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Experts: Muni Community Should Have No Problem Making Case to Save Exemption From 'Blank Slate'.

The Senate Finance Committee's top two tax writers asked their 98 colleagues on Thursday to submit detailed proposals justifying which tax breaks should be kept in the code as they move forward on comprehensive tax reform.

Committee chairman Max Baucus, D-Mont., and ranking minority member Orrin Hatch, R-Utah., called for a "blank slate" approach to tax reform, stripping all existing tax deductions, exemptions and credits including the tax exemption for municipal bonds from the code.

"This blank slate is not, of course, the end product, nor the end of the discussion," Hatch and Baucus wrote in a "dear colleague" letter to senators. "Indeed, we both believe that some existing tax expenditures should be preserved in some form. But the tax code is also littered with preferences for special interests."

Both Baucus and Hatch are meeting with their respective members this afternoon to discuss the plan, sources said. Senators have until July 26 to submit their proposals.

Baucus and Hatch said "special attention" will be given to bipartisan proposals. They said they plan to operate from the assumption that all special provisions are "out" unless there is clear evidence that they help expand the economy, make the tax code fairer or effectively promote other important policy objectives.

Mike Nicholas, chief executive officer of the Bond Dealers of America, said that the muni bond tax exemption accomplishes at least two of those three issues.

"You think about infrastructure, jobs, or capital improvement growth, Nicholas said. "That's been done for 100 years by issuing tax exempt debt." Nicholas added that if the goal is to simplify or make the tax code more fair, "the muni bond tax exemption is not one of the extra layers that has made the code more complicated. It has been in the tax code since there was a tax code."

Chuck Samuels, a lawyer at Mintz Levin, Michael Decker, managing director of the municipal securities group at SIFMA and other market participants said the muni bond community should have no problem making the case on the merits of the tax exemption so that it will be retained.

To aide senators with their submissions, the nonpartisan Joint Committee on Taxation and the Finance Committee staff analyzed the relationship between tax expenditures and the current tax rates if the current level of progressivity is roughly maintained.

"The blank slate approach would allow significant deficit reduction or rate reduction, while maintaining the current level of progressivity," Baucus and Hatch wrote. They warned that each tax preference inserted back into the code reduces the amount of deficit reduction or revenue that could go towards lowering individual and corporate tax rates. "As we work to craft a tax reform bill, we will bear these trade-offs in mind," they wrote. The letter omits how much revenue the plan would raise or how low they aim to get tax rates.

Some market participants were skeptical. “There are so many details that need to be filled in that we are not optimistic that the Senate could act in this Congress,” said Lars Etzkorn, program director for the National League of Cities’ center for federal relations, who expressed support for a simplified tax structure and the plan’s “noble” policy goals. “The clock is ticking and time is limited for the Senate to act.”

Etzkorn said he hoped that the Senators would include state and local groups like the NLC in the conversation beceause there could be serious consequences with a comprehensive overhaul.

“If the muni bond exemption was eliminated it would be detrimental to home towns,” Etzkorn said. “We don’t need a local tax increase as part of federal tax reform.”

The framework is similar to the “Zero Plan” used by the National Commission on Fiscal Responsibility and Reform in 2010, co-chaired by Erskine Bowles and Alan Simpson. The Bowles-Simpson Zero Plan would establish three individual income tax rates of 8%, 14% and 23%. It would repeal all individual and corporate tax expenditures and would tax capital gains and dividends as ordinary income.

by: JENNIFER DEPAUL