

Administrative Release No. 13

Subject: Tax Status of Interest Received From Federal, State and Local Obligations

I. General

This release provides guidance to determine whether interest from certain obligations is taxable in Maryland.

II. Federal obligations

A. Under federal law the State of Maryland is precluded from taxing interest received from obligations of the United States.

B. While it is clear that interest from United States obligations is not taxable by Maryland, there are many obligations issued under various designations which do not clearly indicate whether they are United States obligations. Interest, for example, received from mortgage participation certificates issued by the Federal Home Loan Mortgage Corporation (FHLMC) is not tax exempt even though it would appear to fall within the term "federal obligation." Other examples of more commonly known obligations are provided in this release. It should, however, be stressed that this release does not provide an exhaustive listing of all obligations. If an obligation is not referred to in this release, the burden will be upon the taxpayer to show that the obligation is an obligation of the United States.

C. Maryland does not tax interest, dividends, or profit realized from the sale or exchange of United States obligations. Because interest, dividends, and any profit realized from the sale or exchange of United States obligations is included in federal adjusted gross income, or federal taxable income in the case of a corporation, a subtraction modification is provided.

The subtraction modification for profit realized on the sale or exchange of United States obligations is equal to the amount of all realized profits. Losses on the sale or exchange of United States obligations are not netted against profits in calculating the amount of the subtraction.

III. State and local obligations

A. Maryland does not tax interest or dividends on obligations or securities of the State of Maryland or any of its political subdivisions. Maryland also does not tax any profit realized from the sale or exchange of bonds issued by this State or its political subdivisions. This exclusion from income does not include any profit realized from the sale or exchange of shares in a mutual fund that holds bonds issued by this State or its political subdivisions. (Refer to Administrative Release No. 5.) Because any profit received from the sale or exchange of State or local obligations is included in federal adjusted gross income, or federal taxable income in the case of a corporation, appropriate subtraction modifications are provided by law. With regard to interest or dividends received from this State or political subdivisions, because such interest or dividends are not included in federal adjusted gross income or taxable income, no subtraction modification is needed.

B. Interest or dividends on obligations or other securities of a state or political subdivision of a state other than Maryland are taxable by Maryland. Any profit realized from the sale or exchange of bonds issued by a state or political subdivision of a state other than Maryland is taxable by Maryland. Because profit realized on such sale is already included in federal adjusted gross income, no addition modification is required for the profit realized. Interest and dividends earned on obligations of a state or political subdivision other than Maryland must be added to federal adjusted gross income. See §E for certain exceptions.

C. Generally, there are very few problems with identifying state or local obligations. However, based upon a number of inquiries, several issues should be mentioned. In the case of District of Columbia Bonds, prior to 1975 and the advent of Home Rule, they were considered obligations of the United States and accorded tax-exempt status by Maryland. Bonds issued by the District of Columbia after the advent of Home Rule are

accorded the same status as bonds issued by any other state and are subject to Maryland tax on an individual's or corporation's return filed with Maryland. Interest from Washington Metropolitan Transit Authority Bonds (METRO) and Washington Suburban Sanitary Bonds is not subject to tax under a specific provision of the Maryland Code.

D. Taxpayers who receive interest from regulated investment companies (mutual funds) which invest in municipal bonds, state and local, should refer to Administrative Release No. 5.

E. To the extent that interest income from Build America Bonds¹ issued by a state or political subdivision of a state is included in the federal adjusted gross income or federal taxable income, this interest income is not taxable by Maryland through a subtraction modification. Build America Bonds include Recovery Zone Economic Development Bonds under § 1400U-2 of the Internal Revenue Code, and may include also Qualified School Construction Bonds to which the Hiring Incentives to Restore Employment Act of 2010 extended the Direct Payment option.

IV. The following is a list of some of the more commonly known obligations, the interest from which is designated as being either subject to or not subject to Maryland income taxes.

Subject to Maryland Tax

1. District of Columbia Armory Bonds (issued after 1975)
2. District of Columbia Bonds (issued after 1975)
3. Export-Import Bank of the United States (Eximbank) Certificate of Beneficial Interest (CBIs)
4. Farmers Home Administration (including USAVE Certificates)

¹ On February 17, 2009, President Obama signed into law the American Recovery and Reinvestment Act of 2009 (hereinafter the "ARRA") (Public Law No. 111-5). Section 1531 of Title I of Division B of the ARRA created Build America Bonds which are federally taxable state and local governmental bonds, with Federal subsidies as either tax credits for bond holders (Tax Credit) or refundable tax credits paid to bond issuers (Direct Payment). Build America bonds can be issued in 2009 and 2010, and may have an average life of ten or more years.

5. Federal Home Loan Mortgage Corporation (Freddie Mac) Mortgage Participation Certificates (PCs)
6. Federal Housing Authority (FHA)
7. Federal National Mortgage Association (Fannie Mae)
8. Government National Mortgage Association (Ginnie Mae) - See Administrative Release No. 10.
9. International Institutions
 - a. Asian Development Bank
 - b. Inter-American Development Bank
 - c. International Bank of Reconstruction and Development (World Bank)
 - d. International Monetary Fund
10. Maritime Administration (Merchant Marine)
11. Money Market Certificates
12. Municipal or State Obligations - Other than Maryland
13. New Communities Debentures issued under the Housing and Urban Development Act of 1968 and supplemented and extended in 1970 (includes Jonathan Development Corporation)
14. Repurchase Agreements
15. RFK Stadium Bonds
16. Washington Airports Authority Bonds

Not Subject to Maryland Tax

1. Banks for Cooperatives
2. Federal Deposit Insurance Corporation
3. Federal Farm Credit Banks
 - a. Farm Credit Consolidated Systemwide Discount Notes
 - b. Farm Credit Banks Consolidated Systemwide Bonds
4. Federal Financing Bank
5. Federal Home Loan Banks
6. Federal Intermediate Banks
7. Federal Land Bank Association
8. Federal Land Banks

9. Federal Savings and Loan Insurance Corporation (FSLIC)
10. Financial Assistance Corporation (Farm Credit System Financial Assistance Corporation)
11. Financing Corporation (FICO)
12. General Services Administration (GSA) (Participation Certificates)
13. Guam Bonds
14. Maryland Municipal and State Obligations
15. Panama Canal Zone Bonds specifically exempt from tax by 31 USC 744 and 745
16. Production Credit Association
17. Public Housing and Urban Renewal Project Notes issued by Public Housing and Urban Renewal Agencies administered by the Department of Housing and Urban Development
18. Puerto Rican Bonds
19. Resolution Funding Corporation
20. Small Business Administration SBA Debentures
21. Student Loan Marketing Association (Sallie Mae)
22. Tennessee Valley Authority (TVA)
23. U.S. Postal Service
24. U.S. Savings Bonds (Series E and H or EE and HH)
25. U.S. Treasury Notes and Bills
26. The Virgin Island Bonds
27. Washington Metropolitan Area Transit Authority Bonds (METRO)
28. Washington Suburban Sanitary Commission Bonds

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