

HASHEM and SIMMS, PLLC
CERTIFIED PUBLIC ACCOUNTANTS

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Dear Client

In general, you are taxable on any interest you receive. You are also taxable on any interest credited to your account, regardless of whether you actually withdraw it. If, however, you cannot withdraw the interest during the taxable year, you are not taxed on that amount. If there would be a "substantial penalty" if you were to withdraw funds (a penalty of three months or more interest on a certificate of deposit of one year or less), the income should not be reported until the year the certificate matures. Income reporting may also be deferred on an account that matures in one year or less and gives a single payment at maturity. You are not taxable on interest earned on these accounts until you can withdraw the funds. Thus, if you put \$10,000 in a one-year CD in January 2006, you will not be taxed on the interest earned in 2006 until your tax year 2007, i.e., April 15, 2008. Please note that if you actually withdraw funds early, any penalty you pay is deductible.

Interest for tax purposes includes certain amounts that financial institutions call "dividends." Some common examples are amounts earned on deposits, or "share accounts," in cooperative banks, credit unions, building and loan associations, savings and loan associations, and mutual savings banks. Also, amounts you earn on bank money market accounts are interest. Interest on insurance dividends that you leave on deposit with the insurance company is taxable when you are able to withdraw it. Such interest is also taxable if it is used to pay premiums. You must also pay tax on interest you receive on tax refunds. Interest on U.S. obligations, such as Treasury bills and Series H or HH bonds, is fully taxable for federal income tax purposes, but is exempt from state and local income tax. If you own Series E or EE bonds, however, you do not have to report the accrued interest until the bond matures, unless you cash it in earlier. Alternatively, you can report the interest you earn each year.

You are generally not taxable for federal income tax purposes on interest received from state or local obligations, i.e., "munibonds."

You must report both taxable and tax-exempt interest on your individual income tax return, Form 1040. Also, if your taxable interest income was more than \$1,500, you must fill out a Schedule B. [Note: Taxpayers who use Form 1040A report interest income in excess of \$1,500 on Schedule 1. Taxpayers having \$1,500 or less of taxable interest income may, in general, use Form 1040EZ.]



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Ordinarily, the payor of interest, including money market funds, will give you a statement of the amount of taxable and tax-exempt interest paid or credited to you during the taxable year. This statement is provided on Form 1099-INT, which is also sent to the IRS.

There is also a type of interest recognized for tax purposes that can arise in various ways, but most commonly when corporate bonds are purchased at a discount or when property is sold on the installment basis. This type of interest may be called "imputed interest," "original issue discount," or "market discount." If you would like more information about this type of interest, please let us know.

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