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SC INFORMATION LETTER #88-7

TO: Vicki Jinnette
Public Information Officer

FROM: John Swearingen, Manager
Tax Policy and Procedures Department

DATE: April 29, 1988

SUBJECT: Tax Exempt Status of Interest Dividends Distributed by Money Market
and Municipal Bond Funds

REFERENCE: S.C. Code Section 12-7-430(b)(1) & (b)(2)
IRC Section 852(b)(5)(B)

AUTHORITY: S.C. Code Section 12-3-140
SC Revenue Procedure #87-3

SCOPE: An Information Letter is a temporary document issued for the purpose of disseminating general tax information and to respond to technical questions from within the Commission which are not related to a specific set of facts.

IRC Section 852(b)(5)(B) allows regulated investment companies to pass the exemption of bond interest to its shareholders as exempt-interest dividends if at least 50% of the value of the fund's total assets consists of state and local obligations.

South Carolina modifies this provision in Code Section 12-7-430(b)(1) and (b)(2) by exempting only interest on obligations of South Carolina and any of its subdivisions and United States obligations. Therefore, a mutual fund that is organized as a regulated investment company and has at least 50% of the assets invested in South Carolina obligations and/or U.S. obligations would qualify for the exempt-interest dividend flow-through. For example, if a fund had 40% of the assets in U.S. Government Securities and 20% in South Carolina bonds, the fund would qualify for the exempt-interest dividend flow through.

If a fund invested solely in municipal bonds of which only 20% of the total are from South Carolina sources, the flow-through would not apply. The fund does not meet the South Carolina requirements of at least 50% in South Carolina source bonds.

When a fund does not or cannot give adequate information in order to make a determination of the exempt-interest, then all income is taxed as a dividend and the flow-through character does not apply.

Some money market funds and municipal bond funds are organized as trusts rather than regulated investment companies. The exempt status of the interest paid on South Carolina and United States obligations in the trust will flow through to holders of certificates of beneficial interests as allowed under the provisions of the Internal Revenue Code.