

Excise Tax Advisory

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Interest Received on Direct Obligations of the Federal Government

Purpose

This Excise Tax Advisory (“ETA”) provides information about the business and occupation (B&O) tax deduction for interest received on direct obligations of the Federal Government.

Under [RCW 82.04.4286](#), a taxpayer may deduct from gross income, “amounts derived from business which the state is prohibited from taxing under the Constitution of this state or the Constitution or laws of the United States.”

The B&O deduction applies to amounts earned, i.e., interest, on *direct* obligations of the Federal Government. See also 31 USC § 3124(a).

Only Direct Obligations Qualify

The RCW 82.04.4286 deduction applies only to interest received on direct obligations of the Federal Government, not on obligations where the Federal Government is merely a guarantor, insurer, or obligator. [WAC 458-20-146](#) (“Rule 146”).

Direct US Government Obligations

United States savings bonds, Treasury bills, Treasury bonds, Treasury inflation protected securities, and Treasury notes are direct obligations of the U.S. government. As such, interest received on those investments is deductible from the measure of the B&O tax.

Examples of Non-Qualifying, Indirect Obligations

Ginnie Mae (Government National Mortgage Association)-Backed Securities

The Government National Mortgage Association (GNMA), or “Ginnie Mae,” was established in 1968 to promote home ownership. It is a wholly owned government corporation within the Department of Housing and Urban Development (HUD).

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Ginnie Mae neither originates nor purchases mortgage loans. It does not purchase, sell, or issue securities. Instead, private lending institutions approved by Ginnie Mae originate eligible loans, pool them into securities, and issue the Ginnie Mae mortgage-backed security (“MBS”) instruments. Ginnie Mae is the guarantor of MBS instruments issued by government-approved securities issuers who participate in Ginnie Mae’s program.

The RCW 82.04.4286 B&O tax deduction does not apply to income from Ginnie Mae MBS instruments. Ginnie Mae is a guarantor, but is not the issuer of the securities. Since Ginnie Mae does not issue the securities, the securities are not direct obligations of the Federal Government for purposes of this deduction.

Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) (“Fannie Mae”, and “Freddie Mac”) Obligations

Fannie Mae and Freddie Mac, are both "government-sponsored enterprises" (“GSEs”), which are federally chartered corporations, but still privately owned by shareholders. There is no federal statute preventing the state taxation of interest payments received from Fannie Mae- and Freddie Mac-issued securities. As neither of these GSEs are branches of the federal government, the RCW 82.04.4286 B&O tax deduction does not apply to income from Fannie Mae- or Freddie Mac-issued securities. These GSE interest payments do not represent tax exempt direct obligations of the Federal Government, and are therefore subject to B&O tax.

Federal Conservatorships

On September 7, 2008, the Federal Housing Finance Agency (“FHFA”) put Fannie Mae and Freddie Mac under the conservatorship of the FHFA. As of the start of the conservatorship, each GSE contracted to issue common stock warrants representing a Federal Government ownership stake in Fannie Mae and Freddie Mac. Although these conservatorships give the Federal Government a share of these companies, these entities have not been absorbed into a branch of the Federal Government itself, such as the FHFA. Instead, the Federal Government views the conservatorship as a pathway towards self-sufficiency of these GSEs. Income from Fannie Mae and Freddie Mac securities remains subject to B&O tax. [Det. No. 13-0212, 33 WTD 125 \(2014\)](#).

Small Business Administration Certificates

The Small Business Administration (“SBA”), a federal agency, is authorized to issue trust certificates to encourage the formation and growth of small business investment companies (“SBICs”). SBICs provide venture capital to start-up businesses. One of the ways SBICs raise money for investment is by issuing participating securities to the SBA.

The SBA receives participating securities from SBICs that entitle it to receive payments from the SBICs. The SBA assembles these SBIC securities into a pool to be

securitized. In the process of securitization, the SBA transfers rights to payment to an underwriter, together with a guarantee. The underwriters transfer both the right to payments and the SBA guarantee to an independent trust and the trust issues a certificate representing ownership of the participating securities in the pool.

The underlying obligation to pay is on the SBICs, and if those initial payments are sufficient, the SBA is not obligated to make payments to the investors under its guarantee. The conditional nature of the SBA's responsibility indicates that the income received by investors is not from a direct obligation of the Federal Government, but only a guarantee.

**Examples of
Qualifying Federal
Obligations**

The following are examples, as of the issuance date of this ETA,¹ of direct obligations of the Federal Government. Interest received from the following is not subject to B&O tax per RCW 82.04.4286 and Rule 146:

1. Armed Services Housing Mortgage Insurance debentures, 12 USC § 1748b(f).
2. Bank for Cooperative debentures, 12 USC § 2134.
3. Bank repurchase agreements for U.S. Government treasury bills, notes and bonds, if interest is paid by the Federal Government directly to the taxpayer.
4. Commodity Credit Corporation bonds, notes, and debentures, 15 USC § 713a-5.
5. Commonwealth of Puerto Rico public improvement bonds, 48 USC § 745.
6. Farm Credit System Financial Assistance Corporation notes, bonds, and debentures. 12 USC § 2160.
7. Federal Deposit Insurance Corporation bonds, notes, and debentures, 12 USC § 1825.
8. Federal Farm Credit Banks Consolidated Systemwide Securities, 12 USC § 2023.
9. Federal Home Loan Bank bonds, debentures, and notes, 12 USC § 1433.
10. Federal Housing Authority debentures, 12 USC §§ 1710(d) and 1747g(g).
11. Federal Intermediate Credit Bank debentures, 12 USC § 2023.
12. Federal Land Bank Association bonds, notes, and debentures, 12 USC § 2098.

¹ Federal statutes and caselaw, in effect at the time the B&O deduction is being claimed, govern the taxability of the interest. Entities on this list could become ineligible for the deduction in the future, or entities not currently eligible could become eligible.

13. Federal Land Bank bonds. 12 USC § 2094.
14. Federal Reserve Bank² dividends, 12 USC § 531.
15. Financial Assistance Corporation bonds, notes, and debentures, 12 USC § 2278b-10.
16. Financing Corporation obligations, 12 USC § 1441.
17. General Insurance Fund debentures issued to acquire housing projects, 12 USC § 1747g(g).
18. General Insurance Fund debentures issued under the War Housing Insurance Law, 12 USC § 1739(d).
19. General Services Administration Public Building Trust Participation certificates, 31 USC § 3124.
20. Guam bonds, 48 USC § 1423a.
21. Industrial Development bonds of East Samoa, 48 USC § 1670.
22. Production Credit Association notes, bonds, and debentures, 12 USC § 2098.
23. Proprietary zero-coupon certificates, 31 USC § 3124.

Note: Proprietary zero-coupon certificates include CATS, TIGRs, Cougars, ETRs, Lions, STARs, Zebras, etc.
24. Puerto Rico Aqueduct and Sewer Authority revenue bonds, 48 USC § 745.
25. Puerto Rico Electric Power Authority electric revenue bonds, 48 USC § 745.
26. Puerto Rico Electric Power Authority power revenue bonds, 48 USC § 745.
27. Puerto Rico Highway Authority revenue bonds, 48 USC § 745.
28. Puerto Rico Industrial Development Company bonds, 48 USC § 745.
29. Puerto Rico Municipal Finance Agency 1974 Series A bonds, 48 USC § 745.
30. Puerto Rico Ports Authority revenue bonds, 48 USC § 745.

² In contrast with Federal Reserve Bank dividends, dividends from banks chartered and regulated by the Federal Government's Office of the Comptroller of the Currency (OCC) do *not* qualify for this deduction, because they are not direct obligations of the Federal Government.

31. Puerto Rico Public Buildings Authority public education and health facility bonds, 48 USC § 745.
32. Puerto Rico Public Buildings Authority revenue bonds, 48 USC § 745.
33. Puerto Rico Telephone Authority revenue bonds, 48 USC § 745.
34. Puerto Rico Water Resource Authority Series B debentures, 48 USC § 745.
35. Resolution Funding Corporation bonds, notes, and debentures, 12 USC § 1441b(f)(7).
36. Student Loan Marketing Association obligations, 20 USC §§ 1087-2.
37. Tennessee Valley Authority bonds, 16 USC § 831n-4(d).
38. Territory of Puerto Rico bonds, 48 USC § 745.
39. United States Postal Service bonds, 39 USC § 2005.
40. United States savings bonds, 31 USC § 3124.
41. United States Treasury bills and notes, 31 USC § 3124.
42. University of Puerto Rico university system revenue bonds, 48 USC § 745.
43. Virgin Islands general obligation bonds and notes, 48 USC § 1574(b)(ii)(A).
44. Virgin Islands Public Improvement bonds and notes, 48 USC § 1574(b)(i).

**Verification
Required**

Under RCW [82.32.070](#), taxpayers must retain and make available those records necessary to verify that the correct tax liability has been reported and paid by the taxpayer with respect to the taxes administered by the Department. This deduction is subject to audit and taxpayers must keep documentation to support claimed amounts, including the following:

1. Information about the related Federal Government obligations and associated interest;
2. If the source of the Federal Government obligation interest is a trust, partnership, or S corporation, a statement from the entity identifying the sources and amounts of interest earned. A federal Schedule K-1 is insufficient unless it cites the source and amount of interest; and
3. If the source of the Federal Government obligation interest is from a mutual fund, a statement from the mutual fund identifying the percentage of mutual

fund income earned from Federal Government obligations, and the percentage of Federal Government obligation interest earned from each source. A Form 1099 is insufficient unless it provides this information.

The Department may request additional documentation depending on the facts and circumstances.

The Department presumes that interest from obligations not listed in this ETA is not deductible under RCW 82.04.4286. Taxpayers seeking to deduct interest from unlisted obligations must submit the documentation described in this section to the Department to substantiate that the interest is from a direct obligation of the Federal Government.
