




State of North Carolina Office of the State Controller

Michael F. Easley, Governor

Robert L. Powell, State Controller

February 19, 2007

TO: Chief Fiscal Officers
Vice Chancellors

FROM: Robert L. Powell 
State Controller

SUBJECT: Tax Exempt Bonds Interest Reporting Requirements
IMMEDIATE ATTENTION REQUIRED

Section 502 of the Tax Increase and Prevention Act of 2005 (TIPRA) amended IRC Section 6049 by eliminating the exemption from information reporting requirements for interest paid on tax-exempt bonds. This means that we must report the interest paid on tax exempt bonds issued by the State on IRS Form 1099-INT beginning with calendar year 2006.

We realize that the notification of this IRS requirement is coming late in the 2006 calendar year tax reporting cycle, however, we must make a good faith effort to comply with this new reporting requirement. Therefore, the following are the general rules that you should follow for 2006 calendar year-end reporting. Rules and procedures for the 2007 calendar year will be issued at a later date.

General Explanation of the Law

Under the IRC, any obligation for which a state or local government pays interest is a bond. This may even include items like copier leases or mail metering machines if the lease is a capital lease or if the transaction is an installment purchase. However, not every lease is a bond issuance for tax purposes, but if there is an interest component then it is a bond issuance. If the requirements for issuing IRS Form 8038 have been met and if the recipient of the interest income is a *reportable payee*, a capital lease or an installment purchase transaction is considered a tax exempt bond issuance and subject to this interest reporting requirement. *Reportable payees* are individuals, partnerships, LLC's, trust and estates. Corporations and tax exempt entities are exempt from this reporting requirement.

The determination of whether or not a tax exempt obligation has been issued should begin at the point of negotiation for the asset by a state agency. The state agency should be able to negotiate a better deal based on the interest component being tax-free to the vendor. If the negotiations determine the interest is to be tax-free, the purchaser (the state agency) should sign and send to

MAILING ADDRESS
1410 Mail Service Center
Raleigh, NC 27699-1410

Telephone: (919) 981-5454
Fax Number: (919) 981-5567
State Courier: 56-50-10
Website: www.ncosc.net

LOCATION
3512 Bush Street
Raleigh, NC

the IRS a Form 8038-G Information Return for Tax-Exempt Governmental Obligations or 8038-GC Information Return for Small Tax-Exempt Governmental Bond Issues, Leases and Installment Sales, thus putting the IRS on notice that the interest will be tax free to the recipient. The recipient should be set up in the vendor file with a supporting Form W-9 or vendor questionnaire. Payments will be subject to the backup withholding rules of IRC Section 3406 if a valid EIN/name combination is not provided.

General Procedures to Follow for Calendar Year 2006 Form 1099-INT Reporting:

1. Review your records to determine if your agency/institution has executed IRS Forms 8038-G or 8038-GC in connection with any bond issuance, installment purchase, or capital lease.
2. Determine if the recipient of interest income paid in connection with that bond issuance, installment purchase, or capital lease is a *reportable payee*.
3. Compute the interest paid during the 2006 calendar year to the *reportable payee* and report on Form 1099-INT, block 8.
4. Summarize all Forms 1099-INT data on IRS Form 1096, Annual Summary and Transmittal of US Information Returns.
5. Mail *reportable payees* the Form 1099-INT with block 8 filled out and also mail to the IRS the Form 1096 and copy A of all the Forms 1099-INT issued for 2006. The copy to the IRS must be mailed by February 28, 2007.

Other General Information You Will Need to Note:

1. NCAS agencies will need to prepare Forms 1099-INT on a manual basis for calendar year 2006.
2. If the total number of 1099-INT forms exceeds 250, they must be transmitted to the IRS electronically, not on paper. **NCAS agencies must notify OSC immediately if that is the case.**
3. The following IRS Forms are attached for your review only: Forms 8038-G, 8038-GC, 1099-INT, and 1096. The IRS will only accept machine readable forms, so these attachments are not satisfactory for filing with the IRS.
4. Please complete the attached survey in connection with this new IRS reporting requirement and return to the Office of the State Controller, Attention: John Morgan by February 27, 2007.

Should you have questions concerning the above, please call Randy Thomas at (919)981-5488 or e-mail randy.thomas@ncosc.net. Thank you for your prompt attention to this matter.

Attachments

Survey of Compliance with IRS Tax Exempt Interest Reporting Requirements

Agency Name _____

Person Completing Survey _____

Telephone Number of Person Completing Survey _____

Agency has reviewed the tax exempt interest reporting requirements? Yes _____ No _____

The agency has issued IRS Forms 8038-G or 8038-GC in the past? Yes _____ No _____

The agency paid tax-exempt interest to reportable payees during 2006? Yes _____ No _____

The agency has issued IRS Forms 1099-INT for 2006, if applicable? Yes _____ No _____

Please return this survey to John Morgan at the Office of the State Controller by February 27, 2007. Thank you.