



Indiana Department of Revenue

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Income Tax Information Bulletin #19

Subject: Government Obligations

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Summary of Changes

Aside from technical, nonsubstantive changes, this bulletin has been updated to include a new introduction section, to eliminate obligations that likely no longer exist, and to clarify the acquisition date for out-of-state obligations in certain situations due to changes made in Senate Enrolled Act 419 (2023).

Introduction

All interest income 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. Further, 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 Indiana's adjusted gross income tax. The purpose of this bulletin is to explain and list these various obligations, and explain in more detail how the deductions apply in practice.

Obligations of the United States Government

For purposes of Indiana's adjusted gross income tax, 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 list below of United States obligations , which is not inclusive of all obligations. 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 Corporation;
- District of Columbia;
- Export-Import Bank of the United States;
- Federal Deposit Insurance Corporation (FDIC);
- Federal Farm Credit Banks
- Federal Farm Credit Financial Assistance Corporation;
- Federal Farm Loan Corporation;
- Federal Financing Bank;
- Federal Home Loan Bank;
- Federal Housing Administration;
- Federal Intermediate Credit Banks;
- Federal Land Banks Association;
- Federal Land Banks;
- Federal Savings and Loan Insurance Corporation;
- Financing Corporation (FICO)
- General Services Administration;
- Maritime Administration;
- Production Credit Association;
- Resolution Funding Corporation (REFCO);
- Student Loan Marketing Association (Sallie Mae) (issued by, not guaranteed by);
- Series E, EE, F, G, H, HH, and I 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
- 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 (FHA);
- Federal or state savings and loan associations;
- Federal Home Loan Mortgage Corporation (Freddie Mac);
- Federal National Mortgage Association (Fannie Mae);
- GI loans;
- Government National Mortgage Association (Ginnie Mae);
- Inter-American Development Bank;
- International Bank for Reconstruction and Development (World Bank);
- International Monetary Fund (IMF);
- Participating loans in the Federal Reserve System for member banks (federal funds);
- 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:

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

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 Indiana's adjusted gross income tax. 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, including interest earned from a direct obligation of a state or political subdivision of a state other than Indiana. 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.

For purposes of determining the date an obligation is considered to be acquired, the following apply for tax years beginning in 2023 and later:

1. If an obligation is held through a mutual fund, pass-through entity such as a partnership or S corporation, a trust, a hedge fund, or similar arrangement, the acquisition date is the date the entity acquired the obligation.
2. If an obligation is acquired in a manner other than a purchase, the transfer date of the obligation is considered to be the acquisition date for the transferee. Transfers considered to not be acquired by purchase include but are not limited to:
 - gifts
 - inheritances or transfers on death
 - distributions of obligations from trusts or other entities
 - contributions of obligations to partnerships or corporationsHowever, if a transfer is of an interest in an entity described in paragraph 1 above, the purchase date is determined by the entity's acquisition date.
3. If an obligation is refinanced, the owner of the obligation is treated as acquiring the refinanced obligation as of the date of refinancing.

For taxable years prior to 2023, a taxpayer is permitted to use any reasonable interpretation of acquisition date, provided that the taxpayer treats the acquisition date consistently.

The Effect of Government Obligations on Indiana Adjusted Gross Income Tax

As mentioned in the introduction to this bulletin, 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.

If you have any questions concerning this bulletin, please contact the Tax Policy Division at taxpolicy@dor.in.gov.

