
Fitch: Tax Proposal May Add Fiscal Strain to US Public Finance.

Fitch Ratings-New York-06 November 2017: A tax reform proposal by Republicans in the U.S. House of Representatives could affect some states' and local jurisdictions' revenues if passed, says Fitch Ratings. The likelihood of the passage of this proposed legislation into law remains far from certain and will be subject to potentially key changes as it proceeds through the House and the rest of Congress.

The proposal could limit tax raising flexibility, particularly for the states that charge higher taxes, as it would substantially reduce the federal tax deduction for state and local taxes. This would cause an increase in the impact of state and local taxes, as they would be without an offsetting federal deduction. Residents in states with comparatively high taxes, such as California, Connecticut, Massachusetts, New Jersey and New York, would be more affected and may have less tolerance for higher taxes going forward. The proposed tax cuts for the higher-income taxpayers most likely to benefit from the current deduction for state and local taxes, including rate reductions and elimination of Alternative Minimum Tax, could somewhat offset this effect. Most states are not in a position to lower taxes in response to the federal tax increase due to tepid revenue growth and ongoing spending pressures.

If the proposed changes to the deduction of mortgage interest and the cap on the deduction for property taxes reduce the incentive to buy houses, assessed property values in areas with high average home prices could see lowered growth or even decline and reduce the amount of property tax local governments collect. This change could result in lower revenue growth prospects for local governments absent tax rate increases.

A proposed 1.4% excise tax on net income from the largest private colleges' endowments would be an incremental financial stress but would likely not have significant near-term credit effects on Fitch-rated colleges or universities. The impact would be narrow. For example, only approximately 140 endowments had funds in this range according to 'The Chronicle of Higher Education.' However, it could lower the incentives for donors to fund endowments and raise the possibility of higher and more onerous taxes on endowments in the future.

The potential elimination of private activity bonds (PABs) and 501(c)3 non-profit bonds would likely lower the interest in and feasibility of public-private partnerships, which have increasingly been used to procure transportation projects. Eliminating PABs would raise airport financing costs and possibly cause a reduction in private participation in water projects.

Eliminating the use of these bonds would also mean an incremental increase in borrowing costs and, eventually, slow issuance for the non-profit healthcare sector. Fitch would expect the increase in hospital borrowing costs to add pressure to the sector, but not result in downgrades.