

New Tax-Exempt Interest Reporting Requirements

By

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Congress has enacted legislation that requires the annual reporting of tax-exempt interest paid on municipal obligations, beginning with calendar year 2006. The new Act requires a Form 1099-INT to be mailed out to all persons who have received tax-exempt interest payments from a municipal issuer ("Issuer") in connection with an outstanding obligation (such as bonds, notes or lease agreements). Although this sounds burdensome, an Issuer will only have to send Forms 1099-INT when (a) the Issuer did not hire a corporate paying agent for the obligations, and (b) the obligations were not issued in "book entry" form (i.e., Depository Trust Company or DTC).

For obligations on which interest payments are made by a corporate paying agent, the Form 1099-INT mailings should be handled by the corporate paying agent. For obligations where an Issuer official (finance officer, clerk, secretary, or treasurer) is designated as the paying agent, that designated paying agent will only have to mail Forms 1099-INT for obligations that were not authorized in "book entry" form with DTC as the registered holder (if an issue is in book entry form, the bonds, notes or lease documents will show "CEDE & CO" as the registered owner).

Most obligations that are not book entry are sold in a private placement to a local bank or equipment vendor.

If an Issuer has one or more series of obligations that are not in book entry form, and the Issuer has not hired a corporate paying agent for them, the designated paying agent must, before January 31, 2007, send a Form 1099-INT to all registered holders to whom interest has been paid. For this year only, a "substitute statement" instead of an actual Form 1099-INT may be sent.

The Form 1099-INT or "substitute statement" must include the following information:

- a. The Issuer's name, address and telephone number;
- b. The Issuer's federal identification number;
- c. Payee's name and address;
- d. Payee's taxpayer identification number (TIN). (For bonds or other obligations acquired on or before October 4, 2006 and on which tax-exempt interest will be paid after March 31, 2007, a payee will be treated as satisfying the payee certification requirements if the paying agent obtains from the payee a valid tax identification number by any reasonable manner. This would include an uncertified writing or oral communication by the payee or by a completed, certified Form W-9 by the payee. For bonds or instruments acquired after October 4, 2006 and on which tax-exempt interest will be paid after March 31, 2007, the paying agent must obtain a completed, certified Form W-9 from the

payee. In the future, where a taxpayer identification number is not certified to the paying agent in those cases where it is required, the paying agent will have to comply with the tax withholding regulations.);

- e. Payee's account number;
- f. The amount of tax-exempt interest (including tax-exempt interest that is paid as exempt-interest dividends);
- g. The amount of tax-exempt Alternative Minimum Tax ("AMT") interest (including tax-exempt AMT interest that is paid as exempt-interest dividends), to the extent possible after reasonable effort (requirement "g" above should not apply to most governmental bond issues.); and
- h. Federal income tax withheld, if any.

The Issuer must also file a copy of each Form 1099-INT or "substitute statement" with the Internal Revenue Service by February 28, 2007 using Form 1096.

You can obtain the IRS Forms 1099-INT and 1096 from the IRS website at: <http://www.irs.gov/pub/irs-pdf/f1099int.pdf>. In addition, instructions may be obtained at: <http://www.irs.gov/pub/irs-pdf/i1099int.pdf>.

Under IRS Notice 2006-93 the IRS will not impose penalties under section 6721 or 6722 for failure to report payments attributable to tax exempt interest paid in calendar year 2006. Code section 6721 generally imposes a penalty of \$50 for each information return a payor fails to file, with a cap on the aggregate penalties at \$250,000. Lesser amounts may be imposed if the failure is corrected within 30 days or by August 1, as the case may be, of the following tax year. In addition to the penalties that may be assessed for failure to file the information returns with the Internal Revenue Service, penalties may also be assessed under Code section 6722 for the failure to furnish payees of the interest with proper informational returns. Penalties will be assessed at the amount of \$50 for each failure to provide a payee with the proper statement, with a cap on the total penalties of \$100,000. If the reporting requirements are "intentionally disregarded," more severe penalties may be assessed.

The purpose of this column is to identify issues. It does not purport to be exhaustive or to render legal advice. You should consult with qualified bond counsel or other professionals in developing responses to specific situations.