIVE DATE: Upon Publication

I. Obligations of the United States Government

For purposes of the Adjusted Gross Income Tax Act, obligations issued by the following organizations are considered direct United States Government obligations specifically exempted from state income taxation by federal law. Although not all inclusive, the Department recognizes the following list of United States obligations; this is correct as of the date of the issuance of this bulletin. For obligations not listed here, refer to 31 U.S.C. 3124(a) for further guidance:

- Banks for cooperatives;
- Central banks for cooperatives;
- Commodity credit corporations;

- District of Columbia;
- Export-Import banks of the United States;
- Farm Credit System Financial Assistance Corporation;
- Federal Deposit Insurance Corporation;
- Federal Farm Loan Corporation;
- Federal financing banks;
- Federal home loan banks;
- Federal Housing Administration;
- Federal intermediate credit banks;
- Federal Intermediate Credit Corporation;
- Federal Land Banks Association;
- Federal land banks;
- Federal Savings and Loan Insurance Corporation;
- General Services Administration;
- Maritime Administration;
- Production Credit Association;
- Reconstruction Finance Corporation;
- Resolution Funding Corporation;
- Student Loan Marketing Association;
- Series E, F, G, ~ H bonds;
- Small Business Administration;
- Tennessee Valley Authority (bonds only);
- U.S. government bonds;
- U.S. government certificates;
- U.S. government notes;
- U.S. Housing Authority;
- U.S. Treasury bills;
- U.S. possessions - obligations of Puerto Rico, Virgin Islands, Guam, American Samoa, and Northern Mariana; and
- U.S. Postal Service.

The proportionate share of dividends or interest received from a mutual fund, a money market fund, a regulated investment trust, or another investment fund derived from investments in **direct** U.S. government obligations will be allowed as a deduction in the computation of Indiana adjusted gross income tax. This deduction will be allowed to the extent that such income is included in Indiana adjusted gross income. (For purposes of this deduction, earnings from investing in repurchase agreements are not considered to be derived from **direct** obligations of the U.S. government.)

The following sources of obligations are **not** considered United States obligations:

- Asian Development Bank;
- District of Columbia Armory Board;
- Farmer's Home Administration;

- Federal or state savings and loan associations;
- Federal Home Loan Mortgage Corporation;
- Federal National Mortgage Association;
- GI loans;
- Government National Mortgage Association;
- Inter-American Development Bank;
- International Bank for Reconstruction and Development;
- International Monetary Fund;
- Panama Canal bonds;
- Participating loans in the Federal Reserve System for member banks (federal funds);
- Philippine bonds;
- Reconstruction Finance Corporation;
- Small business investment companies;
- Student loans; and
- U.S. Postal Service certificates and savings deposits.

Also, interest or dividends received in the following instances are **not exempt** for **adjusted gross income** tax purposes:

- a) Debentures issued to mortgage or mortgages foreclosed under the provisions of the National Housing Act;
- b) Interest-bearing certificates issued in lieu of tax-exempt securities, such as income losing its identity when merged with other funds;
- c) Promissory notes of a federal instrumentality;
- d) Refunds of federal income tax; and
- e) Earnings from repurchase agreements.

II. Obligations of the State of Indiana

Any interest earned from a direct obligation of the State of Indiana or a political subdivision of the State of Indiana is not taxable for purposes of the Adjusted Gross Income Tax Act. Interest earned from a direct obligation of a state or political subdivision other than Indiana is subject to the adjusted gross income tax if the obligation is acquired after Dec. 31, 2011. An obligation will be considered to be acquired if the trade date is after Dec. 31, 2011. Interest earned from obligations held or acquired prior to December 31, 2011 is not subject to Indiana income tax.

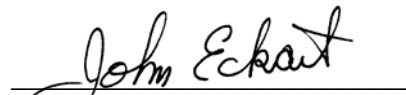
Interest earned from obligations of Puerto Rico, Guam, Virgin Islands, American Samoa, or Northern Mariana is not included in federal gross income and is exempt under federal law. There is no add-back for interest earned on these obligations.

III. The Effect of Government Obligations on Indiana Adjusted Gross Income Tax

All interest reported for federal tax purposes must be reported for Indiana adjusted gross income tax purposes. However, in determining taxable interest income for Indiana adjusted gross income tax purposes, a deduction may be taken for interest received on direct obligations of the federal

government or its agencies, as required under 31 U.S.C. Section 3124. The exemption for government obligations is not a total exclusion and may be limited by charging the obligations and interest their fair share of related expenses. However, the deductions generated by the expenses are limited to the amount of income generated by the obligation.

NOTE: Although Indiana municipal bond interest and bond interest from United States government obligations are excludable, the gain derived from the sale of tax-exempt municipal bonds and United States government obligations held as investments is not exempt. The gain to be reported for Indiana tax purposes is the gain reported for federal income tax purposes. Losses sustained are deductible, subject to capital loss limitations.



John Eckart
Commissioner