

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

TSB-A-90 (9) I  
Income Tax  
June 29, 1990

STATE OF NEW YORK  
COMMISSIONER OF TAXATION AND FINANCE

ADVISORY OPINION

PETITION NO. I900202C

On February 2, 1990, a Petition for Advisory Opinion was received from Michael W. Kreimer, c/o A.G. Edwards, P.O. Box 9036, Smithtown, N.Y. 11787.

The issue raised by Petitioner, Michael W. Kreimer, is whether the following zero coupon obligations are considered "obligations of the United States" and therefore the interest payments on such obligations are exempt from personal income tax under Article 22 of the Tax Law: Certificate of Accrual Treasuries ("CATS"), Treasury Bond Receipts ("TBR"), Coupon Treasury Receipts ("CTR"), Easy Growth Treasury Receipts ("ETR"), and Separate Trading of Registered Interest and Principal of Securities ("STRIPS").

Generally, CATS, TBRs, CTRs, ETRs and STRIPS evidence ownership of future interest and principal payments on issue or issues of United States Treasury notes or bonds. Such interest and principal payments are direct obligations of the United States of America. The Treasury securities are held in custody by a custodian on behalf of the holders of the related instruments. Holders of the related instruments are the beneficial owners of the underlying Treasury securities entitled to the rights and privileges evidenced thereby.

Section 612(c) of the Tax Law, as amended by Chapter 535 of the Laws of 1986, provides, in part:

There shall be subtracted from federal adjusted gross income:

(1) Interest income on obligations of the United States and its possessions to the extent includible in gross income for federal income tax purposes; such interest income shall include the amount received as dividends from a regulated investment company, as defined in section eight hundred fifty-one of the internal revenue code, which has been designated as the amount of such interest income in a written notice to shareholders not later than forty-five days following the close of its taxable year; provided that, at the close of each quarter of the taxable year of such regulated investment company, at least fifty percent of the value of its total assets, as defined in subsection (c) of section eight hundred fifty-one of the internal revenue code, consists of obligations of the United States and its possessions ....

Chapter 535 of the Laws of 1986 was enacted to permit individuals who invest in United States government obligations through regulated investment companies (hereinafter "RICs") to treat the income they receive therefrom as if they had directly invested in such securities. Specifically, section 612(c)(1) of the Tax Law was amended to provide that "interest income on obligations of the United States and its possessions" includes income received from a RIC that is

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attributable to its investment in obligations of the United States and its possessions. (See NY Legis Ann, 1986, p 246.)

For purposes of defining a RIC for federal income tax purposes, it has been determined under section 851(b)(4) of the Internal Revenue Code, that the United States government is considered to be the issuer of zero coupon obligations, including CATS, TIGRs (Treasury Investment Growth Receipts), and interests purchased through the Treasury Department's STRIPS Program, when the underlying Treasury securities are placed in permanent escrow for the exclusive benefit of investors of those instruments. (See Internal Revenue Service GCM 39699 (November 16, 1987); LTR8806044 (November 17, 1987)). Counsel held that in determining the issuers of CATS, TIGRS and similar derivative zero coupon obligations, it is proper to look through to the person burdened with "true" liability in respect of payments on such security or to the person whose activities will determine the success of the investment in such security. In the case of CATS, TIGRS and similar derivative zero coupon obligations, the investor can look only to the income from the underlying Treasury securities for payment. Any misuse of payments from the government by the escrow agent generally will be covered by fidelity bonds. In situations in which a fidelity or similar bond exists, the entities generating such bonds have generally insulated themselves from, and generally have minimal liability in respect of the zero coupon obligations. In those situations where the entity has not generated such fidelity bonds, the entity has not insulated itself from liability in respect of the zero coupon obligations and the entity that generated the obligations is the issuer of such obligations rather than the United States government.

Herein, the zero coupon obligations in question; namely, CATS, TBR, CTR, ETR and STRIPS have met the requirements to be considered government securities for purposes of the diversification tests for RICs under section 851 of the Internal Revenue Code. Therefore, such obligations are considered "obligations of the United States" for purposes of section 612(c)(1) of the Tax Law. Accordingly, the interest income on such zero coupon obligations is exempt from tax under section 612(c)(1) of the Tax Law. However, when the zero coupon obligations are acquired through a RIC, the interest income from such obligations is exempt only if the RIC meets the requirements of section 612(c)(1).

DATED: June 29, 1990

s/PAUL B. COBURN  
Deputy Director  
Taxpayer Services Division

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