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Senate Bill Saves, Enhances PABs, but Eliminates Advance Refundings.

WASHINGTON – The municipal bond market would fare better in the Senate Republicans' tax reform proposal released Thursday, which would preserve private activity bonds and even enhance them. But advance refundings would still be terminated after this year.

Halting advance refundings after Dec. 31, which is also in the House tax reform bill, would generate $16.8 billion in tax revenue over 10 years, according to the Joint Committee on Taxation.

The proposal, which was released by Senate Finance Committee Chairman Orrin Hatch, R-Utah, on Thursday as a conceptual outline and will be debated by the panel in the coming week, would not only preserve private activity bonds but also eliminate the alternative minimum tax. Most PABs, except those issued for nonprofit entities, are subject to the AMT, which makes them less attractive to investors under current law.

Muni market organizations reacted positively to the retention of municipal bonds and PABs while pledging to try to persuade senators to preserve advance refundings, which Thomson Reuters estimated as representing almost 27% of the market last year.

"The fact that the Senate draft bill recognizes that private activity bonds are critical to building and maintaining the nation's infrastructure is good, and we will work to help the Senate reach the same conclusion when it comes to advance refunding bonds," William Daly, director of governmental affairs for the National Association of Bond Lawyers, said in a statement.

Mike Nicholas, CEO of the Bond Dealers of America, expressed a similar view. He applauded the Senate for "preserving the tax exemption on municipal bonds and for protecting private activity bonds which help finance housing, senior living facilities, hospitals, airports and the nation's infrastructure, among many other projects."

But Nicholas urged the Senate Finance Committee to remove its halt to advance refundings because it " simply allows municipal bond issuers the flexibility to reduce their cost of finance and frees up borrowing authority for additional capital improvement projects at a lower cost to the taxpayer."

The Municipal Bonds for America Coalition echoed the same sentiments, thanking the Senate Finance Committee for preserving municipal bonds and PABs while saying work needs to be done to fight the repeal of advance refundings.

MBFA Director Justin Underwood said termination of advance refunding "will only burden taxpayers and is in direct conflict to the stated objective of the Tax Cuts and Jobs Act. The MBFA, and its partners, will continue to make a strong coordinated effort on both sides of the Capitol to ensure the tax treatment of all municipal bonds is protected during tax reform."

The Senate outline also would lower the top income tax rate to 38.6% for high income earners, which is below the current effective top rate of 43.4% and the 39.6% top rate in the House bill. The

current tap rate includes a 3.8% Obamacare tax on top of the 39.6% top income tax rate.

The Senate and House bills each would set the income threshold for their top rate at $500,000 for single filers and $1 million for married couples filing jointly. The current threshold is set to be $426,700 for individuals in 2018 and $480,050 for married couples filing jointly.

The Senate proposal also has a proration provision that would make tax-exempt bonds less attractive to property and casualty insurance companies relative to other fixed income investments, like corporate bonds. Insurance companies currently make up about 10% to 15% or the muni market, according to sources.

As expected, the Senate panel's proposal would fully repeal the federal deduction for state and local taxes, which would be harsher than in the pending House bill that would allow the deduction of up to $10,000 of state and local property taxes.

The Senate proposal would preserve the home mortgage interest deduction for loans of up to $1 million unlike the $500,000 loan cap on new borrowing in the House bill. But the Senate would eliminate the mortgage interest deduction for home equity lines.

Both measures pending in the House and Senate would hurt states, especially high-tax states like California, New York and New Jersey.

Emily Brock, director of the Government Finance Officers Association, described the elimination of the SALT deduction and advance refunding as "a one-two punch for state and local governments across the United States."

"It seems counter-intuitive to tear away the opportunity to realize substantial savings on debt service while also promoting the enhancement of public infrastructure," Brock said. "We look forward to helping Congress understand the impact of the plan on communities in both the short- and long-term."

The SALT deduction is used by more than six million California tax returns, California's Finance Director Michael Cohen said in a letter to his state's congressional delegation. The average deduction for state and local income taxes alone is nearly $16,000 per return, while state and local property taxes average less than $6,000 per return.

Seven New York House Republicans who "knew the elimination of SALT would be crippling," recently wrote a letter expressing their opposition to the tax bill, Rep. Joe Crowley, D-N.Y., said during the closing statements of members of the House Ways and Means Committee Thursday.

That committee approved its tax reform bill in a vote along party lines, sending it to the floor for passage that's expected before the congressional Thanksgiving recess.

Senate staffers who briefed reporters Thursday said their proposal was the result of five years of bipartisan work. "We feel this is a pretty middle of the road bill, "a senior staff member said.

The Senate bill is not yet in legislative language, which will be worked out during the Finance Committee's deliberations.

The Bond Buyer

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November 09 2017, 11:52pm EST

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