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Bank of America to Trump: Taxing Munis Won't Raise Very Much.

- Bank reckons the tax break costs less than official estimate
- Mayors previously said Trump backs keeping munis tax exempt

If President Donald Trump and Congressional Republicans are looking for revenue to offset planned tax cuts, Bank of America Merrill Lynch analysts say taxing investors' interest on state and local debt wouldn't provide as much as it seems.

The tax break for the \$3.8 trillion municipal market — which holds down the expense of financing state and local projects — cost the federal government about \$39 billion in 2016, according to the U.S. Treasury Department's figures.

But Bank of America analysts led by Phil Fischer estimate that the revenue raised by repealing it would be much lower. Because taxing the interest would likely cause individual investors to move money elsewhere, many securities would wind up with buyers who don't pay income tax, such as overseas firms or 401(K) plans. Once that's factored in, taxing municipal bonds may only yield about \$8.9 billion a year, the analysts reckon.

Moreover, the shift would foist about \$7.6 billion of extra costs on state and local governments, assuming yields rise about 0.2 percentage points. That would push up the expense of financing the types of infrastructure projects Trump has vowed to promote.

The bonds have been targeted by previous proposals that stalled in Congress. Former President Barack Obama sought to cap the benefits the wealthiest earners can receive from municipal debt, while a deficit-cutting panel previously suggested eliminating the exemption outright. Lobbyists for state and local-government groups have fiercely opposed any change to the tax treatment of their bonds, given the cost it may impose.

"Hopefully, this helps clarify the point that the attack on the tax-exempt status of municipal bonds from time to time appears to be based more on political calculus than economic analysis," the analysts wrote. "This is becoming more widely recognized and we do not expect that the tax exemption would be targeted in any tax-reform legislation."

The president may agree: A delegation of mayors, after meeting with Trump in December, said he expressed support for keeping the tax break intact.

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