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[As Tax Season Arrives, 8 Ways You Can Get Taxed on Municipal Bonds.]

It's tax season and the April tax filing deadline is less than two weeks away. Death and taxes are both supposed to be unavoidable. Most people do eventually come to the realization that death is the inevitable outcome in the game of life. When it comes to investing, some investors do manage to get tax-free income by investing in municipal bonds. Some muni-bond investments just might not be quite as tax-free as some investors hope.

After featuring the [19 mistakes that the IRS does not want you to make], 24/7 Wall St. wanted to remind investors that the world of muni bonds can still create instances in which investors may have to pay taxes.

What is generally not taxed at the federal level by the Internal Revenue Service is basic coupon payments and income. Other aspects of muni-bond investments may get taxed directly, while other aspects of them may inadvertently trigger other federal taxes. There can also end up being taxes at the state level.

It is always important for investors to understand exactly what it is that they own. It is each investor's responsibility to know whether or not they will get taxed on something they think is tax-free. Relying solely upon a broker to say a muni-bond is tax-free will not get investors out of a tax bill. Sadly, investors also might have to pay taxes even though a tax professional might have thought a muni-bond investment was tax-free.

Here are eight ways that investors can still get stuck with a tax bill on municipal bond investments. Unfortunately, there are likely other ways that investors may find out their tax-free investment wasn't quite as tax-free as they thought.

1. Capital gains taxes.

The most basic formula for bond investing is that yields and bond prices move inversely. As interest rates fall, the face value of a bond (all things being equal) will rise. If you own a 20-year municipal bond with a 4% coupon, and in just a few years the same municipality can issue debt at a 3% coupon, the value of that bond has likely risen considerably. If that investor sells out at a profit before maturity, then a capital gain was just created that can be taxed at the federal level. It may also be taxed as a capital gain at the state tax level, depending on the state in which the investor lives. One way to avoid getting a capital gains tax on a muni-bond is to "hold to maturity."

2. State income taxes in muni-bonds.

State and locally issued tax-free municipal bond income is not taxed at the federal level. Most states do not tax that income if the bond is issued in that same state, but they may have a tax on a muni-bond that is issued from another state. This varies greatly from state to state, and one rule of thumb is that the states with higher taxes tend to tax these out-of-state muni-bonds. Investors that reside in a state without a state income tax get to avoid a state-level tax on municipal bonds.

3. Some muni-bonds aren’t even tax-free!

Unfortunately, not every single muni-bond is automatically tax-free on the income portion. A small amount of muni-bonds that have been issued are classified as taxable municipal bonds. Some of these bond issuances by a city, county or other district may be issued to help an underfunded pension system. Others might fall under the Build America Bonds program. These can be taxed at the federal level, even though they might still avoid certain state income taxes. A good rule of thumb is that taxable muni-bonds usually have higher yields than their tax-free counterparts — usually. It is each investor’s responsibility to make sure that the high-yield tax-free coupon that sounded too good to be true might actually taxable after all.

4. Taxation on Social Security benefits.

You have paid into Social Security your whole adult life. Unfortunately, the IRS counts income from muni-bonds in each taxpayer’s modified adjusted gross income, or MAGI, to determine how much of that Social Security benefit is actually taxable. Charles Schwab shows that if your combined income from Social Security checks and from investments (dividends and bond interest included) is over $34,00 for an individual or $44,000 for a married/joint filing, then about 85% of the taxpayer’s Social Security benefit can be taxed at the federal level.

5. Higher Medicare premiums?

If your health insurance is through Medicare, you might not be quite as home-free as you thought. The tax-exempt interest earned from muni-bonds can sometimes increase the amount that you have to pay for Part B or prescription drug coverage. If your MAGI is more than $170,000 under a married or joint filing (half that for individual filers), then you may have to pay more for that Medicare Part B and Medicare prescription drug coverage. The good news about tax-free muni-bond income is not part of that 3.8% Medicare tax under Obamacare/ACA for those in the higher tax brackets.

6. That pesky Alternative Minimum Tax.

The IRS has known for many years that some muni-bond buyers buy these because they do not get taxed on the income. There is a dual tax system that allows the government to still tax people, even if they thought they might escape federal taxes. There is the ordinary income tax that hits most of us, but there is an Alternative Minimum Tax, the AMT, which blocks some of the deductions that are otherwise allowed by the IRS under the tax code for ordinary income. This was first designed to keep a few old wealthy people from avoiding federal taxes, but the AMT has reached more and more people over the years. It turns out that the IRS gets to tax you at the rate that would generate the higher tax bill. And some muni-bonds that fund more business-oriented efforts can also be subject to AMT. What looked like a great 5% yield might really be a 4% yield (or less) by the time AMT gets figured into the equation.

7. Taxing at the de minimis level.

You do not hear the term “OID” that much anymore, which was an Original Issue Discount bond in which the bond may have had a par-value (100) at maturity but was issued at a discounted price. What is far more common today is a bond value that falls and an investor buys the bond at a substantial discount to the 100 par value. This can trigger the de minimis rule in taxes. Investors buying bonds at a discounted price under 0.25% for each year (purchase date to maturity date), those incremental price gains in the discount get taxed as capital gains. If the rate is over 0.25% per year then that discount gets taxed at the investor’s income tax rate. PIMCO, Fidelity, Schwab and other sites offer details about the de minimis tax rule, and there are warnings that rising interest rates may fuel more concerns on this front.

8. Bond funds versus individual bonds.

Many investors hate taking individual issue risks, whether they are in stocks, bonds, annuities, CDs or other instruments. That steers some investors into mutual funds or exchange traded funds. Many investors will see a bond yield in a muni-bond fund (open-end or closed-end) and they might believe they are avoiding the multiple catch-all tax buckets. Unfortunately, many bond funds use a bit of leverage to juice up their bond yields and that can create certain taxable events. Some muni-bond funds also buy bonds that are taxable munis or they may own muni-bonds that get hit by the AMT (sports arena bonds, pension fund bonds or airport bonds) and it can translate into the fund investor eventually getting a tax bill. Some muni funds also trade in and out of their bonds long before maturity, which can create capital gains that an investor might not have otherwise considered when investing. The Closed-End Fund Association (CEFA) website can help investors identify individual closed-end funds with AMT and which part of a dividend might have capital gains.

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