Bond Case Briefs

Municipal Finance Law Since 1971

Camp Draft Would End State and Local Income Tax Deduction, Bond Exclusion.

One of the largest federal tax expenditures — the deduction for state and local income taxes — would be eliminated under the proposal from House Ways and Means Committee Chair Dave Camp, R-Mich., to overhaul the tax code, which was released February 26.

One of the largest federal tax expenditures — the deduction for state and local income taxes — would be eliminated under the proposal from House Ways and Means Committee Chair Dave Camp, R-Mich., to overhaul the tax code, which was released February 26.

The option to deduct sales taxes in lieu of income taxes was one of 55 federal tax expenditures that expired at the end of 2013. The state and local income tax deduction is forecast to cost approximately $277 billion between 2013 and 2017, according to a Joint Committee on Taxation score of the Camp plan (JCX-20-14).

“This deduction redistributes wealth to big-government, high-tax states from small-government, low-tax states,” Camp’s plan says.

Experts said that repeal of the state and local tax deduction would put increasing pressure on state governments to keep their taxes low, especially in already high-tax states like California and New York.

“That’s been something that states easily rally around, and they will fight it to the death,” Tax Foundation Chief Economist Will McBride said. “Every indication of history says that there will be a lot of pushback on this.”

Verenda Smith, deputy director of the Federation of Tax Administrators, wasn’t surprised by Camp’s proposal to eliminate the state and local tax deduction, because it’s not a new idea. She said it would be a “pretty heavy lift” to accomplish and that Congress should not mess with state tax codes.

Camp’s long-awaited comprehensive tax reform proposal is the culmination of three years of work. At its core, he said, the discussion draft would produce a “fairer and simpler” U.S. tax code. “We close a lot of loopholes; we got a lot of the junk out of the code,” Camp said at a February 26 press conference on Capitol Hill. “Our plan repeals 228 sections of the tax code. And we cut the size of the income tax code by roughly 25 percent.”

Camp proposes “flattening the code” so that it would include only a top income tax rate of 25 percent for both individual and corporate filers and a 10 percent introductory bracket for individual filers.

Jeff Saviano of EY said trimming the tax code by 25 percent would be a massive shift and would place a burden on states to fully adopt the plan or not. States would have to decide whether they would benefit more from adopting the proposed new tax code or from taking subsequent legislative action to lower tax rates, he said.

Bond Provisions

Camp calls for a 10 percent surtax on some sources of income — including municipal bond interest that's now tax exempt — for single filers earning more than $400,000 and joint filers earning more than $450,000. Under current law, the tax-exempt interest on municipal bonds is forecast to total approximately $191 billion between 2013 and 2017, according to the JCT.

Camp's plan also would eliminate the alternative minimum tax, the tax exemption for private activity bonds, and advance refunding bonds issued after 2014. Private activity bonds are primarily used to finance airport, hospital, university, water and sewer, and housing projects.

The plan would eliminate banks' ability to deduct all of the interest expenses associated with the acquisition of municipal bonds — the so-called bank qualified bonds of small issuers. Recently, banks have been active in purchasing municipal bonds directly, which saves money for issuers and small 501(c)(3) organizations, according to Linda B. Schakel of Ballard Spahr LLP.

It would also do away with the 2 percent de minimis rule, which allows corporations to have up to 2 percent of their assets in tax-exempt bonds without losing any portion of their interest expense deduction.

Camp's proposals to significantly alter the treatment of tax-exempt municipal bonds and repeal the exemption for private activity bonds could reduce the appeal of buying government debt altogether.

Generally, a reduction in overall tax rates makes tax-exempt bonds less attractive, said Howard Gleckman, resident fellow with the Urban-Brookings Tax Policy Center. The exclusion for tax-exempt bonds is worth less to investors, he added.

Practitioners React

State and local groups and practitioners were alarmed by the proposals, saying they will increase financing costs.

"These new taxes would be borne ultimately by states and localities in the form of higher capital costs, and could result in increases in state and local property and income taxes," said Michael Decker of the Securities Industry and Financial Markets Association.

"State and local capital investment in projects like hospitals, schools, and roads creates jobs and enhances economic productivity," Decker said. "Taken together, these proposals would have the effect of raising capital costs for state and local governments and discouraging investment in much-needed infrastructure."

Susan Collet, senior vice president of government relations with Bond Dealers of America, likened the 10 percent surtax to the 28 percent cap on municipal bond interest proposal that has appeared in President Obama's annual budget. "It will raise costs and have a similar impact on borrowing costs because issuers will have to increase their yield to compensate for that class of investor," she said.

Collet said she is also alarmed by the proposal to eliminate advance refunding bonds because they allow state and local governments to take advantage of current interest rates. "The combination of those three proposals creates a very difficult environment for borrowing for critical infrastructure at affordable rates," she said.

Schakel said Camp's plan changes the landscape for the municipal bond market.

“It has a lot of repercussions. . . . This is going to be hard for people to figure out where to put their money,” Schakel said. “In some ways this is a zero sum game: If they don’t provide the subsidy through the tax code, you will still have to find the funds somewhere else.”

Charles A. Samuels of Mintz Levin Cohn Ferris Glovsky and Popeo PC said the proposal to eliminate the exclusion for private activity bond income would have a “devastating” impact on nonprofits, particularly in the health and education sectors.

Still, Samuels wasn’t surprised that Camp took a swipe at private activity bonds because of a congressional hearing last March that had many House Ways and Means Committee members questioning the need to maintain federal support for them.

Changes to Rate Structures, Depreciation Provisions

Camp’s plan also includes sweeping changes to personal and corporate income tax rate structures. Coupled with the rate changes are significant changes to permitted income tax deductions. Changes in the determination of federal adjusted gross income would affect states that have a floating conformity date to the current-year Internal Revenue Code.

Camp proposes several changes to the calculation of a taxpayer’s taxable base. Among them is the repeal of the modified accelerated cost recovery system for taking depreciation deductions. In place of MACRS, Camp would institute the alternative depreciation system, requiring shorter recovery periods using the straight-line depreciation method. The proposal would permit taxpayers to elect to take an additional depreciation deduction to account for the effects of inflation on depreciable personal property.

The proposal also would eliminate several depreciation provisions without replacing them, including bonus depreciation, the special recovery periods for Indian reservation property, the special allowance for second-generation biofuel plant property, the special allowance for some reuse and recycling property, and the special allowance for qualified disaster assistance property.

Also, Camp’s proposal would change current rules that permit the deduction of research and experimental expenditures. Instead of allowing corporations to take a current-year deduction for those expenses, the proposal would require the amortization of those deductions over five years.

by Jennifer DePaul and David Sawyer

Copyright © 2026 Bond Case Briefs | bondcasebriefs.com