

February 19, 1926.

OPINION No. 1325.

TAXATION: INCOME TAX EXEMPTION NOT ALLOWED ON CERTAIN INTEREST PAYMENTS FROM THE FEDERAL GOVERNMENT:

When the Federal Government repays, with interest, overpayments of Federal taxes, neither the principal of the refund nor the interest thereon is exempt from Territorial taxation.

Honorable Henry C. Hapai,
Treasurer, Territory of Hawaii,
Honolulu, Hawaii.

Dear Sir:

Under date of February 15th you submitted to this department a letter from Mr. Harold C. Hill, Income Tax Assessor, First Division, dated February 13, 1926, in which the following question was presented:

Certain plantations represented in this Territory by Theo. H. Davies & Co., Ltd., and by Castle & Cooke, Limited, overpaid their Federal income and profits taxes during the years 1920 and 1921. In 1925 the Federal Government refunded the overpayments with interest at six per cent per annum. The plantation agencies referred to now request my opinion as to whether or not *the interest* paid by the Federal Government is taxable to the recipients for Territorial income tax purposes.

I beg to advise you that in my opinion the interest upon these refunded payments is no more exempt from taxation than is the refund proper.

It has been suggested that the interest on these

refunds is “interest upon obligations of the United States” (in the language of the departmental regulations) and would therefore be exempt from Territorial taxation. The departmental regulation just quoted, however, in my opinion clearly refers to a different character of obligation.

The departmental regulation that “interest upon obligations of the United States” is exempt from taxation, is founded upon either (a) general principles of constitutional law or (b) Section 3701 of the Revised Statutes of the United States.

It is, of course, not competent for the several states (or territories) to tax income derived from the bonds or other obligations of the Federal Government—this because of the general constitutional principle of the necessary independence of the federal and state (territorial) governments which would prohibit the income tax law of any state or territory including interest on the bonds or other *public securities* of the United States.

Black on Income Taxes (2nd Ed.), Sections 204 and 244, and authorities cited.

Furthermore, Section 3701 of the United States Revised Statutes (Comp. St. 1913, Sec. 6816) provides that “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”.

It would seem to be the clear intent of the law whether approached from the constitutional standpoint or from that of the federal statute above quoted, that “the obligations of the United States” referred to must be bonds and other *public securities* —i.e., securities issued by the Federal government to secure *moneys borrowed* by it.

This, I believe, is the proper, and only, meaning, of the expression “interest upon obligations of the United States” in the sense in which said language applies to the point under discussion.

But the case under discussion is one where moneys belonging to a taxpayer were improperly paid over to the United States which later repays same, together with interest by way of reparation for the illegal detention of such money. And the result is that neither the principal amount refunded nor the the accrued interest on same would be exempt from taxation as “an obligation of the United States”, but both would represent income for the year 1925 which is taxable as any income would be.

Trusting that this answers your inquiry, and that of the Income Tax Assessor, I am

Respectfully yours,

WILLIAM B. LYMER,

Attorney General.