

**New York State Department of Taxation and Finance  
Taxpayer Services Division  
Technical Services Bureau**

TSB-A-86 (10) I  
Income Tax  
July 30, 1986

STATE OF NEW YORK  
STATE TAX COMMISSION

ADVISORY OPINION

PETITION NO. 1860423A

On April 23, 1986, a Petition for Advisory Opinion was received from Brian E. Lorenz, Esq., Carro, Spanbock, Fass, Geller, Kaster and Cuiffo, 1345 Avenue of the Americas, New York, New York 10105.

The issue raised involves the method of computation of the portion of regulated investment company exempt interest dividends which represents the amount of interest of other states required to be added back to Federal adjusted gross income pursuant to the provisions of section 612(b)(1) of the Tax Law. Petitioner asks whether such computation should be based upon the proportion that such interest for the distribution period is of the total Federal exempt interest, whether distributed or not, received by the regulated investment company during the distribution period or will be based upon the proportion that such interest for the distribution period is of the total Federal exempt interest, whether distributed or not, received during the distribution period by the series in which the shareholder has an ownership interest.

Petitioner is an attorney who is involved in the incorporation of a tax exempt series fund. Petitioner states that the articles of incorporation and the operations of the tax exempt fund will be in accordance with section 851 of the Internal Revenue Code, thereby qualifying as a regulated investment company.

Ordinarily, regulated investment companies, commonly known as mutual funds, are incorporated as a single entity authorized to issue stock in different series with each series having its own distinct investment objectives and shareholders.

Series of a mutual fund may include an income series, utilities series and/or growth series. The subject of this petition is a municipal bond fund (tax exempt fund), which also uses a series format, each series specializing in the municipal bonds of a particular state. Each series in the tax exempt fund will be comprised of obligations of a particular state. Each series operates as a separate investment company or fund, even though the tax exempt fund is organized as a single regulated investment company.

The articles of incorporation of the tax exempt municipal bond fund, in accordance with the Investment Act of 1940, will provide that all assets received as consideration for the issue or sale of shares of stock of a series together with all income, earnings, profits and proceeds shall appertain to such class of stock, shall constitute the assets of such class of stock and shall be so segregated upon the books of account. For example, shareholders owning an interest only in the one series investing primarily in municipal bonds of New York State (New York Series) are entitled to receive dividends and other distributions only from the investments owned by the New York Series. The shareholders would have no right or claim to distributions from securities constituting series investing in other state's municipal bonds.

Exempt interest dividends are paid by a regulated investment company when at least 50% of the value of the total assets of the fund consist of obligations of a State, a Territory or a possession of the United States or any political subdivision of any of the foregoing or of the District of Columbia. Exempt interest dividends issued by a regulated investment company are excluded from Federal gross income pursuant to sections 103(a) and 852(b)(5)(b) of the Internal Revenue Code. Such income is therefore not included in Federal adjusted gross income, which is the starting point in computing taxable income under New York's Personal Income Tax.

Section 612(b)(1) of the New York State Tax Law requires an addition to Federal adjusted gross income in computing New York adjusted gross income of "interest income on obligations of any state other than this state, or of a political subdivision of any such other state ... to the extent not properly includible in federal adjusted gross income". There is no such required addition of interest income from obligations of the State of New York or its political subdivisions. Exempt interest dividends constitute interest for the purposes of the provision of the Tax Law here referred to. Municipal Fund for Temporary Investment, Inc., State Tax Commission Advisory Opinion, July 18, 1980, TSB-H-80-(245)-I.

Petitioner points out that a notice from the Director of the New York State Income Tax Bureau dated March 7, 1977 provides that the amount of exempt interest dividends on obligations other than those of New York State's that is included in New York's adjusted gross income is based upon the proportion that such interest is of the total Federal exempt interest received by the regulated investment company during the distribution period. Such notice is consistent with a regulated investment company consisting of a single series but inconsistent with a multiple series regulated investment company in that it fails to take into account the limited ownership rights of an owner of shares in a single series of a multiple series regulated investment company.

Accordingly, the portion of each shareholder's exempt interest dividend which represents the amount of his modification to Federal adjusted gross income, for the amount attributable to interest on obligations of states other than those of New York State or its political subdivisions should be based upon the proportion that such interest, for the distribution period, is of the total Federal exempt interest income, whether distributed or not, earned by the series of the municipal bond fund in which the shareholder has an ownership interest. It need not be based upon the total Federal exempt interest received by the regulated investment company as indicated by the March 7, 1977 notice.

DATED: July 30, 1986

s/FRANK J. PUCCIA  
Director  
Technical Services Bureau

NOTE: The opinions expressed in Advisory Opinions are limited to the facts set forth therein.