Publication 550

Investment Income and Expenses

(Including Capital Gains and Losses)

For use in preparing

2022 Returns

Volume 1 of 9

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Future Developments

For the latest information about developments related to Pub. 550, such as legislation enacted after it was published, go to *IRS.gov/Pub550*.

Reminders

Foreign source income. If you are a U.S. citizen with investment income from sources outside the United States (foreign income), you must report that income on your tax return unless it is exempt by U.S. law. This is true whether you reside inside or outside the United States and whether or not you receive a Form 1099 from the foreign payer.

Employee stock options. If you received an option to buy or sell stock or other property as payment for your services, see Pub. 525, Taxable and Nontaxable Income, for the special tax rules that apply.

Disaster relief. Relief is available for those affected by some disasters. See *IRS.gov/DisasterTaxRelief.*

Photographs of missing children. The Internal Revenue Service is a proud partner with the *National Center for Missing & Exploited Children® (NCMEC)*. Photographs of missing children selected by the Center may appear in this publication on pages that would otherwise be blank. You can help bring these children home by looking at the photographs and calling 800-THE-LOST (800-843-5678) if you recognize a child.

Introduction

This publication provides information on the tax treatment of investment income and expenses. It includes information on the tax treatment of investment income and expenses for individual shareholders of mutual funds or other regulated investment companies, such as money market funds. It explains what investment income is taxable and what investment expenses are deductible. It explains when and how to show these items on your tax return. It also explains how to determine and report gains and losses on the disposition of investment property and provides information on property trades and tax shelters.

TIP *The glossary at the end of this publication defines many of the terms used.*

Investment income. This generally includes interest, dividends, capital gains, and other types of distributions including mutual fund distributions.

Investment expenses. These include interest paid or incurred to acquire investment property and expenses to manage or collect income from investment property.

Qualified retirement plans and IRAs. The rules in this publication do not apply to investments held in individual retirement arrangements (IRAs), section 401(k) plans, and other qualified retirement plans. The tax rules that apply to retirement plan distributions are explained in the following publications.

- Pub. 560, Retirement Plans for Small Business.
- Pub. 571, Tax-Sheltered Annuity Plans.

- Pub. 575, Pension and Annuity Income.
- Pub. 590-A, Contributions to Individual Retirement Arrangements (IRAs).
- Pub. 590-B, Distributions from Individual Retirement Arrangements (IRAs).
- Pub. 721, Tax Guide to U.S. Civil Service Retirement Benefits.

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1.

Investment Income

Topics

This chapter discusses:

- *Interest Income*,
- *Discount on Debt Instruments*,
- *When To Report Interest Income*,
- *How To Report Interest Income*,
- *Dividends and Other Distributions*,
- *How To Report Dividend Income*,
- *Stripped Preferred Stock*,
- *Real estate mortgage investment conduits (REMICs), financial asset securitization investment trusts*

(FASITs), and other collateralized debt obligations (CDOs), *S Corporations*, and

- *Investment Clubs*.

Useful Items

You may want to see:

Publication

- ☐ **525** Taxable and Nontaxable Income
- ☐ **537** Installment Sales
- ☐ **590-B** Distributions from Individual Retirement Arrangements (IRAs)
- ☐ **925** Passive Activity and At-Risk Rules
- ☐ **1212** Guide to Original Issue Discount (OID) Instruments

Form (and Instructions)

- ☐ **Schedule B (Form 1040)** Interest and Ordinary Dividends

- ☐ **Schedule D (Form 1040)** Gains and Losses
- ☐ **1040** U.S. Individual Income Tax Return
- ☐ **1040-SR** U.S. Income Tax Return for Seniors
- ☐ **1099** General Instructions for Certain Information Returns
- ☐ **2439** Notice to Shareholder of Undistributed Long-Term Capital Gains
- ☐ **3115** Application for Change in Accounting Method
- ☐ **6251** Alternative Minimum Tax — Individuals
- ☐ **8582** 8582 Passive Activity Loss Limitations
- ☐ **8615** Tax for Certain Children Who Have Unearned Income

- ☐ **8814** Parents' Election To Report Child's Interest and Dividends
- ☐ **8815** Exclusion of Interest From Series EE and I U.S. Savings Bonds Issued After 1989
- ☐ **8818** Optional Form To Record Redemption of Series EE and I U.S. Savings Bonds Issued After 1989
  8824 8824 Like-Kind Exchanges
- ☐ **8949** Sales and Other Dispositions of Capital Assets
- ☐ **8960** Net Investment Income Tax—Individuals, Estates, and Trusts

See chapter 5, *How To Get Tax Help*, for information about getting these publications and forms.

General Information

A few items of general interest are covered here.

Recordkeeping. You should keep a list of the sources and investment income amounts you receive during the year. Also, keep the forms you receive showing your investment income (Forms 1099-INT, Interest Income, and 1099-DIV, Dividends and Distributions, for example) as an important part of your records.

Net investment income tax (NIIT). You may be subject to the NIIT. The NIIT is a 3.8% tax on the lesser of your net investment income or the amount of your modified adjusted gross income (MAGI) that is over a threshold amount based on your filing status.

Filing Status	Threshold Amount
Married filing jointly	$250,000
Married filing separately	$125,000
Single	$200,000
Head of household (with qualifying person)	$200,000
Qualifying surviving spouse with dependent child	$250,000

For more information, see Form 8960, Net Investment Income Tax—Individuals, Estates, and Trusts, and the Instructions for Form 8960.

Tax on unearned income of certain children. Generally, a child must file Form 8615 if the child:

1. has more than $2,300 of unearned income;
2. is required to file a tax return;
3. meets certain age/earned-income/self-support threshold;
4. has at least one parent alive at the end of the year; and
5. doesn’t file a joint return for the year.

See Form 8615 and its instructions for details.

However, the parent can choose to include the child's interest and dividends on the parent's return if certain requirements are met. Use Form 8814, Parents’ Election To Report Child’s Interest and Dividends, for this purpose.

For more information about the tax on unearned income of children and the parents' election, see Pub. 929, Tax Rules for Children and Dependents.

Beneficiary of an estate or trust. Interest, dividends, and other investment income you receive as a beneficiary of an estate or trust generally is taxable income. You should receive a Schedule K-1 (Form 1041), Beneficiary's Share of Income, Deductions, Credits, etc., from the fiduciary. Your copy of Schedule K-1 (Form 1041) and its instructions will tell you where to report the income on your Form 1040 or 1040-SR.

Taxpayer Identification Number (TIN). You must give your name and TIN (either a social security number (SSN), an employer identification number (EIN), or an individual tax identification number (ITIN)) to any person required by federal tax law to make a return, statement, or other document that relates to you. This includes payers of interest and dividends. If you do not give your TIN to the payer, you may have to pay a penalty. In addition, if you do not provide a certified TIN on Form W-9, Request for Taxpayer Identification Number and Certification, the payer must backup withhold on your interest payments, at a rate of 24%.

TIN for joint account. If the funds in a joint account belong to one person, list that person's name first on the account and give that person's TIN to the payer. (For information on who owns the funds in a joint account, see *Joint accounts*, later.) If the joint account contains combined funds, give the TIN of the person whose name is listed first on the account. This is because only one name and TIN can be shown on Form 1099.

These rules apply both to joint ownership by a married couple and to joint ownership by other individuals. For example, if you open a joint savings account with your child using funds belonging to the child, list the child's name first on the account and give the child's TIN.

Custodian account for your child. If your child is the actual owner of an account that is recorded in your name as custodian for the child, give the child's TIN to the payer. For example, you must give your child's SSN to the payer of dividends on stock owned by your child, even though the dividends are paid to you as custodian.

Penalty for failure to supply TIN. You may be subject to a penalty if, when required, you fail to:

- Include your TIN on any return, statement, or other document;
- Give your TIN to another person who must include it on any return, statement, or other document; or
- Include the TIN of another person on any return, statement, or other document.

The penalty is $50 for each failure up to a maximum penalty of $100,000 for any calendar year.

This penalty may be abated if you can show that your failure to provide the TIN was due to reasonable cause and not to willful neglect.

If you fail to supply a TIN in the manner required, you also may be subject to backup withholding.

Backup withholding. Your investment income generally is not subject to regular withholding. However, it may be subject to backup withholding to ensure that income tax is collected on the income. The bank, broker, or other payer of interest, original issue discount (OID), dividends, cash patronage dividends, or royalties must withhold income tax on these reportable payments at a rate of 24% under backup withholding.

Backup withholding applies if:

1. You do not give the payer your TIN in the required manner;
2. The IRS notifies the payer that you gave an incorrect TIN;
3. The IRS notifies the payer that you are subject to backup withholding on interest or dividends because you underreported interest or dividends on your income tax return; or
4. You are required, but fail, to certify that you are not subject to backup withholding for the reason described in (3).

Certification. For new accounts paying interest or dividends, you must certify under penalties of perjury that your TIN is correct and that you are not subject to backup withholding. Your payer will give you a Form W-9, Request for Taxpayer Identification Number and Certification, or similar form, to make this certification. If you fail to make this certification, backup withholding may begin immediately on your new account or investment.

Underreported interest and dividends. You will be considered to have underreported your interest and dividends if the IRS has determined for a tax year that:

- You failed to include any part of a reportable interest or dividend payment required to be shown on your return, or
- You were required to file a return and to include a reportable interest or dividend payment on that return, but you failed to file the return.

How to stop backup withholding due to underreporting. If you have been notified that you underreported interest or dividends, you can request a determination from the IRS to prevent backup withholding from starting or to stop backup withholding once it has begun. You must show that at least one of the following situations applies.

- No underreporting occurred.
- You have a bona fide dispute with the IRS about whether underreporting occurred.
- Backup withholding will cause or is causing an undue hardship, and it is unlikely that you will underreport interest and dividends in the future.
- You have corrected the underreporting by filing a return if you did not previously file one and by paying all taxes, penalties, and interest due for any underreported interest or dividend payments.

If the IRS determines that backup withholding should stop, it will provide you with a certification and will notify the payers who were sent notices earlier.

How to stop backup withholding due to an incorrect TIN. If the IRS notifies a payer that your TIN is incorrect, the payer must contact you and ask you to provide your correct TIN. Follow the instructions provided by the payer to prevent or stop backup withholding.

Reporting backup withholding. If backup withholding is deducted from your interest or dividend income or other reportable payment, the bank or other business must give you an information return for the year (for example, a Form 1099-INT) indicating the amount withheld. The information return will show any backup withholding as "Federal income tax withheld."

Nonresident aliens. Generally, payments made to nonresident aliens are not subject to backup withholding. You can use Form

W-8BEN, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding and Reporting (Individuals), to certify exempt status. However, this does not exempt you from the 30% (or lower treaty) withholding rate that may apply to your investment income. For information on the 30% rate, see Pub. 519, U.S. Tax Guide for Aliens.

Penalties. There are civil and criminal penalties for giving false information to avoid backup withholding. The civil penalty is $500. The criminal penalty, upon conviction, is a fine of up to $1,000, or imprisonment of up to 1 year, or both.

Where to report investment income. Table 1-1 gives an overview of the forms and schedules to use to report some common types of investment income. But see the rest of this publication for detailed information about re-porting investment income.

Joint accounts. If two or more persons hold property (such as a savings account, bond, or stock) as joint tenants, tenants by the entirety, or tenants in common, each person's share of any interest or dividends from the property is determined by local law.

Community property states. If you are mar-ried and receive a distribution that is community income, half of the distribution generally is con-sidered to be received by each spouse. If you file separate returns, you must each report one-half of any taxable distribution. See Pub. 555, Community Property, for more information on community income.

If the distribution is not considered commun-ity property and you and your spouse file sepa-rate returns, each of you must report your sepa-rate taxable distributions.

Table 1-1. **Where To Report Common Types of Investment Income**

(For detailed information about reporting investment income, see the rest of this publication, especially *How To Report Interest Income* and *How To Report Dividend Income* in chapter 1.)

Type of Income	**If you file Form 1040 or 1040-SR, report on ...**
Tax-exempt interest	Line 2a (See the instructions there.)
Taxable interest	Line 2b (See the instructions there.)
Savings bond interest you will exclude because of higher education expenses	Schedule B; also use Form 8815
Qualified dividends	Line 3a (See the instructions there.)
Ordinary dividends	Line 3b (See the instructions there.)
Capital gain distributions	Line 7, or, if required, Schedule D, line 13. (See the instructions of Form 1040 or 1040-SR.)
Section 1250, 1202, or collectibles gain (Form 1099-DIV, box 2b, 2c, or 2d)	Form 8949 and Schedule D
Nondividend distributions (Form 1099-DIV, box 3)	Generally not reported*
Undistributed capital gains (Form 2439, boxes 1a–1d)	Schedule D
Gain or loss from sales of stocks or bonds	Line 7; also use Form 8949, Schedule D, and the Qualified Dividends and Capital Gain Tax Worksheet or the Schedule D Tax Worksheet
Gain or loss from exchanges of like-kind investment property	Line 7; also use Schedule D, Form 8824, and the Qualified Dividends and Capital Gain Tax Worksheet or the Schedule D Tax Worksheet

*Report any amounts in excess of your basis in your mutual fund shares on Form 8949. Use Part II if you held the shares more than 1 year. Use Part I if you held your mutual fund shares 1 year or less. For details on Form 8949, see *Reporting Capital Gains and Losses* in chapter 4, and the Instructions for Form 8949.

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Example. You and your spouse have a joint money market account. Under state law, half the income from the account belongs to you, and half belongs to your spouse. If you file separate returns, you each report half the income.

Income from property given to a child. Property you give as a parent to your child un-der the Model Gifts of Securities to Minors Act, the Uniform Gifts to Minors Act, or any similar law becomes the child's property.

Income from the property is taxable to the child, except that any part used to satisfy a legal obligation to support the child is taxable to the parent or guardian having that legal obligation.

Savings account with parent as trustee. Interest income from a savings account opened for a minor child, but placed in the name and subject to the order of the parents as trustees, is taxable to the child if, under the law of the state in which the child resides, both of the following are true.

- The savings account legally belongs to the child.
- The parents are not legally permitted to use any of the funds to support the child.

Accuracy-related penalty. An accuracy-related penalty of 20% can be charged for under-payments of tax due to negligence or disregard of rules or regulations or substantial understatement of tax. For information on the penalty and any interest that applies, see *Penalties* in cha-ter 2.

Interest Income

Terms you may need to know (see Glossary):

- Accrual method
- Below-market loan

- Cash method
- Demand loan
- Forgone interest
- Gift loan
- Interest
- Mutual fund
- Nominee
- Original issue discount
- Private activity bond
- Term loan

This section discusses the tax treatment of different types of interest income.

In general, any interest that you receive or that is credited to your account and can be withdrawn is taxable income. Exceptions to this rule are discussed later.

Form 1099-INT. Interest income generally is reported to you on Form 1099-INT, or a similar statement, by banks, savings and loans, and other payers of interest. This form shows you the interest you received during the year. Keep this form for your records. You do not have to attach it to your tax return.

Report on your tax return the total interest income you receive for the tax year. See the Instructions for Recipient of Form 1099-INT to see whether you need to adjust any of the amounts reported to you.

Interest not reported on Form 1099-INT. Even if you do not receive a Form 1099-INT, you must still report all of your interest income. For example, you may receive distributive shares of interest from partnerships or S corporations. This interest is reported to you on Schedule K-1 (Form 1065), Partner's Share of Income, Deductions, Credits, etc., and Schedule K-1

(Form 1120S), Shareholder's Share of Income, Deductions, Credits, etc.

Nominees. Generally, if someone receives interest as a nominee for you, that person must give you a Form 1099-INT showing the interest received on your behalf.

If you receive a Form 1099-INT that includes amounts belonging to another person, see the discussion on *Nominee distributions*, later.

Incorrect amount. If you receive a Form 1099-INT that shows an incorrect amount (or other incorrect information), you should ask the issuer for a corrected form. The new Form 1099-INT you receive should be denoted “Corrected.”

Form 1099-OID. Reportable interest income also may be shown on Form 1099-OID, Original Issue Discount. For more information about amounts shown on this form, see *Original Issue Discount (OID)*, later in this chapter.

Exempt-interest dividends. Form 1099-DIV, box 12, shows exempt-interest dividends from a mutual fund or other regulated investment company paid to you during the calendar year. See the Instructions for Form 1040 or 1040-SR for where to report.

Form 1099-DIV, box 13, shows exempt-interest dividends subject to the alternative minimum tax. This amount is included in box 12. See the Instructions for Form 6251.

Interest on VA dividends. Interest on insurance dividends left on deposit with the Department of Veterans Affairs (VA) is not taxable. This includes interest paid on dividends on converted United States Government Life Insurance policies and on National Service Life Insurance policies.

Individual retirement arrangements (IRAs). Interest on a Roth IRA generally is not taxable. Interest on a traditional IRA is tax deferred. You generally do not include it in your income until you make withdrawals from the IRA. See Pub. 590-B for more information.

Taxable Interest—General

Taxable interest includes interest you receive from bank accounts, loans you make to others, and other sources. The following are some sources of taxable interest.

Dividends that are actually interest. Certain distributions commonly called dividends are actually interest. You must report as interest so-called “dividends” on deposits or on share accounts in:

- Cooperative banks,
- Credit unions,
- Domestic building and loan associations,
- Domestic savings and loan associations,

- Federal savings and loan associations, and
- Mutual savings banks.

The “dividends” will be shown as interest income on Form 1099-INT.

Money market funds. Money market funds are offered by nonbank financial institutions such as mutual funds and stock brokerage houses, and pay dividends. Generally, amounts you receive from money market funds should be reported as dividends, not as interest.

Certificates of deposit and other deferred interest accounts. If you buy a certificate of deposit or open a deferred interest account, interest may be paid at fixed intervals of 1 year or less during the term of the account. You generally must include this interest in your income when you actually receive it or are entitled to receive it without paying a substantial penalty. The same is true for accounts that mature in 1 year or less and pay interest in a single payment at maturity. If interest is deferred for more than 1 year, see *Original Issue Discount (OID)*,

later.

Interest subject to penalty for early withdrawal. If you withdraw funds from a deferred interest account before maturity, you may have to pay a penalty. You must report the total amount of interest paid or credited to your account during the year without subtracting the penalty. See *Penalty on early withdrawal of savings*, later, for more information on how to report the interest and deduct the penalty.

Money borrowed to invest in certificate of deposit. The interest you pay on money borrowed from a bank or savings institution to meet the minimum deposit required for a certificate of deposit from the institution and the interest you earn on the certificate are two separate items. You must report the total interest you earn on the certificate in your income. If you itemize deductions, you can deduct the interest you pay as investment interest, up to the amount of your net investment income. See Interest Expenses in chapter 3.

Example. You deposited $5,000 with a bank and borrowed $5,000 from the bank to make up the $10,000 minimum deposit required to buy a 6-month certificate of deposit. The certificate earned $575 at maturity in 2022, but you received only $265, which represented the $575 you earned minus $310 interest charged on your $5,000 loan. The bank gives you a Form 1099-INT for 2022 showing the $575 interest you earned. The bank also gives you a statement showing that you paid $310 interest for 2022. You must include the $575 in your income. If you itemize your deductions on Schedule A (Form 1040), Itemized Deductions, you can deduct

$310, subject to the net investment income limit.

Gift for opening account. If you receive noncash gifts or services for making deposits or for opening an account in a savings institution, the value may be reported to you as interest income on Form 1099-INT and you may have to report it on your tax return.

For deposits of less than $5,000, gifts or services valued at more than $10 must be reported as interest. For deposits of $5,000 or more, gifts or services valued at more than $20 must be reported as interest. The value is determined by the cost to the financial institution.

Example. You open a savings account at your local bank and deposit $800. The account earns $20 interest. You also receive a $15 calculator. If no other interest is credited to your account during the year, the Form 1099-INT you receive will show $35 interest for the year. You must report $35 interest income on your tax return.

Interest on insurance dividends. Interest on insurance dividends left on deposit with an insurance company that can be withdrawn annually is taxable to you in the year it is credited to your account. However, if you can withdraw it only on the anniversary date of the policy (or other specified date), the interest is taxable in the year that date occurs.

Prepaid insurance premiums. Any increase in the value of prepaid insurance premiums, advance premiums, or premium deposit funds is interest if it is applied to the payment of premiums due on insurance policies or made available for you to withdraw.

U.S. obligations. Interest on U.S. obligations, such as U.S. Treasury bills, notes, and bonds, and obligations issued by any agency or instrumentality of the United States is taxable for federal income tax purposes.

Interest on tax refunds. Interest you receive on tax refunds is taxable income.

Interest on condemnation award. If the condemning authority pays you interest to compensate you for a delay in payment of an award, the interest is taxable.

Installment sale payments. If a contract for the sale or exchange of property provides for deferred payments, it also usually provides for interest payable with the deferred payments. Generally, that interest is taxable when you receive it. If little or no interest is provided for in a deferred payment contract, part of each payment may be treated as interest. See *Unstated Interest and Original Issue Discount (OID)* in Pub. 537.

Interest on annuity contract. Accumulated interest on an annuity contract you sell before its maturity date is taxable.

Usurious interest. Usurious interest is interest charged at an illegal rate. This is taxable as interest unless state law automatically changes it to a payment on the principal.

Interest income on frozen deposits. Exclude from your gross income interest on frozen deposits. A deposit is frozen if, at the end of the year, you cannot withdraw any part of the deposit because:

- The financial institution is bankrupt or insolvent, or
- The state in which the institution is located has placed limits on withdrawals because other financial institutions in the state are bankrupt or insolvent.

The amount of interest you must exclude is the interest that was credited on the frozen deposits minus the sum of:

- The net amount you withdrew from these deposits during the year, and
- The amount you could have withdrawn as of the end of the year (not reduced by any penalty for premature withdrawals of a time deposit).

If you receive a Form 1099-INT for interest income on deposits that were frozen at the end of 2022, see *Frozen deposits*, later, for information about reporting this interest income exclusion on your tax return.

The interest you exclude is treated as credited to your account in the following year. You must include it in income in the year you can withdraw it.

Example. $100 of interest was credited on your frozen deposit during the year. You withdrew $80 but could not withdraw any more as of the end of the year. You must include $80 in your income and exclude $20 from your income for the year. You must include the $20 in your income for the year you can withdraw it.

Bonds traded flat. If you buy a bond at a discount when interest has been defaulted or when the interest has accrued but has not been paid, the transaction is described as trading a bond flat. The defaulted or unpaid interest is not income and is not taxable as interest if paid later. When you receive a payment of that interest, it is a return of capital that reduces the remaining cost basis of your bond. Interest that accrues after the date of purchase, however, is taxable interest income for the year received or accrued. See *Bonds Sold Between Interest Dates*, later in this chapter.

Below-Market Loans

If you make a below-market gift or demand loan, you must report as interest income any forgone interest (defined later) from that loan. The below-market loan rules and exceptions are described in this section. For more information, see section 7872 of the Internal Revenue Code and its regulations.

If you receive a below-market loan, you may be able to deduct the forgone interest as well as any interest you actually paid, but not if it is personal interest.

Loans subject to the rules. The rules for below-market loans apply to:

- Gift loans,
- Compensation-related loans,
- Corporation-shareholder loans,
- Tax avoidance loans, and
- Certain loans made to qualified continuing care facilities under a continuing care contract.

A compensation-related loan is any below-market loan between an employer and an employee or between an independent contractor and a person for whom the contractor provides services.

A tax avoidance loan is any below-market loan where the avoidance of federal tax is one of the main purposes of the interest arrangement.

Forgone interest. For any period, forgone interest is:

- The amount of interest that would be payable for that period if interest accrued on the loan at the applicable federal rate and was payable annually on December 31, minus
- Any interest actually payable on the loan for the period.

Applicable federal rate. Applicable federal rates are published by the IRS each month in the Internal Revenue Bulletin. The Internal Revenue Bulletin is available through *IRS.gov/ IRB*. You also can find applicable federal rates in the Index of Applicable

Federal Rates (AFR) Rulings at
https://irs.gov/applicable-federalrates.

See chapter 5, *How To Get Tax Help*, for other ways to get this information.

Rules for below-market loans. The rules that apply to a below-market loan depend on whether the loan is a gift loan, demand loan, or term loan.

Gift and demand loans. A gift loan is any below-market loan where the forgone interest is in the nature of a gift.

A demand loan is a loan payable in full at any time upon demand by the lender. A demand loan is a below-market loan if no interest is charged or if interest is charged at a rate below the applicable federal rate.

A demand loan or gift loan that is a below-market loan generally is treated as an arm's-length transaction in which the lender is treated as having made:

- A loan to the borrower in exchange for a note that requires the payment of interest at the applicable federal rate, and
- An additional payment to the borrower in an amount equal to the forgone interest.

The borrower generally is treated as transferring the additional payment back to the lender as interest. The lender must report that amount as interest income.

The lender's additional payment to the borrower is treated as a gift, dividend, contribution to capital, pay for services, or other payment, depending on the substance of the transaction. The borrower may have to report this payment as taxable income, depending on its classification.

These transfers are considered to occur annually, generally on December 31.

Term loans. A term loan is any loan that is not a demand loan. A term loan is a below-market loan if the amount of the loan is more than the present value of all payments due under the loan.

A lender who makes a below-market term loan other than a gift loan is treated as transferring an additional lump-sum cash payment to the borrower (as a dividend, contribution to capital, etc.) on the date the loan is made. The amount of this payment is the amount of the loan minus the present value, at the applicable federal rate, of all payments due under the loan. An equal amount is treated as original issue discount (OID). The lender must report the annual part of the OID as interest income. The borrower may be able to deduct the OID as interest expense. See *Original Issue Discount (OID)*, later.

Exceptions to the below-market loan rules. Exceptions to the below-market loan rules are discussed here.

Exception for loans of $10,000 or less. The rules for below-market loans do not apply to any day on which the total outstanding amount of loans between the borrower and lender is $10,000 or less. This exception applies only to:

1. Gift loans between individuals if the gift loan is not directly used to buy or carry income-producing assets, and
2. Compensation-related loans or corporation-shareholder loans if the avoidance of federal tax is not a principal purpose of the interest arrangement.

This exception does not apply to term loans. The general below-market loan rules will continue to apply even if the outstanding balance is reduced to $10,000 or less.

Exception for loans to continuing care facilities. Loans to qualified continuing care facilities under continuing care contracts are not subject to the rules for below-market loans for the calendar year if the lender or the lender's spouse is age 65 or older at the end of the year. For the definitions of qualified continuing care facility and continuing care contract, see Internal Revenue Code 7872(g)(4) and (h).

Exception for loans without significant tax effect. Loans are excluded from the below-market loan rules if their interest arrangements do not have a significant effect on the federal tax liability of the borrower or the lender. These loans include:

1. Loans made available by the lender to the general public on the same terms and conditions that are consistent with the lender's customary business practice;

2. Loans subsidized by a federal, state, or municipal government that are made available under a program of general application to the public;
3. Certain employee-relocation loans;
4. Certain loans to or from a foreign person;
5. Gift loans to a charitable organization, contributions to which are deductible, if the total outstanding amount of loans between the organization and lender is $250,000 or less at all times during the tax year; and
6. Other loans on which the interest arrangement can be shown to have no significant effect on the federal tax liability of the lender or the borrower.

For a loan described in (6) above, all the facts and circumstances are used to determine if the interest arrangement has a significant effect on the federal tax liability of the lender or borrower. Some factors to be considered are:

- Whether items of income and deduction generated by the loan offset each other;
- The amount of these items;
- The cost to you of complying with the below-market loan rules, if they were to apply; and
- Any reasons other than taxes for structuring the transaction as a below-market loan.

If you structure a transaction to meet this exception and one of the principal purposes of that structure is the avoidance of federal tax, the loan will be considered a tax-avoidance loan, and this exception will not apply.

Limit on forgone interest for gift loans of $100,000 or less. For gift loans between individuals, if the outstanding loans between the lender and borrower total $100,000 or less, the forgone interest to be included in income by the lender and deducted by the borrower is limited to the amount of the borrower's net investment income for the year. If the borrower's net investment income is $1,000 or less, it is treated as zero. This limit does not apply to a loan if the avoidance of federal tax is one of the main purposes of the interest arrangement.

U.S. Savings Bonds

This section provides tax information on U.S. savings bonds. It explains how to report the interest income on these bonds and how to treat transfers of these bonds.

U.S. savings bonds currently offered to individuals include Series EE bonds and Series I bonds.

For information about U.S. savings bonds, go to *www.treasurydirect.gov/savings-bonds/*. Also, go to *www.treasurydirect.gov/contact-us/* and click on a topic to find answers to your questions by email.

If you prefer, write to:

Treasury Retail Securities Services
P.O. Box 9150
Minneapolis, MN 55480-9150

Accrual method taxpayers. If you use an accrual method of accounting, you must report interest on U.S. savings bonds each year as it accrues. You cannot postpone reporting interest until you receive it or until the bonds mature.

Cash method taxpayers. If you use the cash method of accounting, as most individual taxpayers do, you generally report the interest on U.S. savings bonds when you receive it. But see *Reporting options for cash method taxpayers*, later.

Series H and HH bonds. These bonds were issued at face value in exchange for other savings bonds.

Series HH bonds were issued between 1980 and 2004. They mature 20 years after issue. Series HH bonds that have not matured pay interest twice a year, usually by direct deposit to your bank account. If you are a cash method taxpayer, you must report this interest as income in the year you receive it.

Series H bonds were issued before 1980. All Series H bonds have matured and are no longer earning interest.

In addition to the twice-a-year interest payments, most H/HH bonds also have a deferred interest component.

Series EE and Series I bonds. Interest on these bonds is payable when you redeem the bonds. The difference between the purchase price and the redemption value is taxable interest.

Series E and EE bonds. Series E bonds were issued before 1980. All Series E bonds have matured and are no longer earning interest. Series EE bonds were first offered in January 1980 and have a maturity period of 30 years; they were offered in paper (definitive) form until 2012. Paper Series EE and Series E bonds were issued at a discount and increase in value as they earn interest. Electronic (book-entry) Series EE bonds were first offered in 2003; they are issued at face value and increase in value as they earn interest. For all Series E and Series EE bonds, the purchase price plus all accrued interest is payable to you at redemption.

Series I bonds. Series I bonds were first offered in 1998. These are inflation-indexed bonds issued at face value with a maturity period of 30 years. Series I bonds increase in value as they earn interest. The face value plus all accrued interest is payable to you at redemption.

Reporting options for cash method taxpayers. If you use the cash method of reporting income, you can report the interest on Series EE, Series E, and Series I bonds in either of the following ways.

1. ***Method 1.*** Postpone reporting the interest until the earlier of the year you cash or dispose of the bonds or the year in which they mature. (However, see *Savings bonds traded*, later.) **Note.** Series EE bonds issued in 1992 matured in 2022. If you have used method 1, you generally must report the interest on these bonds on your 2022 return. The last Series E bonds were issued in 1980 and matured in 2010. If you used method 1, you generally should have reported the interest on these bonds on your 2010 return.

2. ***Method 2.*** Choose to report the increase in redemption value as interest each year.

You must use the same method for all Series EE, Series E, and Series I bonds you own. If you do not choose method 2 by reporting the increase in redemption value as interest each year, you must use method 1.

TIP *If you plan to cash your bonds in the same year you will pay for higher education expenses, you may want to use method 1 because you may be able to exclude the interest from your income. To learn how, see* Education Savings Bond Program*, later.*

Change from method 1. If you want to change your method of reporting the interest from method 1 to method 2, you can do so without permission from the IRS. In the year of change, you must report all interest accrued to date and not previously reported for all your bonds.

Once you choose to report the interest each year, you must continue to do so for all Series EE, Series E, and Series I bonds you own and for any you get later, unless you request permission to change, as explained next.

Change from method 2. To change from method 2 to method 1, you must request permission from the IRS. Permission for the change is automatically granted if you send the IRS a statement that meets all the following requirements.

1. You have typed or printed the following number at the top: "131."
2. It includes your name and social security number under "131."
3. It includes the year of change (both the beginning and ending dates).
4. It identifies the savings bonds for which you are requesting this change.
5. It includes your agreement to:

a. Report all interest on any bonds acquired during or after the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest; and

b. Report all interest on the bonds acquired before the year of change when the interest is realized upon disposition, redemption, or final maturity, whichever is earliest, with the exception of the interest reported in prior tax years.

You must attach this statement to your tax return for the year of change, which you must file by the due date (including extensions).

You can have an automatic extension of 6 months from the due date of your return for the year of change (excluding extensions) to file the statement with an amended return. On the statement, type or print "Filed pursuant to section 301.9100-2.” To get this extension, you must have filed your original return for the year of the change by the due date (including extensions). See also Revenue Procedure 2015-13, Section 6.03(4).

Instead of filing this statement, you can request permission to change from method 2 to method 1 by filing Form 3115. In that case, follow the form instructions for an automatic change. No user fee is required.

Co-owners. If a U.S. savings bond is issued in the names of co-owners, such as you and your child or you and your spouse, interest on the bond generally is taxable to the co-owner who bought the bond.

One co-owner's funds used. If you used your funds to buy the bond, you must pay the tax on the interest. This is true even if you let the other co-owner redeem the bond and keep all the proceeds. Under these circumstances, the co-owner who redeemed the bond will receive a Form 1099-INT at the time of redemption and must provide you with another Form 1099-INT showing the amount of interest from the bond taxable to you. The co-owner who redeemed the bond is a “nominee.” See *Nominee distributions*, later, for more information about how a person who is a nominee reports interest income belonging to another person.

Both co-owners' funds used. If you and the other co-owner each contribute part of the bond's purchase price, the interest generally is taxable to each of you in proportion to the amount each of you paid.

Community property. If you and your spouse live in a community property state and hold bonds as community property, one-half of the interest is considered received by each of you. If you file separate returns, each of you generally must report one-half of the bond interest. For more information about community property, see Pub. 555.

Table 1-2. These rules are also shown in Table 1-2.

Child as only owner. Interest on U.S. savings bonds bought for and registered only in the name of your child is income to your child, even if you paid for the bonds and are named as beneficiary. If the bonds are Series EE, Series E, or Series I bonds, the interest on the bonds is income to your child in the earlier of the year the bonds are cashed or disposed of or the year the bonds mature, unless your child chooses to report the interest income each year.

Table 1-2. **Who Pays the Tax on U.S. Savings Bond Interest**

IF ...	**THEN the interest must be reported by ...**
you buy a bond in your name and the	you.

name of another person as co-owners, using only your own funds	
you buy a bond in the name of another person, who is the sole owner of the bond	the person for whom you bought the bond.
you and another person buy a bond as co-owners, each contributing part of the purchase price	both you and the other co-owner, in proportion to the amount each paid for the bond.
you and your spouse, who live in a community property state, buy a bond that is community property	you and your spouse. If you file separate returns, both you and your spouse generally

	report half of the interest.

Choice to report interest each year. The choice to report the accrued interest each year can be made either by your child or by you for your child. This choice is made by filing an in-come tax return that shows all the interest earned to date, and by stating on the return that your child chooses to report the interest each year. Either you or your child should keep a copy of this return.

Unless your child is otherwise required to file a tax return for any year after making this choice, your child does not have to file a return only to report the annual accrual of U.S. savings bond interest under this choice. However, see *Tax on unearned income of certain children*, earlier, under *General Information*. Neither you nor your child can change the way you report the interest unless you request permission from the IRS, as discussed earlier under *Change from method 2*.

Ownership transferred. If you bought Series E, Series EE, or Series I bonds entirely with your own funds and had them reissued in your co-owner's name or beneficiary's name alone, you must include in your gross income for the year of reissue all interest that you earned on these bonds and have not previously reported. But, if the bonds were reissued in your name alone, you do not have to report the interest accrued at that time.

This same rule applies when bonds (other than bonds held as community property) are transferred between spouses or incident to divorce.

Example. You bought Series EE bonds entirely with your own funds. You did not choose to report the accrued interest each year. Later, you transfer the bonds to your former spouse under a divorce agreement. You must include the deferred accrued interest, from the date of the original issue of the bonds to the date of transfer, in your income in the year of transfer. Your former spouse includes in income the interest on the bonds from the date of transfer to the date of redemption.

Purchased jointly. If you and a co-owner each contributed funds to buy Series E, Series EE, or Series I bonds jointly and later have the bonds reissued in the co-owner's name alone, you must include in your gross income for the year of reissue your share of all the interest earned on the bonds that you have not previously reported. The former co-owner does not have to include in gross income at the time of reissue his or her share of the interest earned that was not reported before the transfer. This interest, however, as well as all interest earned after the reissue, is income to the former co-owner.

This income-reporting rule also applies when the bonds are reissued in the name of your former co-owner and a new co-owner. But the new co-owner will report only his or her share of the interest earned after the transfer.

If bonds that you and a co-owner bought jointly are reissued to each of you separately in the same proportion as your contribution to the purchase price, neither you nor your co-owner has to report at that time the interest earned be-fore the bonds were reissued.

Example 1. You and your spouse each spent an equal amount to buy a $1,000 Series EE savings bond. The bond was issued to you and your spouse as co-owners. You both post-pone reporting interest on the bond. You later have the bond reissued as two $500 bonds, one in your name and one in your spouse's name. At that time neither you nor your spouse has to report the interest earned to the date of reissue.

Example 2. You bought a $1,000 Series EE savings bond entirely with your own funds. The bond was issued to you and your spouse as co-owners. You both postponed reporting interest on the bond. You later have the bond re-issued as two $500 bonds, one in your name and one in your spouse's name. You must re-port half the interest earned to the date of reis-sue.

Transfer to a trust. If you own Series E, Series EE, or Series I bonds and transfer them to a trust, giving up all rights of ownership, you must include in your income for that year the interest earned to the date of transfer if you have not already reported it. However, if you are considered the owner of the trust and if the increase in value both before and after the transfer continues to be taxable to you, you can continue to defer reporting the interest earned each year. You must include the total interest in your in-come in the year you cash or dispose of the bonds or the year the bonds finally mature, whichever is earlier.

The same rules apply to previously unreported interest on Series EE or Series E bonds if the transfer to a trust consisted of Series HH or Series H bonds you acquired in a trade for the Series EE or Series E bonds. See *Savings bonds traded*, later.

Decedents. The manner of reporting interest income on Series E, Series EE, or Series I bonds, after the death of the owner (decedent), depends on the accounting and income-reporting methods previously used by the decedent.

Decedent who reported interest each year. If the bonds transferred because of death were owned by a person who used an accrual method, or who used the cash method and had chosen to report the interest each year, the interest earned in the year of death up to the date of death must be reported on that person's final return. The person who acquires the bonds includes in income only interest earned after the date of death.

Decedent who postponed reporting interest. If the transferred bonds were owned by a decedent who had used the cash method and had not chosen to report the interest each year, and who had bought the bonds entirely with his or her own funds, all interest earned before death must be reported in one of the following ways.

1. The surviving spouse or personal representative (executor, administrator, etc.) who files the final income tax return of the decedent can choose to include on that return all interest earned on the bonds before the decedent's death. The person who acquires the bonds then includes in income only interest earned after the date of death.

2. If the choice in (1) is not made, the interest earned up to the date of death

is income in respect of the decedent and should not be included in the decedent's final return. All interest earned both before and after the decedent's death (except any part reported by the estate on its income tax return) is income to the person who acquires the bonds. If that person uses the cash method and does not choose to report the interest each year, he or she can postpone reporting it until the year the bonds are cashed or disposed of or the year they mature, whichever is earlier. In the year that person reports the interest, he or she can claim a deduction for any federal estate tax paid on the part of the interest included in the decedent's estate.

For more information on income in respect of a decedent, see Pub. 559, Survivors, Executors, and Administrators.

Example 1. Your uncle, a cash method taxpayer, died and left you a $1,000 Series EE bond. He had bought the bond for $500 and had not chosen to report the interest each year. At the date of death, interest of $200 had accrued on the bond, and its value of $700 was included in your uncle's estate. Your uncle's executor chose not to include the $200 accrued interest in your uncle's final income tax return. The $200 is income in respect of the decedent.

You are a cash method taxpayer and do not choose to report the interest each year as it is earned. If you cash the bond when it reaches a value of $1,000, you report $500 interest income—the difference between the value of $1,000 and the original cost of $500.

Example 2. If, in *Example 1*, the executor had chosen to include the $200 accrued interest in your uncle's final return, you would report only $300 as interest when you cashed the bond. $300 is the interest earned after your uncle's death.

Example 3. If, in _Example 1_, you make or have made the choice to report the increase in redemption value as interest each year, you include in gross income for the year you acquire the bond all of the unreported increase in value of all Series E, Series EE, and Series I bonds you hold, including the $200 on the bond you inherited from your uncle.

Example 4. When your aunt died, she owned Series HH bonds that she had acquired in a trade for Series EE bonds. You were the beneficiary of these bonds. Your aunt used the cash method and did not choose to report the interest on the Series EE bonds each year as it accrued. Your aunt's executor chose not to include any interest earned before your aunt's death on her final return.

The income in respect of the decedent is the sum of the unreported interest on the Series

EE bonds and the interest, if any, payable on the Series HH bonds but not received as of the date of your aunt's death. You must report any interest received during the year as income on your return. The part of the interest payable but not received before your aunt's death is income in respect of the decedent and may qualify for the estate tax deduction. For information on when to report the interest on the Series EE bonds traded, see *Savings bonds traded*, later.

Savings bonds distributed from a retirement or profit-sharing plan. If you acquire a U.S. savings bond in a taxable distribution from a retirement or profit-sharing plan, your income for the year of distribution includes the bond's redemption value (its cost plus the interest accrued before the distribution). When you redeem the bond (whether in the year of distribution or later), your interest income includes only the interest accrued after the bond was distributed. To figure the interest reported as a taxable distribution and your interest income when you redeem the bond, see *Worksheet for savings bonds distributed from a retirement or profit-sharing plan*, later.

Savings bonds traded. Prior to September 2004, you could trade (exchange) Series E or EE bonds for Series H or HH bonds. At the time of the trade, you had the choice to postpone (defer) reporting the interest which had been earned on your Series E or EE bonds until the Series H or HH bonds received in the trade were redeemed or matured. Any cash you received in the transaction was income up to the amount of the interest that had accrued on the Series E or EE bonds. The amount of income that you chose to postpone reporting was recorded on the face of the Series H or HH bonds as "Deferred Interest"; this amount is also equal to the difference between the redemption value of the Series H or HH bonds and your cost. Your cost is the sum of the amount you paid for the exchanged Series E or EE bonds plus any amount you had to pay at the time of the transaction.

Example. You traded Series EE bonds that cost you $2,200 (on which you postponed reporting the interest) for $2,500 in Series HH bonds and $223 in cash. At the time of the trade, the Series EE bonds had accrued interest of $523 and a redemption value of $2,723.

You reported the $223 as taxable income on your tax return.

You hold the Series HH bonds until maturity, when you receive $2,500. You must report $300 as interest income in the year of maturity. This is the difference between their redemption value, $2,500, and your cost, $2,200 (the amount you paid for the Series EE bonds).

Note. The $300 amount that is reportable upon redemption or maturity may be found on the face of the Series HH bond as “Deferred Interest.” If more than one Series HH bond is received in the exchange, the total amount of interest postponed/deferred in the transaction is divided proportionately among the Series HH bonds.

Choice to report interest in year of trade. You could have chosen to treat all of the previously unreported accrued interest on Series EE or Series E bonds traded for Series HH bonds as income in the year of the trade. If you made this choice, it is treated as a change from method 1. See *Change from method 1*, earlier.

Note. If you chose to report all of the previously unreported interest in the year of the trade, then there would be the no "Deferred Interest" recorded on the face of the new bond.

Note. The subsequent annual interest earnings on the Series HH bonds received in the exchange would be paid and reported annually by Treasury regardless of whether the previously accrued interest was further deferred or reported in the year of the exchange.

Form 1099-INT for U.S. savings bond interest. When you cash a bond, the bank or other payer that redeems it must give you a Form 1099-INT if the interest part of the payment you receive is $10 or more. Box 3 of your Form 1099-INT should show the interest as the difference between the amount you received and the amount paid for the bond. However, your Form 1099-INT may show more interest than you have to include on your income tax return. For example, this may happen if any of the following are true.

- You chose to report the increase in the redemption value of the bond each year. The interest shown on your Form

1099-INT will not be reduced by amounts previously included in income.

- You received the bond from a decedent. The interest shown on your Form 1099-INT will not be reduced by any interest reported by the decedent before death, or on the decedent's final return, or by the estate on the estate's income tax return.
- Ownership of the bond was transferred. The interest shown on your Form 1099-INT will not be reduced by interest that accrued before the transfer.

Note. This is true for paper bonds. Treasury reporting process for electronic bonds is more refined. If Treasury is aware that the transfer of an electronic savings bond is a reportable event, then the transferor will receive a 1099-INT for the year of the transfer for the interest accrued up to the time of the transfer; when the transferee later disposes of the bond (redemption, maturity, or further transfer), the transferee will receive a 1099-INT showing interest accrued reduced by the amount reported to the transferor at the time of the original transfer.

- You were named as a co-owner, and the other co-owner contributed funds to buy the bond. The interest shown on your Form 1099-INT will not be reduced by the amount you received as nominee for the other co-owner. (See *Co-owners*, earlier, for more information about the reporting requirements.)
- You received the bond in a taxable distribution from a retirement or profit-sharing plan. The interest shown on your Form 1099-INT will not be reduced by the interest portion of the amount taxable as a distribution from the plan and not taxable as interest.

(This amount generally is shown on Form 1099-R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., for the year of distribution.)

For more information on including the correct amount of interest on your return, see *U.S. savings bond interest previously reported* or *Nominee distributions*, later.

Interest on U.S. savings bonds is exempt from state and local taxes. The Form 1099-INT you receive will indicate the amount that is for U.S. savings bonds interest in box 3. Do not include this income on your state or local income tax return.

Education Savings Bond Program

You may be able to exclude from income all or part of the interest you receive on the redemption of qualified U.S. savings bonds during the year if you pay qualified higher education expenses during the same year. This exclusion is known as the Education Savings Bond Program.

You do not qualify for this exclusion if your filing status is married filing separately.

Form 8815. Use Form 8815 to figure your exclusion. Attach the form to your Form 1040 or 1040-SR.

Qualified U.S. savings bonds. A qualified U.S. savings bond is a Series EE bond issued after 1989 or a Series I bond. The bond must be issued either in your name (sole owner) or in your and your spouse's names (co-owners). You must be at least 24 years old before the bond's issue date. For example, a bond bought by a parent and issued in the name of his or her child under age 24 does not qualify for the exclusion by the parent or child.