

ITIB 1981-2
(ITIB 1973-1 Superseded)
(ITIB 1969-2 Superseded)

April 1981

STATE OF ILLINOIS
DEPARTMENT OF REVENUE
INCOME TAX INFORMATION BULLETIN

INCOME EXEMPT FROM TAX

This bulletin is intended to supersede the information contained in ITIB 1973-1.

Under section 203 of the Illinois Income Tax Act, taxpayers are entitled to deduct in the computation of "base income" amounts which would otherwise be included therein but "which are exempt from taxation by this State either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States.

1. INTEREST ON OBLIGATIONS OF THE UNITED STATES

A federal statute, 31 U.S.C.A. Section 742, exempts interest on all "stocks, bonds, Treasury notes and other obligations of the United States from state income taxation.

Obligations of the United States within the meaning of this statute have been held to be those obligations issued "to secure credit to carry on the necessary functions of government." SMITH V. DAVIS (1944) 323 U.S. 111, 119, 65 S. Ct. 157, 161. The exemption is aimed at protecting the federal borrowing power, and is derived from the "Borrowing" and "Supremacy" clauses of the Constitution. SOCIETY FOR SAVINGS V. BOWERS (1955) 349 U.S. 143, 144, 75 S. Ct. 607, 608. HIBERNIA V. CITY AND COUNTY OF SAN FRANCISCO (1906) 200 U.S. 310, 313, 26 S. Ct. 265, 266.

The term "other obligations" as used in this statute has been construed as referring only to obligations or securities of the same type as those specifically enumerated. A governmental obligation which is secondary, indirect, or contingent, such as a guaranty of a nongovernmental obligor's primary obligation to pay the principal amount of and interest on a note, is not an obligation of the type exempted under 31 U.S.C.A. Section 742. MONTGOMERY WARD LIFE INSURANCE CO. V. ILLINOIS DEPARTMENT OF LOCAL GOVERNMENT AFFAIRS (1980) 89 Ill. App. 3d 292, 411 N.E. 2nd 973. Leave to appeal to the Illinois Supreme Court denied January 30, 1981.

Furthermore, the credit instrumentalities recognized as falling within the U.S. Constitutional exemption from state and local taxation have been characterized by (1) written documents, (2) the bearing of interest, (3) a binding promise by the United States to pay specified sums at specified dates and (4) specific Congressional authorization, which also pledged the faith and credit of the United States in support of the promise to pay. SMITH V. DAVIS, supra.

Based on the above, the following types of income are currently being recognized as exempt under 31 U.S.C.A. Section 742 by the Illinois Department of Revenue:

Interest on U.S. Treasury bonds, notes, bills, certificates and savings bonds.

Income from GSA Public Building Trust Participation Certificates: First Series A through E; Second Series, Series F, Third Series, Series G, Fourth Series, Series H and I. Various rates; various due dates.

Income from Participation Certificates in the Government Mortgage Liquidation Trust, the Federal Assets Financing Trust, and the Federal Assets Liquidation Trust, issued by the Federal National Mortgage Association as Trustee (the Government National Mortgage Association is the current Trustee) under 12 U.S.C.A. Section 1717(c). (Note: Income from debentures, notes, and bonds issued by the Federal National Mortgage Association including mortgage-backed bonds issued under authority of 12 U.S.C.A. Section 1719(d) and guaranteed by GNMA under 12 U.S.C.A. Section 1721(g) is NOT exempt; and income from securities, commonly known as GNMA "Pass-Through Securities", issued by approved issuers under 12 U.S.C.A. Section 1721(g) and guaranteed by the Government National Mortgage Association under 12 U.S.C.A. Section 1721(g) is also NOT exempt).

2. OTHER INCOME EXEMPTED BY REASON OF OTHER FEDERAL STATUTES

Other federal statutes provide exemption from state income taxation with respect to various specifically named types of income. Following is a list (intended to be exhaustive) of exempt income and the specific statutes relating thereto:

BANKS FOR COOPERATIVES

- a. Income of Banks for Cooperatives for any year or part thereof in which stock in the Bank is held by the Governor of the Farm Credit Administration (12 U.S.C.A. Section 2134);
- b. Income from notes, debentures, and other obligations issued by Banks for Cooperatives (12 U.S.C.A. Section 2134).

COMMUNITY CREDIT CORPORATION

- a. Income of Commodity Credit Corporation (15 U.S.C.A. Section 713a-5);
- b. Interest derived from bonds, notes, debentures and other similar obligations issued by Commodity Credit Corporation (15 U.S.C.A. Section 713a-5).

FEDERAL CREDIT UNIONS

Income of Federal Credit Unions (12 U.S.C.A. Section 1768).

FEDERAL DEPOSIT INSURANCE CORPORATION

- a. Income of Federal Deposit Insurance Corp. (12 U.S.C.A. Section 1825);
- b. Interest derived from notes, debentures, bonds or other such obligations issued by Federal Deposit Insurance Corp. (12 U.S.C.A. Section 1825).

FEDERAL FARM CREDIT BANKS

Income from consolidated systemwide notes, debentures, and other obligations issued jointly and severally under 12 U.S.C.A. Section 2153 by Banks of the Federal Farm Credit System (12 U.S.C.A. Section 2055; 12 U.S.C.A. Section 2079; U.S.C.A. Section 2098; and 12 U.S.C.A. Section 2134).

FEDERAL FINANCING BANK

Income of Federal Financing Bank (12 U.S.C.A. Section 2290(a)).

FEDERAL HOME LOAN BANKS

a. Income of Federal Home Loan Banks (12 U.S.C.A. Section 1433);
b. Interest derived from notes, debentures, bonds and other obligations issued by Federal Home Loan Banks and from consolidated Federal Home Loan Bank bonds and debentures (12 U.S.C.A. 1433).

FEDERAL HOME LOAN MORTGAGE CORPORATION

Income of Federal Home Loan Mortgage Corp. (12 U.S.C.A. Section 1452 (d)).

FEDERAL INTERMEDIATE CREDIT BANKS

a. Income of Federal Intermediate Credit Banks (12 U.S.C.A. Section 2079);
b. Income from notes, bonds debentures, and other obligations issued by Federal Intermediate Credit Banks (12 U.S.C.A. Section 2079).

FEDERAL LAND BANKS AND FEDERAL LAND BANK ASSOCIATIONS

a. Income of Federal Land Banks and Federal Land Bank Associations (12 U.S.C.A. Section 2055);
b. Income from notes, bonds debentures, and other obligations issued by Federal Land Banks and Federal Land Bank Associations (12 U.S.C.A. Section 2055).

FEDERAL NATIONAL MORTGAGE ASSOCIATION

Income of Federal National Mortgage Association (12 U.S.C.A. Section 1723a(c)(2)).

FEDERAL RESERVE BANKS

Income of Federal Reserve Banks (12 U.S.C.A. Section 531).

FEDERAL SAVINGS AND LOAN INSURANCE CORPORATION

a. Income of Federal Savings and Loan Insurance Corp. (12 U.S.C.A. 1725(e));
b. Interest derived from notes bonds, debentures, or other obligations issued by Federal Savings and Loan Insurance Corp. (12 U.S.C.A. Section 1725(e)).

GENERAL INSURANCE FUND

a. Interest derived from debentures issued by General Insurance Funds under War Housing Insurance Law (12 U.S.C.A. Section 1739(d));
b. Interest derived from debentures issued by General Insurance Fund to acquire rental housing project (12 U.S.C.A. Section 1747g(g));
c. Interest derived from Armed Services Housing Mortgage Insurance Debentures issued by General Insurance Fund (12 U.S.C.A.

Section 1748b(f)).

GOVERNMENT NATIONAL MORTGAGE ASSOCIATION

Income of Governmental National Mortgage Association (12 U.S.C.A. Section 1723a(c)(1)).

PANAMA CANAL

Interest derived from Panama Canal Bonds (31 U.S.C.A. Section 744, 745). NOTE that this income is not presently included in federal taxable income.

PRODUCTION CREDIT ASSOCIATIONS

a. Income of Production Credit Associations for any year or part thereof in which stock in the Association is held by the Governor of the Farm Credit Administration (12 U.S.C.A. Section 2098);

b. Income from notes debentures and other obligations issued by Production Credit Associations (12 U.S.C.A. Section 2098).

PUERTO RICO

Interest derived from bonds issued by Government of Puerto Rico (48 U.S.C.A. Section 745). NOTE that this income is not presently included in federal taxable income.

RAILROAD RETIREMENT ACT

Annuity and supplemental annuity payments as qualified under the Railroad Retirement Act of 1974 (45 U.S.C.A. Section 231m).

Note that under the Railroad Retirement Act, annuity payments ARE NOT presently includible in the federal adjusted gross income of the recipient. However, supplemental annuity payments ARE presently includible in the recipient's federal adjusted gross income.

SPECIAL FOOD SERVICE PROGRAM

Assistance to children under Special Food Service Program (42 U.S.C.A. Section 1760(e)).

TENNESSEE VALLEY AUTHORITY

Interest derived from bonds issued by Tennessee Valley Authority (16 U.S.C.A. Section 831n-4(d)).

UNITED STATES POSTAL SERVICE

Interest derived from obligations issued by the United States Postal Service (39 U.S.C.A. Section 2005 (d)(4)).

VIRGIN ISLANDS

Interest derived from bonds issued by Government of Virgin Islands (48 U.S.C.A. Section 1574(b)(ii)(A)). NOTE that this income is not presently included in federal taxable income.

3. OTHER INCOME EXEMPTED BY REASON OF STATE STATUTES. (Income from state or local obligations issued in Illinois are subject to the income tax except where authorizing legislation adopted after August 1, 1969 specifically provides for an exemption from state taxes.)

Illinois Housing Development Authority, bonds and notes (Ill. Rev. Stat. 1979, Ch 67 1/2. par. 331)

4. The Department emphasizes that section 203 of the Act permits the deduction of items of exempt income only to the extent such items of income would otherwise be included in base income. For example, a railroad retirement pension or social security pension would not be included in an individual's federal adjusted gross income. It would, therefore, not be included in his base income, properly computed under the Act. Consequently, the amount of such pension should not be deducted from his base income. On the other hand, interest on Treasury notes would be included in an individual's federal adjusted gross income and thus would be part of his base income under the Act. The amount of such interest so included should be deducted to eliminate such interest from the Illinois tax base.

5. Taxpayers seeking exemption for income not listed herein but which the taxpayer believes to be exempt from taxation by this State "either by reason of its Constitution or by reason of the Constitution, treaties or statutes of the United States" should prepare adequate support and sent to:

Illinois Department of Revenue
Income Tax Legal Services Division
1500 South Ninth Street
Springfield, Illinois 62708

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