

CALIFORNIA FRANCHISE TAX BOARD

Legal Ruling No. 255

August 21, 1964

PERSONAL INCOME – GROSS INCOME – EXEMPT INTEREST INCOME

Syllabus:

An opinion was requested on the following questions:

a. Is interest income from the obligations of the following organizations excludable from gross income under section 17137 of the Personal Income Tax Law?

- (1) Federal Land Banks
- (2) Federal Intermediate Credit Banks
- (3) Federal Home Loan Banks
- (4) Banks for Cooperatives
- (5) Federal National Mortgage Association

b. If such interest income is excludable, does it remain excludable if the Federal Government's capital investment in the organization is retired?

When Congress constitutionally creates corporations, such as the federal credit agencies with which we are here concerned, through which the Federal Government lawfully acts, the activities of such corporations are governmental and Congress has power to protect them by prescribing tax immunity for activities connected with, or in furtherance of, their lending functions. Smith v. Kansas City Title & Trust Co., 255 U.S. 180, 65 L. Ed. 577, 41 S. Ct. 243. Similarly, Congress may also waive wholly, or with such limitations and qualifications as may be deemed proper, the exemption of its instrumentalities from state taxation. Austin v. Boston, 7 Wall. (US) 694, 19 L. Ed. 224. In addition to the congressional power to exempt from tax, there is also an implied constitutional immunity of the Federal Government, its agencies and instrumentalities from taxation from state and local governments. These powers are reflected in section 17137 of the Personal Income Tax Law which provides that gross income does not include income which this State is prohibited from taxing under the Constitution or laws of the United States.

a(1)-(4). Congress has exempted from state income taxation the income from bonds, debentures and other obligations, as the case may be, issued by Federal Land Banks, Federal Intermediate Credit Banks, Federal Home Loan Banks and Banks

for Cooperatives by statute as set forth in Sections 931, 1111, 1433 and 1138c, respectively, of Title 12, U.S.C.A.

a(5). The Federal National Mortgage Association has the power to issue interest bearing obligations (12 USCA 1719(b)) and has been granted an exemption from taxation (12 USCA 1712a(c)). The exemption provides that the association, its franchise, capital, reserves, surplus, mortgages and income shall be exempt from all taxation (with certain exceptions that are not applicable here) imposed by any state. There is no express exemption from taxation of either the principal or interest of the obligations issued by the association nor can such exemption be implied since the code (12 USCA 1719(b)) provides that these obligations, together with the interest thereon, do not constitute a debt or obligation of the United States or of any agency or instrumentality thereof other than the association. Therefore, in the absence of an express or implied exemption the conclusion is that Congress did not intend the association's obligations and interest therefrom to be exempt from state income taxation.

b. The various code provisions exempting from state taxation the income from obligations of the Federal Land Bank, Federal Intermediate Credit Banks and Federal Home Loan Banks do not contain any provision for the curtailment or limitation of the tax exemption by reason of retirement of the United States Government's stock investment in such corporations. Accordingly, in the absence of such a provision it is concluded that the tax exemption is not affected by a complete withdrawal of the Government's stock interest in those organizations.

However, with respect to Banks for Cooperatives, the code (12 USCA 1138c) provides, in addition to exempting the bank, its property and obligations from tax, that: "The exemption provided herein shall not apply . . . with respect to any bank for cooperatives or its property or income after the stock held in it by the United States had been retired."

The meaning of the above language is that the exemption of the bank's obligations (notes, debentures, and bonds) is a continuing exemption, whereas the exemption to the bank, its property and its income is dependent upon whether the United States holds a stock interest in such bank.