

Taxability of Interest and Dividend Income From State, Local, and U.S. Government Obligations

Overview

Interest income from state and local government obligations is exempt federally, but is **taxable** in Nebraska, except interest on bonds issued by Nebraska state and local government subdivisions. This also includes interest on federally taxable bonds (known as Build America Bonds) issued by Nebraska state and local subdivisions under the American Recovery and Reinvestment Act. Interest income from non-Nebraska state and local government obligations must be reported as an adjustment increasing federal adjusted gross income (AGI) for Nebraska purposes.

Interest and dividend income from U.S. government obligations is subject to federal income tax but is exempt from state income tax by federal law. This includes interest and dividend income from U.S. territories and possessions that are taxed federally. Interest and dividend income from U.S. government obligations is reported as an adjustment decreasing federal AGI for Nebraska purposes.

Income from a regulated investment company which invests in state and local obligations is taxable, except the portion of any income attributable to Nebraska source bonds. Dividends from a regulated investment company investing directly in exempt U.S. government obligations are deductible to the extent they represent exempt U.S. government obligations.

Use [Nebraska Schedule I – Nebraska Adjustments to Income](#), to report both adjustments increasing and decreasing income.

This information guide is intended to provide an overview. Nothing in this document supersedes, alters, or otherwise changes any provisions of the Nebraska tax code, regulations, Department rulings, or court decisions.



This information guide may change with updated information or added examples. The Department recommends you do not print this guide. Instead, sign up for the subscription service at revenue.nebraska.gov to get updates on your topics of interest.

Terms

Adjustments Decreasing Federal AGI. Adjustments decreasing federal AGI reflect items of income that are taxed federally, but are exempt in Nebraska.

Adjustments Increasing Federal AGI. Adjustments increasing federal AGI reflect items of income that are tax exempt federally, but are taxed by Nebraska.

State and Local Government Obligations. State and local government obligations are state and municipal bonds issued by state and local subdivisions.

U.S. Government Obligations. U.S. government obligations are bonds and other federal certificates, notes, etc.

State and Local Government Obligations

The total of all interest income from state and local government obligations that is federally tax exempt must be reported on [Nebraska Schedule I](#), Part A, as an adjustment increasing federal AGI. The amount must include any income from a regulated investment company (including certain mutual funds) which invests in state and local government obligations. While this income is exempt for federal tax purposes, it is an addition to income for Nebraska income tax purposes. This amount can be reduced by expenses not previously deducted, which relate to the production of this income, only if you claim federal itemized deductions.

However, interest from bonds issued by Nebraska state and local government subdivisions, including any part of a fund dividend attributable to Nebraska source bonds, is not subject to Nebraska tax. This would include any Nebraska-based bond that is taxable as a Build America Bond under the American Recovery and Reinvestment Act of 2009. Recovery Zone Economic Development Bonds and Qualified School Construction Bonds that are classified as Build America Bonds may also be deducted if issued by a Nebraska governmental unit. Show the Nebraska amount on Form 1040N, Schedule I, to reduce the total amount of state and local bond interest income added as an increase to federal AGI.

Exempt interest income from Nebraska state and local government obligations includes:

- ❖ Municipal water bonds;
- ❖ Nebraska public power district (NPPD, OPPD, and LES) bonds;
- ❖ Federally exempt Nebraska Investment Finance Authority (NIFA) bonds;
- ❖ Local city or village bonds; and
- ❖ School district bonds.

Also, interest income from the obligations of Puerto Rico, Guam, and the Virgin Islands should not be included as income from state and local obligations. Federal law prohibits states from taxing this income.

U.S. Government Obligations

Interest and dividend income from obligations of the United States, its territories, and possessions are exempt from state income tax. Interest and dividend income included in federal AGI from U.S. government obligations may be reported on Nebraska Schedule I, Part B, as adjustments decreasing federal AGI. The type of obligation and the amount received must be entered on the Form 1040N, Schedule I. If the space provided on Form 1040N, Schedule I is not sufficient, attach a worksheet listing all obligations and amounts for which a deduction is claimed.

NOTE: Capital gains from the sale of U.S. government obligations are not deductible.

Exempt U.S. government obligations include, but are not limited to:

- 1 U.S. government bonds, such as series EE and HH savings bonds;
- 2 U.S. Treasury bills;
- 3 U.S. government notes;
- 4 U.S. government certificates;
- 5 Commodity Credit Corporation;
- 6 Federal Home Loan Banks;
- 7 Federal Reserve Banks;
- 8 Federal Savings and Loan Insurance Corporation;
- 9 Farm Credit Bank Consolidated System-wide bonds;
- 10 Farm Credit System including the following members unless noted elsewhere –
 - a Federal Land Banks and Federal Land Bank Associations;
 - b Federal Intermediate Credit Banks;

- c** Federal Farm Mortgage Corporation; and
 - d** Any other institution chartered by and subject to the supervision of the Farm Credit Administration unless noted elsewhere;
- 11** General Service Administration Participation Certificates;
 - 12** Federal Housing Finance Board;
 - 13** Resolution Trust Corporation; and
 - 14** Reconstruction Finance Corporation.

Interest, but not dividend income, included in federal AGI from the following sources is deductible for Nebraska individual income tax purposes:

- 1** Federal Deposit Insurance Corporation (FDIC);
- 2** Student Loan Marketing Association;
- 3** Production Credit Association; and
- 4** Central Bank for Cooperatives.

Obligations Which Cannot be Deducted for Nebraska Tax Purposes

Several quasi-governmental organizations issue bonds which are not considered to be backed by the full faith and credit of the U.S. government, or whose licensing act did not specifically exempt them from state taxation. The following are NOT deductible for Nebraska purposes:

- 1** Federal or State Banks;
- 2** Federal or State Savings and Loan Associations;
- 3** Building and Loan Associations;
- 4** Postal Savings Accounts (discontinued in 1966);
- 5** Export Import Bank bonds;
- 6** Federal or State Credit Unions;
- 7** Interest on debentures issued to mortgagees of mortgages foreclosed under the National Housing Act, if insured before February 3, 1938;
- 8** Interest on federal income tax refunds;
- 9** Farmers Home Administration;
- 10** New Community debentures;
- 11** Merchant Marine bonds;
- 12** Ship Financing bonds;
- 13** U.S. Merchant Marine Ship notes;
- 14** U.S. Merchant Marine Offshore Ship Services notes;
- 15** Federal Home Loan Mortgage Corporation;
- 16** World Bank;
- 17** International Bank for Reconstruction and Development bonds;
- 18** Asian Development Bank notes and bonds;
- 19** Inter-American Development Bank bonds;
- 20** Interest from U.S. Government Life Insurance (unless exempted by I.R.C. § 101[d][1][B]);
- 21** Bankers' Acceptance;

Nondeductible Obligations (Continued)

- 22 Certificates of Deposit;
- 23 Penn Central Transportation certificates;
- 24 Federal Financing Bank;
- 25 Federal National Mortgage Association (FNMA);
- 26 Federal Mortgage Corporation (FMC);
- 27 Government National Mortgage Association (GNMA);
- 28 Chrysler Corporation secured notes;
- 29 Lockheed convertible bonds; and
- 30 Washington Metropolitan Area Transit Authority bonds.

Certain government money market or mutual funds issued by regulated investment companies claim to be obligations of the U.S. government. Nebraska law provides that dividends from a regulated investment company investing **directly** in exempt U.S. government obligations are deductible to the extent they represent exempt U.S. government obligations. To claim a deduction, the fund must issue to the holder a statement showing the percentage of the dividend which represents exempt U.S. government obligations. If you have received a dividend from this type of fund, you must list the name of the fund and the portion of the dividend representing exempt U.S. government obligations.

Interest income from repurchase agreements involving U.S. government obligations is not deductible as U.S. government interest, and cannot be taken as an adjustment decreasing federal AGI. Capital gains from the sale of U.S. government obligations are also not deductible.

Resource List

- ❖ [Individual Income Tax Reg-22-002.05A and .06A](#)
- ❖ [Neb. Rev. Stat. § 77-2716](#)

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