



STATE OF DELAWARE
DEPARTMENT OF FINANCE
DIVISION OF REVENUE
DELAWARE STATE BUILDING
820 N. FRENCH STREET
WILMINGTON, DELAWARE 19801

DIVISION OF REVENUE

Tax Ruling 84 - 2

June 1, 1984

SUBJECT: Delaware Taxation of Interest Income from "Ginnie Mae" (GNMA) and "Fannie Mae" (FNMA) Securities.

Questions have been raised as to whether interest income earned on certain Government National Mortgage Association (GNMA) securities (Ginnie Maes) and on Federal National Mortgage Association (FNMA) securities (Fannie Maes) is exempt from Delaware income taxation. Section 1106 (b) (1), 30 Del. C., exempts from Delaware income taxation "interest on obligations of the United States . . . or of any authority, commission or instrumentality of the United States, to the extent includable in gross income for federal income tax purposes but exempt from state income taxes under the laws of the United States." Under federal law, interest earned on GNMA and FNMA securities is includable in adjusted gross income for federal income tax purposes. Hence, the question presented is whether such income qualifies as interest on "obligations of the United States" exempt from state income taxation under the laws of the United States.

The Congress established a broad exemption of federal obligations from state and local taxation in 31 USC §742 which provides:

"Except as otherwise provided by law, all stocks, bonds, Treasury notes, and other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

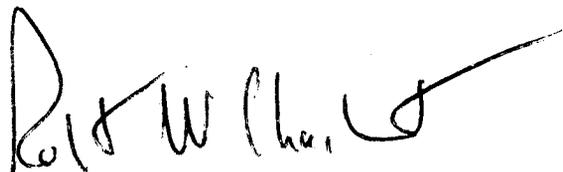
The above exemption, which codified the constitutional immunity rule laid down by the U.S. Supreme Court in McCulloch v. Maryland, 4 Wheat 316 (1819), applies not only to notes and bills issued by the U.S. Treasury, but also to the obligations of such instrumentalities of the United States as Federal Credit Banks. In Smith v. Davis, 323 U.S. 114, 117 (1944), the Supreme Court stated that exempt obligations of the United States were characterized by "(1) written documents, (2) bearing of interest, (3) a binding promise by the United States to pay specified sums at specified dates, and (4) specific Congressional authorization which also pledged the faith and credit of the United States in support of the promise to pay".

The Government National Mortgage Association (GNMA) was created by the Congress to perform certain functions in the secondary mortgage market. It is primarily involved with mortgage-backed securities that are issued and sold by a private issuer, with payments of interest and principal guaranteed by GNMA. These securities, commonly referred to as Ginnie Maes, are not obligations of the United States, but are merely guaranteed by the United States and do not entail a binding promise by the United States to pay specified sums at specified dates. The private issuer actively manages and controls the pool of mortgages and is primarily liable to make the payments required by the securities. Payment of the obligation by GNMA is only a contingent and speculative liability. Montgomery Ward Life Insurance Co. v. Dept. of Local Government Affairs, 89 Ill. App. 3d 292 (1980). In the Montgomery Ward Case, the Court found that Ginnie Maes were not issued by a government agency to borrow money on the credit of the United States to finance an essential governmental function, but were guaranteed by GNMA to facilitate their marketability, and concluded that Ginnie Mae certificates were not within that category of obligations issued by the Federal Government under which it makes a binding promise to pay, backed by the full faith and credit of the Federal Government, and therefore, held that Ginnie Mae certificates do not fall within the meaning of the term "other obligations" in 31 U.S.C. §742.

Federal National Mortgage Association (Fannie Mae) is a federally chartered organization, which is entirely privately owned and operated. FNMA raises money in the public markets to invest in residential mortgages. Its securities (Fannie Maes) are not guaranteed by the United States government, are not backed by the full faith and credit of the United States, and clearly are not "obligations of the United States." In Farmers and Traders State Bank v. Johnson, Ill. App. (1984), the court held that the interest earned on Ginnie Mae and Fannie Mae certificates was not constitutionally immune or statutorily exempt from state income taxation.

In view of the foregoing, it is held that securities commonly known as "Ginnie Maes" and "Fannie Maes" do not constitute obligations of the United States within the meaning of 31 U.S.C., §742 and, therefore, that interest earned on such securities is not exempt from Delaware income taxation and may not be subtracted from federal adjusted gross income under sec. 1106 (b)(1), 30 Del. C.

This ruling will be effective for all taxable years beginning after December 31, 1983.



Robert W. Chastant
Director of Revenue