



De Minimis Tax on Municipal Bonds: When Municipal Bonds aren't Completely Tax-Free

Municipal Bond interest is typically tax-free from Fed and State taxes, and most people think of that to mean that these bonds are totally tax-free. However, some circumstances could apply which change that status.

One exception applies when a municipal bond is purchased at a discount to face value. In such a case, the accretion of the bond at maturity, from the price paid, will be taxable to the investor at their ordinary income tax rate, as opposed to being taxed at a long-term capital gains rate, like you typically see for other types of investments. The only exception to this is if the discount to face value is considered "de minimis", which means that it is of so small an amount, that it is of no concern.

The de minimis rule or exception is only applicable when purchasing municipal bonds at a discount to face value. In such cases, the bond's accretion at maturity, from the price paid, is taxed at the investor's ordinary income tax rate rather than the long-term capital gains rate, which is typically applied to other types of investments. However, the only exception to this is if the discount to face value is deemed "de minimis." Essentially, if the discount is less than 25 basis points per full year to maturity, any gain at maturity will be subjected to long-term capital gains rates. Conversely, if the discount is more, any gain will be subjected to ordinary income rates. This represents a significant risk that must be disclosed at the time of the trade.

Contact your Broker if you have any questions regarding this or any of your investments. Please consult a qualified tax advisor regarding any questions you may have with respect to your personal tax liability.

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