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TO: Mr. W. R. Bland
Director, Income Tax Division
State Tax Commission of Arizona

RE: Taxability Under the Provisions of
the Arizona State Income Tax Law
of Income Received from United
States Government Obligations

QUESTION: Is income received from United
States Government obligations
taxable under the provisions of
the Arizona State Income Tax Law?

The opinion of this office of the taxability of income received from United States Government obligations under the provisions of "The Income Tax Act of 1933", as amended (A.C.A. 1939, Section 73-1501 to Section 73-1551) is based on the following:

Section 73-1551, A.C.A. 1939, reads as follows:

"The taxes herein levied shall not be construed to apply to income which under the Constitution of the United States, the state of Arizona is prohibited from taxing."

The United States Constitutional provisions involved are Article VI, Clause 2, which makes the Constitution of the United States "the Supreme Law of the Land; and the judges in every state shall be bound thereby", and Article I, Section 8, Clause 2 of the Constitution which grants to the Congress of the United States the power "to borrow money, on the credit of the United States".

Pursuant to the above, the Congress has enacted the following:

"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." (R.S. Sec. 3701) (31 U.S.C.A. Sec. 742)

In the recent case of Commonwealth v. Curtis Publishing Company, 365 Penn. 299, 69 A. 2d 410, decided on November 22, 1949, the Supreme Court of Pennsylvania used the following language:

"It is settled law that a state tax imposed directly upon United States securities or the interest derived therefrom cannot be sustained. In Northwestern Mutual Life Insurance Co. v. Wisconsin, 275 U.S. 136, 48 S. Ct. 55, 56, 72 L. Ed. 202, the United States Supreme Court said: 'It cannot be denied (and denial is not attempted) that bonds of the United States are beyond the taxing power of the states. Home Savings Bank v. City of Des Moines, 205 U.S. 503, 509, 27 S. Ct. 571, 51 L. Ed. 901; Farmers' & Mechanics' Sav. Bank v. Minnesota, 232 U.S. 516, 34 S. Ct. 354, 58 L. Ed. 706; and First National Bank v. Anderson, 269 U.S. 341, 347, 46 S. Ct. 135, 70 L. Ed. 295. Certainly since Gillespie v. Oklahoma, 257 U.S. 501, 42 S. Ct. 171, 66 L. Ed. 338, it has been the settled doctrine here that where the principal is absolutely immune, no valid tax can be laid upon income arising therefrom. To tax this would amount practically to laying a burden on the exempted principal. Accordingly if the challenged Act, whatever called, really imposes a direct charge upon interest derived from United States bonds, it is pro tanto void.'"

In the case of New Jersey Realty Title Insurance Company v. Division of Tax Appeals in Department of Taxation and Finance

of New Jersey, et al, (338 U.S. 655, 70 S. Ct. Reporter 413)
decided February 6, 1950, the United States Supreme Court ruled
as follows:

"4. Taxation

The federal statute generally exempting interest-bearing obligations of the United States from state and local taxation was enacted to prevent taxes which diminish in the slightest degree the market value or investment attractiveness of obligations issued by the United States in an effort to secure necessary credit. 31 U.S.C.A. § 742; U.S.C.A. Const. art. 1, § 8."

"5. Taxation

The federal statute generally exempting interest-bearing obligations of the United States from state and local taxation also exempts accrued but unpaid interest on federal securities. 31 U.S.C.A. § 742."

The court in the above case in commenting upon the failure of the Congress to include the words "and interest thereon" in Section 3701 of the Revised Statutes (above quoted) used the following language, at page 419 of the Supreme Court Reporter:

" * * * Congress on occasion has expressly declared an exemption from state taxation of interest on federal securities, and we do not find a contrary purpose disclosed by the omission from § 3701 of the phrase 'and interest thereon.'"

Therefore, we are of the opinion that income received from United States Government Obligations is not taxable under the provisions of the Arizona State Income Tax Law.

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