

State of Minnesota
Department of Revenue

**In the Matter of the Proposed Adoption
Without a Public Hearing of Amendments
to Minnesota Rules, Part 8002.0300 which
Governs Subtraction for Interest on United
States Government Obligations.**

**STATEMENT OF NEED
AND REASONABLENESS**

This document has been prepared to establish the statutory authority, need for, and reasonableness of the proposed amendments to the existing part. It is submitted pursuant to Minnesota Statutes, section 14.23 and Minnesota Rules, part 2010.0700 requiring a Statement of Need and Reasonableness.

A Notice of Intent to Solicit Outside Opinion regarding Minnesota Rules, part 8002.0300 was published in the State Register on March 30, 1992. The notice specifically mentioned this part and invited interested persons to submit comments or suggestions in writing to the Department by April 15, 1992. No written comments were submitted.

In preparing the amendments to this part, the Department has considered the requirements of Minnesota Statutes, section 14.115, in regard to the impact of the proposed amendments to the part on small business. Adoption of the part will not adversely affect small businesses. Minnesota Statutes, section 14.11, subdivision 1, does not apply because adoption of the part will not result in additional spending by local public bodies in excess of \$100,000 per year for the first two years following adoption of the part. Minnesota Statutes, section 14.11, subdivision 2, does not apply because adoption of the part will not impact agricultural land. Minnesota Statutes, section 16A.128, subdivisions 1a and 2a, does not apply because the part does not fix fees.

Authority to Adopt Rules.

Minnesota Statutes, section 270.06(13) provides that the Commissioner of Revenue shall promulgate rules concerning the administration of state tax laws.
**Minnesota Rules, Part 8002.0300 Subtraction for Interest on United States
Government Obligations.**

This rulemaking proceeding proposes amendments to Minnesota Rules, part 8002.0300. This part was adopted in 1982. It sets out the requirements for subtraction of interest earned on United States government obligations from federal adjusted gross income for Minnesota state individual income determination. This part also contains nonconclusive exhibits of securities that are usually exempt, securities that

are usually taxable, issuers whose obligations are generally exempt, and issuers whose obligations are generally taxable.

Since the adoption of this part, the Department has determined that additional obligations should be included as exhibits. The Department has also determined that certain obligations are no longer properly exhibited and that certain citations in this part have become inaccurate because of revision of the *United States Code*. The primary reason the part needs to be amended, however, is that a recent Minnesota Supreme Court decision requires a change in the Department's interpretation of state law as it applies to the subtraction from federal taxable income of mutual fund dividends derived from federal obligations. The part must be amended so that it will contain useful exhibits, accurate citations, and current law. The amendments to this part are not intended to reflect the merits of *Meunier v. Minnesota*, No. 91-00043 (Hennepin County Dist. Ct. May 14, 1992), which is currently under appeal.

Part Analysis.

The following is a subpart-by-subpart analysis of amendments to Minnesota Rules, part 8002.0300.

Subpart 1. Amendments to item A indicate that in cases where original issue discount is considered interest and included in federal taxable income, it can be subtracted from federal taxable income to the same extent as other interest. Allowing the subtraction of the income at the state level is consistent with its inclusion in federal taxable income under the Internal Revenue Code, sections 454 and 1271 through 1286. Amendments also reflect change in the Department's position on the subtraction of mutual fund dividends derived from interest on federal obligations. The Minnesota Supreme Court's holding in *Yurista v. Commissioner*, 460 N.W.2d 24, (1990), requires the subtraction of interest on federal obligations pass through to individuals who own shares in mutual funds that own federal obligations.

Amendments to items B and C delete the requirement that the full faith and credit of the United States must be pledged to the payment of underlying obligations. Amendments delete the full faith and credit requirement because some obligations issued through an agency, authority, commission, or instrumentality of the United States are exempted from state taxation by federal statute, but are also defined by statute as not guaranteed by or obligations of the United States. For example, obligations issued by the Tennessee Valley Authority are specifically made exempt from state taxation by 16 U.S.C. 831n-4(d) (1990) and specifically defined as not guaranteed by or obligations of the United States by 16 U.S.C. 831n-4(b) (1990).

Item E provides that only amounts which have been included in federal taxable income may be deducted from federal taxable income for state income tax purposes. This provision was originally found in item A, but was moved to improve readability of the part. Item E also provides a formula for determining the percent of dividends received by shareholders that qualify as exempt. The formula is provided because dividends from a regulated investment company may not be derived entirely from exempt obligations. Only the portion of the dividends which is derived from exempt obligations is exempt. The formula is a convenient way to determine the portion which is exempt.

Subpart 3. Amendments delete citations made inaccurate by revision of the *United States Code* and insert current citations. Amendments insert additional items. The items list other securities found to be exempt along with the agency authorized to secure their issuance. The securities are included because they are exempt from state taxation under federal law. The authority relied upon to determine that each additional security is exempt is cited directly following the listing of the security.

Subpart 4. Amendments insert additional items which exhibit securities which may appear to be exempt but are not. These securities are not exempt from state taxation under federal law. The authority relied upon to determine that each additional security is not exempt is cited directly following the listing of the security.

Subpart 5. Amendments delete citations made inaccurate by revision of the *United States Code* and insert current citations. Amendments eliminate item K, Panama Canal bonds, because the authority for this security as cited in the part has been repealed. Act of September 13, 1983, Pub. L. No. 97-258, ch. 661, 96 Stat. 1068. Amendments insert additional items that name agencies which generally issue exempt obligations. The authority relied upon to determine the status of obligations generally issued by each agency is cited directly following the listing of the agency.

Subpart 6. Amendments delete citations made inaccurate by revision of the *United States Code* and insert current citations. Amendments eliminate item P, Washington Metropolitan Area Transit Authority, because the authority has been repealed. Act of December 9, 1969, Pub. L. No. 91-143, sec. 8(a)(1), 83 Stat. 322. Amendments eliminate item S, Student Loan Marketing Association, because of a change in federal law, which occurred just before adoption of this part. That change exempts from state taxation bonds and notes issued by the Student Loan Marketing Association. 20 U.S.C. § 1087-2 (1990). Amendments insert additional items that name agencies which generally issue taxable obligations. The authority relied upon

to determine the status of obligations generally issued by each agency is cited directly following the listing of the agency.