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Munis Remain Attractive Despite Tax Changes.

Despite passage of the Tax Cuts and Jobs Act at the end of last year, municipal bonds can still be an attractive investment and reliable source of tax-free income.

Over the last seven years or so, we have seen significant increases in the holdings of municipal bonds by both banks and insurance companies.1 Within the insurance industry itself, while bond purchases by property and casualty ("P&C") companies have diminished, those by life insurers have increased. Although, with a reduction in the corporate tax rate to 21%, we may now see some reduction in demand from banks, whether the same holds true for life insurance companies remains to be seen.

When it comes to individual investors, however, the picture in the crystal ball becomes murkier. One thing that hasn't changed, though, is the nature of municipal bonds themselves and the attractiveness of their tax-exempt status. So, for those investors who live in states with high state and local taxes, perhaps there is, now, even more reason to look to munis to help mitigate their tax bills.

If history is anything to go by, tax reforms that have lowered personal taxes have led to no less interest in muni funds on the part of investors. Following the Tax Reform Act of 1986, signed into law by President Reagan on October 22 that year, investment in muni bonds by individuals did anything but fall.

Back then, of course, there were no muni ETFs. Now there are. While it remains to be seen, therefore, just what effect on inflows and outflows the latest tax reforms will have, the nature of neither munis nor muni ETFs have changed. The former still provide attractive tax-free income, and the latter provide diversification, trading flexibility, daily transparency, lower costs, and tax efficiency.

Seeking Alpha

Feb. 8, 2018