

Ruling 91-07

Vermont Department of Taxes

Date: September 25, 1991

Written By: Jacqueline A. Hughes, Attorney for the Department

Approved By: Joyce Errecart, Commissioner of Taxes

You have requested a formal ruling on whether interest and dividends paid to individuals from direct investment in, or from mutual funds or regulated investment companies which invest in, U.S. Treasury Obligations are subject to Vermont income tax. This ruling relies on the facts and prospectus contained in your August 21, 1991, letter and my telephone conversation of September 10, 1991, with [Name] of your office.

[Corporation] is the administrator of the [Trust] (the "Trust"), a diversified, open-end investment company which is organized as a [State] business trust. The Trust currently offers an investment fund option known as [Fund] (the "Fund") that invests solely in U.S. Treasury bills, notes and direct obligations of the U.S. Treasury. You have asked how Vermont's personal income tax law applies to distributions to shareholders of the interest from the Fund's investment in federal obligations. You have also asked how Vermont's income tax law treats interest received by individuals from direct investment in federal obligations.

31 U.S.C. § 3124(a) exempts the interest paid on federal obligations from state taxation, except for two types of taxes not relevant here. In accordance with 31 U.S.C. § 3124(a), interest paid to an individual from direct investments in U.S. Treasury obligations is not subject to the Vermont personal income tax.

In 1987, the Vermont Supreme Court found that 31 U.S.C. § 3124(a) also exempts from the Vermont personal income tax the portion of a dividend attributable to a mutual fund's investment in direct obligations of the federal government. In re Sawyer Estate, 149 Vt. 541, 544 (1987) cert. den. 108 S.Ct. 1596; See also Keys v. Vermont Department of Taxes, 149 Vt. 658 (1987).

The Department treats mutual funds that derive at least 90% of their gross income from the business of investing in stock, securities and currencies and that distribute 90% of their net income each year as conduits of the income they derive directly from exempt federal obligations. The portion of the mutual fund's dividend that is attributable to its investment in direct obligations of the federal government will be exempt from Vermont tax, except any dividend which results from reinvestment in non-exempt obligations. In

re Sawyer Estate, 149 Vt. at 544. There is no requirement that the fund derive a particular percentage of its income from federal obligations.

The distributions from the Fund described in your letter and prospectus are of the same type described in the Sawyer decision and are exempt from the Vermont income tax to the extent that they are derived from the direct investment in federal obligations. The Sawyer court rejected the claim that the trust was not a conduit of the interest from federal obligations, so that for Sawyer-type investments, shareholders of the Fund are treated as if they own the obligations directly. Id., 149 Vt. at 544. To the extent that Formal Rulings 82-7, 83-4 and 84-15 conflict with this ruling, they are withdrawn.

You have indicated that the Fund also receives interest from repurchase agreements for federal obligations. The Sawyer Court found that interest received on repurchase agreements is not derived from the investment in federal obligations and is, therefore, not exempt from the Vermont tax. Id., 149 Vt. at 545.

You may be interested to know that Vermont law was amended in 1989 to specify the method of tax calculation to be used when a taxpayer has non-Vermont income such as interest and dividends derived from federal obligations. Vermont taxpayers are required to adjust their federal income tax liability for the percentage of their income that is not Vermont income. Vermont no longer allows recomputation of a taxpayer's federal income tax liability for income that is not Vermont. 32 V.S.A. § 5822 (amendment effective for taxes payable for taxable years beginning on or after January 1, 1989).

This ruling is issued solely to your firm and is limited to the facts presented as affected by current statutes and regulations. Other taxpayers may refer to this ruling to determine the Department's general approach, but the Department will not be bound by this ruling in the case of any other taxpayer or in the case of any change in the relevant statute or regulations.