2006 Tax Legislation - Reporting Tax-Exempt Interest

Congress recently passed the Tax Increase Prevention and Reconciliation Act (Tax Reconciliation Act). The Tax Increase Prevention and Reconciliation Act requires that interest paid on tax-exempt obligations be subject to information reporting similar to that of taxable interest income. Therefore, a Form 1099 or similar form will be issued to you for tax-exempt interest income you receive during the calendar year over $10 after 2005. You have always been required to report the entire amount of any tax-exempt interest you receive. However, because of the new reporting requirements, the IRS will now have the information documents necessary to reconcile the amounts reported on your tax return with their records. It will also be easier for you to compile the information for tax preparation.

Although interest from state and local bonds is tax exempt for federal purposes, it may not be tax exempt for state purposes. In addition, you should be aware that interest on loans used to purchase tax-exempt obligations is not deductible. This rule is to avoid the double benefit of receiving tax free income and reducing income by the interest on the loan proceeds as well. However, there are some exceptions to this rule.

Please call our office at your earliest convenience to discuss these exceptions and evaluate the tax benefits and pitfalls of tax-exempt obligations.