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Tax Reform Shines Light on Muni Bond Funds.

The 2017 Tax Cuts and Jobs Act (TCJA) is the first major set of reforms to this country's tax codes in decades. While it's getting lots of headlines for cutting corporate rates and lowering the highest marginal federal tax bracket, the new law also features a less appealing feature for many high net-worth investors.

Starting with individual 2018 tax returns, the state and local taxes (SALT) you pay will be capped at $10,000 a year as a tax deduction against your income in calculating federal taxes. Among the common types of taxes that many states impose are personal income tax, corporate income tax, sales tax, and real property tax. This $10,000 cap is low for high net-worth individuals in states with high tax rates like California and New York.

Muni bonds are issued to help finance public projects like road repairs and water treatment plants. To help enhance their allure to investors and to provide lower cost of capital for the municipalities, interest income paid to investors is exempt from federal taxes and may also be exempt from state taxes, if issued within the state. As we have stated many times before, the investor's expected return equals the cost of capital of the firm or in this case, the municipality. That cost of capital is a measure of the risk and, in the case of munis, the tax benefits offered to the buyers of those securities.

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