Bond Case Briefs

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Tax Reform: The Truth About Municipal Bonds.

The Committee for a Responsible Federal Budget (CRFB), a bipartisan, non-profit organization committed to educating the public about issues that have significant fiscal policy impact, is made up of some of the nation's leading budget experts (including past Chairmen and Directors of the Budget Committees, the Congressional Budget Office, the Office of Management and Budget, the Government Accountability Office, and the Federal Reserve Board). The CRFB is posting a series of articles in its blog series, "The Tax Break-Down", which analyze and review tax breaks under discussion as a part of tax reform.

Near and dear to the hearts of state and local governments in Georgia and across the country is the tax-exempt status of interest on municipal bonds. By way of background, interest earned from state and local government bonds has been tax-free since the income tax started in 1913. The interest that people earn from holding these bonds, unlike other interest, does not count as income; rather, the federal government forgoes income tax revenue to indirectly subsidize the cost of borrowing for local governments. Because these municipal bonds offer tax-free returns, investors are willing to accept a lower level of interest, depending on their individual tax rates.

Proponents of the municipal bond tax exemption argue that the exclusion provides important support for state and local governments to invest in infrastructure, education, health care, and other productive public investments. They also point out that infrastructure investment in the United States is centered around the tax-exemption, with a $3.7 trillion bond market. Changes to the exclusion – especially for existing bonds – could cause severe disruptions in this large market and thus the broader economy. Reduction could also hurt the ability of state and local government to borrow, as evidenced by S&P's warning that reducing the tax benefits around municipal bond interest would have "negative credit implications for state and local governments and other tax-exempt issuers."

Opponents of the exclusion argue that the tax code should not be the vehicle for supporting local governments and local projects, especially those that have a private purpose. To the extent these projects are worthy, opponents argue that a tax exemption is an expensive and poorly targeted way to encourage investment, with disproportionate benefits for the wealthy, who purchase such bonds as a means of reducing their tax burden.

The debate over whether municipal bonds should be "on the table" during these tax reform discussions is a heated one, with serious ramifications for state and local governments. It is important that stakeholders understand the issues! For a detailed look at who issues municipal bonds and why, and what options are on the tax reform agenda that might impact municipal bonds in the future, review the informative charts, maps and diagrams presented by CRFB in the full blog post here: http://crfb.org/blogs/tax-break-down-municipal-bonds

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