

# Income Tax Fact Sheet 13, U.S. Government Interest

Interest income you received from U.S. bonds, bills, notes and other obligations are taxable by the federal government and generally are exempt from Minnesota income tax.

When you complete your Minnesota income tax return, you may be able to subtract from your federal taxable income the amount of interest earned on certain U.S. government obligations, including those issued at a discount or dividends received from a mutual fund. The amount you may subtract will be reduced by any expenses deducted on your federal return that are attributable to U.S. bond interest.

You may also be able to subtract any U.S. bond interest income you may have received as a partner in a partnership, as a shareholder in an S corporation, or as a beneficiary of a trust.

Because the Minnesota income tax return instructions list only a few obligations, people often question if a particular U.S. government obligation qualifies for the subtraction. This fact sheet should help answer most of those questions.

## Subtraction Requirements

To qualify for this subtraction, the obligation must be all of the following:

- A direct and primary obligation of the United States or be exempt from state taxation under federal law
- In writing, containing a binding promise by the United States to pay specified sums on specific dates, and specifically authorized by Congress
- Interest bearing and the interest income included in your federal taxable income for the year you claim the subtraction

## Special Situations That Qualify for the Subtraction

- If the interest was earned as a dividend from a mutual fund and some of the fund's income is derived from interest on federal obligations, you can subtract a portion of the dividend interest. Multiply the amount of your ordinary dividends from your Form 1099-DIV by the percentage of qualifying federal interest income reported by your fund. To find the applicable percentages, see the statement provided by your fund.
- Original Issue Discount (OID) income from U.S. securities is exempt from Minnesota taxation and qualifies for the subtraction.
- Interest income from "zero coupon" bonds issued by the U.S. government (STRIPS) qualifies for the subtraction. Interest on "LIONS," "CATS," and "TIGRS" is also considered U.S. interest.

## Special Situations That Do Not Qualify

- Interest on federal tax refunds does not qualify for the subtraction.
- Interest from "Repurchase Agreements" involving federal obligations does not qualify for the subtraction.
- Interest income from obligations of U.S. possessions that are not included in federal taxable income cannot be subtracted. U.S. possessions include:
  - American Samoa
  - Puerto Rico
  - Guam
  - Virgin Islands
- Gain on the sale of federal obligations or mutual funds containing federal obligations is not considered to be interest on U.S. obligations. It is taxed the same as any other gain on the sale of an asset.
- Minnesota taxes federally taxable distributions from pension plans, including IRAs and Keoghs which are partially or fully funded by U.S. obligations. The U.S. interest earned by the pension plan is not allowed as a subtraction.

## Agencies Issuing Exempt Obligations

The following is a list of agencies that generally issue obligations that are exempt from Minnesota income tax and for which a subtraction is allowed:

- Bank for Cooperatives
- Commodity Credit Corporation
- Farm Credit System Financial Assistance Corporation
- Federal Deposit Insurance Corporation
- Federal Farm Credit Administration
- Federal Home Loan Banks
- Federal Intermediate Credit Banks
- Federal Land Bank Associations

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- Federal Land Banks
- Federal Savings and Loan Insurance Corporation
- Financing Corporation
- General Insurance Fund of the Department of Housing and Urban Development, including:
  - Armed Services Housing
  - National Defense Housing Insurance
  - Neighborhood Conservation Housing Insurance
  - Production Credit Associations
  - Rental Housing Insurance
  - Rental Housing Project
  - Resolution Funding Corporations
  - Student Loan Marketing Association (*Sallie Mae*)
  - Tennessee Valley Authority
  - U.S. Postal Service
  - U.S. Treasury Department (*notes, bonds, bills, savings bonds, freedom shares, certificates of indebtedness, TIPS*)
  - War Housing Insurance

If you received interest from a government source not listed, you may call the Minnesota Department of Revenue to determine its taxable status. When you call, be sure to have the exact names of the issuing agency and the obligation.

### **Federal Deductions Taken on Related Income**

If you deducted investment interest or other expenses on your federal return which were attributable to income not taxed by Minnesota—including interest earned from U.S. government obligations—you must add back those amounts to your taxable income. For details, see the Minnesota Individual Income Tax instructions and Schedule M1M, *Income Additions and Subtractions*.

### **Agencies Issuing Taxable Obligations**

Following is a list of agencies that generally issue obligations that are taxable by Minnesota, and therefore do not qualify for the subtraction:

- Asian Development Bank
- College Construction Loan Insurance Association
- District of Columbia Armory Board
- Environmental Financing Authority
- Export-Import Bank
- Farmers Home Administration (FHA)
- Federal Agricultural Mortgage Corporation
- Federal Financing Bank
- Federal Home Loan Mortgage Corporation (*Freddie Mac*)
- Federal National Mortgage Association (FNMA) (*Fannie Mae*)
- Federal Reserve Banks
- Government National Mortgage Association (GNMA) (*Ginnie Maes*)
- Inter-American Development Bank
- International Bank for Reconstruction and Development (World Bank)
- International Monetary Fund (IMF)
- Maritime Administration Merchant Marine
- National Consumer Cooperative Bank
- New community development corporations
- Small Business Administration
- Small Business Investment Companies

If you received interest from a government source not listed, you may call us to determine its taxable status. When you call, be sure to have the exact names of the issuing agency and the obligation.

### **Information and Assistance**

Additional forms and information, including fact sheets and frequently asked questions, are available on our website.

Website: [www.revenue.state.mn.us](http://www.revenue.state.mn.us)

Email: [individual.incometax@state.mn.us](mailto:individual.incometax@state.mn.us)

Phone: 651-296-3781 or 1-800-652-9094

This information is available in alternate formats.