

terest) which are not expenses of a trade or business and which are allocable to production of tax-exempt interest are not deductible. Interest on all indebtedness incurred or continued to purchase or carry tax-exempt obligations is not deductible.

6. STATE AND LOCAL PUBLIC RETIREMENT FUNDS

The investment income of funds created by State and local governments to provide for the retirement of their employees is normally exempt from tax, either on the ground that they are qualified pension plans or that they are instrumentalities of the State or local government. This being the case, no tax advantage inures to the fund from investing in municipal obligations.

7. STATE AND LOCAL GOVERNMENTS

State and local governments and their instrumentalities and agencies are exempt from Federal income taxation. There is, therefore, no tax benefit to be derived from investing idle funds in municipal obligations.

8. NONINSURED PENSION FUNDS

Certain pension funds which do not discriminate between employees and meet other tests for qualification are exempt from tax, and are accordingly not taxed on their investment income. Therefore, they do not receive any tax advantages by virtue of investments in municipal obligations as compared to taxable securities.

The investment income of pension trusts which do not meet the qualifications for exemption from tax is taxed to the trust. Therefore, investments in municipal securities may be advantageous because of the interest exemption.

9. PERSONAL TRUST FUNDS

Personal trust funds are taxed at the rates applicable to individuals on income which is not distributed to beneficiaries. Beneficiaries, on the other hand, are generally taxed on distributions which do not exceed the current income of the trust. However, each item of trust income currently distributed to the beneficiaries preserves its character in their hands in the proportion that such item of income bears to the total income of the trust.¹⁴ Thus if a trust receives tax-exempt interest on municipal bonds which it distributes currently, the beneficiaries are not taxed on the amount of the distribution representing tax-exempt interest. If the trust retains the municipal bond interest, such interest is not taxed to the trust.

In determining the tax-exempt interest allocable to distributions received by beneficiaries, deductions must also be allocated between the various items of income in order that the beneficiaries may not be allowed to offset taxable items of income by expenses attributable to exempt interest.¹⁵

¹⁴ Internal Revenue Code, secs. 652(b), 662(b).

¹⁵ *Ibid.*