

General Information Letter: Interest on an Illinois obligation may be subtracted only if expressly exempted from Illinois income taxation by statute.

June 23, 2005

Dear:

I have received your letter dated June 20, 2005, which you wrote in response to my letter to you dated June 2, 2005. The nature of your request and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us.

In my June 2, 2005, letter, I stated that the Department had properly disallowed the subtraction you claimed on your 2004 Illinois income tax return for \$4,276 in interest received on a bond described as "Northern 5.125% 07."

In your letter you have stated the following:

The "Northern 5.125% 07," still denied tax-exempt status in your letter of June 2, 2005, is a bond issued by the Northern Mariana Islands, and the bond interest of \$4,276 is Illinois tax exempt according to U.S. Code Title 48 – Territories and Insular Possessions, Chapter 17 – Northern Mariana Islands, which we have enclosed for your convenient reference. Specifically, Section 607 (page 10 of the printout) states:

(a) All bonds or other obligations issued by the Government of the Northern Mariana Islands or by its authority will be exempt, as to principal and interest, from taxation by the United States, or by any State, territory or possession of the United States, or any political subdivision of any of them.

Additionally, we have enclosed a copy of a Joint Committee on Taxation document dated July 16, 2004 entitled "Description of H.R. 982, A Bill 'To Clarify the Tax Treatment of Bonds and Other Obligations Issued by the Government of American Samoa,'" which states under the section entitled "Present Law":

. . . Congress has provided statutory exempts from State, local, and territorial taxes for all obligations issued by Guam, the Virgin Islands, Puerto Rico, and the Northern Mariana Islands,⁹ in addition to the exemption from Federal income tax. [emphasis added and footnotes omitted]

⁹ Bonds issued by the Northern Mariana Islands are "exempt, as to principal and interest, from taxation by the United States, or by any State, territory or possession of the United States, or any political subdivision of any of them."

We noted in our April 22 letter that COMPANY1 relies on the Bloomberg System for tax status information. COMPANY1 apparently also relies on U.S. Code Title 48 which provides that bonds issued by the governments of all U.S. possessions and territories are exempt from all state taxes as well as federal taxes. COMPANY1 has supplied us

with "An Investor's Guide to Triple-A rated Insured Municipal Bonds" prepared by The Bond Market Association and The Association of Financial Guaranty Insurers which states:

. . . interest income from securities issued by U.S. territories and possessions – Puerto Rico, the U.S. Virgin Islands, Guam, American Samoa and the Northern Mariana Islands – is exempt from federal, state and local income taxes in all 50 states.

Accordingly, in consideration of the above information, we believe that the Northern Mariana Islands bond should be reinstated as tax-exempt in Illinois.

Assuming that the above information about U.S. territories and possessions is correct, we noted that Publication 101 lists bonds issued by Puerto Rico, Guam and the Virgin Islands as being tax-exempt in Illinois, but does not list either American Samoa or the Northern Mariana Islands. Publication 101 also does not include a general statement that all bonds issued by U.S. territories and possessions are free from tax in all states, as provided by federal law.

COMPANY2 has located a prospectus for each of the remaining three bonds listed on page 5 of your letter, and the tax status of the Champaign Co. IL. 4.25%12, the Chicago IL Metro Water Reclam 5.4%06 and Franklin Park 5.5%06 bond interest is identified as not exempt. Apparently, the bonds were incorrectly identified in the COMPANY2 system as tax-exempt in Illinois. Accordingly, we agree that interest from the Champaign, Chicago Metro and Franklin Park bonds is not exempt in Illinois.

In order to correctly determine a bond's tax status in Illinois in the future, we would appreciate information as to what basic authority the State of Illinois relies on to ascertain the tax status of bonds we may purchase in the future. Does the State accept tax information contained in the bond prospectus as a reliable authority? If not, is there some other source we might use to determine whether or not a bond is exempt from Illinois tax?

Response

The Illinois Income Tax Act does not contain any provision exempting interest on Illinois bonds. Rather, Section 203(a)(2)(N) of the Illinois Income Tax Act (35 ILCS 5/203) permits individuals to subtract amounts:

which are exempt from taxation by this State either by reason of its statutes or Constitution or by reason of the Constitution, treaties or statutes of the United States; provided that, in the case of any statute of this State that exempts income derived from bonds or other obligations from the tax imposed under this Act, the amount exempted shall be the interest net of bond premium amortization.

Because the federal Constitution is silent on the matter, bonds issued by a government of a territory

or possession are exempt only if expressly provided by federal statute.

The listing of exempt bonds in Publication 101 and in 86 Ill. Adm. Code Section 100.2470(f) are intended to be comprehensive. I am not aware of any other source that can serve as reliable evidence of exemption or taxation, much less a source whose authority is binding on the State of Illinois. I thank you for bringing to my attention the laws dealing with bonds issued by the governments of American Samoa and the Northern Mariana Islands. These will be added to our publication and regulation. However, because there is no statute that simply exempts all bonds issued by a territory or possession, no such exemption can be included in the publication or regulation.

Your return will be adjusted to allow the subtraction for the Northern Mariana Islands bond interest.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110(b). If you have any further questions, you may contact me at (217) 782-7055.

Sincerely,

Paul S. Caselton
Deputy General Counsel – Income Tax