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Camp Would Repeal Tax-Exemption for New PABs, Advance Refunding Bonds.

WASHINGTON — House Ways and Means Committee chairman Dave Camp's draft tax reform plan, released Wednesday, would terminate the tax exemption for private-activity bonds and advanced refunding bonds issued after 2014.

The proposed plan, which the Michigan Republican is calling "a discussion draft," would also put an end to traditional and direct-pay tax-credit bond rules after the date of enactment, although there is no current authority for direct-pay bonds.

As expected, the plan would create three individual income brackets — 10%, 25% and 35% — and would tax a portion of muni bond interest, which is currently tax-exempt, for those in the highest bracket. The surtax would, apply to individuals with incomes of $400,000 or more and couples with $450,000 or more of income as well as all munis they hold, whether new or outstanding. It would essentially cap at 25% the value of tax exemption for those in the 35% tax bracket, sources said. The surtax would be unprecedented and would likely dampen demand for muni bonds and raise borrowing costs for state and local governments, market participants said.

Also as predicted, the draft would require systemically important financial institutions, such as banks, with total consolidated assets of more than $500 billion, to pay an excise tax equal to 0.035 percent of those assets. Federal bank regulators in 2013 reported eight holding companies with assets that large, many of which have companies that are major underwriters of munis. The holding companies are JPMorgan, Chase & Co., Bank of America Corp., Citigroup, Inc., Wells Fargo & Co., Goldman Sachs Group, Inc,. Morgan Stanley, American International Group, Inc. and General Electric Capital Corp.

The excise tax could discourage big banks from holding municipal bonds and is likely to become a priority issue for lobbying by dealer and bank groups, according to market participants.

The plan would also repeal the alternative minimum tax, which currently applies to PABs, which would benefit PABs that are currently outstanding. In addition, it would eliminate the deduction for state and local taxes, which state and local groups are likely to strongly oppose.

Camp is also proposing to dedicate $126.5 billion to the Highway Trust Fund to fully fund highway and infrastructure investment through the HTF for the next eight years.

It is doubtful that the draft plan will move forward because Camp still needs support from colleagues and Senate Democratic and Republican leaders have said tax reform will not likely happen this year. House Speaker John Boehner even declined to endorse it, stressing it is a "discussion draft."

But tax experts and lobbyists warned these are, in essence "trial balloons."

"This will start a dialogue," said Micah Green, a partner at Patton Boggs. "If people don't express their opinion, there's a risk some of these provisions will be viewed as viable."

The proposal to prohibit new PABs and advance refundings from being issued as tax exempt upset many market participants.

Green said muni market participants will have to begin a discussion with lawmakers and administration officials over whether PABs are used solely for private businesses, as the summary of Camp's plan suggests, or are instead issued for public projects with private involvement.

John Murphy, executive director of the National Association of Local Finance Housing Agencies, called Camp's draft plan "is a disaster for affordable housing"

"These are not businesses being given an advantage. Single-family housing bonds (PABs) are used to help first-time homebuyers" and multifamily housing bonds benefit renters, he said.

Chuck Samuels, an attorney at Mintz Levin and counsel to the National Association of Health & Higher Education Facilities Authorities, said, "It appears that Camp is willing to strip charities of their ability to access reasonably-priced capital. This is particularly surprising from a conservative Republican who believes the charitable sector can often function more efficiently than the governmental sector."

Green said doing away with tax exemption for new advance refundings could dramatically change market practices. Historically, issuers issue bonds that can be called in 10 years, knowing that if interest rates drop before then, they can advance refund those bonds.

"If issuers can't do advance refundings, they're much more exposed to market interest rate movements," Green said. They may have to structure bonds with earlier call dates, which investors may not want, or they have to address interest rate risk by increasing activity in derivatives market, he said.

Michael Decker, the Securities Industry and Financial Markets Association managing director and co-head of munis, said, Camp's proposal "Specifically targets municipal products."

"The 10% tax on municipal bond interest would be unprecedented. It would the first time in the history of the federal income tax system that the U.S. taxed the interest from municipal bonds, absent a tax violation," he said.

Decker noted that the Supreme Court, in a 1988 case, South Carolina v. Baker, ruled Congress has the constitutional authority to tax or not tax municipal bond interest, but added, "It would be interesting to see whether the current high court would agree with that."

He said the 10% surtax will dampen the demand for muni bonds and increase yields. "The tax is really going to be borne by state and local governments through higher borrowing costs. They are ultimately going to pay the costs." Decker also noted that the 10% surtax "would apply, not just to new issues, but to outstanding munis" as well.

Decker also said in a release issued by SIFMA that the 10% surtax, and the elimination of tax exemption for new PABs and advance refunding bonds "could result in increases in state and local property and income taxes."

"State and local capital investment in projects like hospitals, schools and roads creates jobs and enhances economic productivity," he said in the release.

Decker also told The Bond Buyer that the excise or asset tax on systemically important financial institutions is "a very negative proposal that really is a strong discouragement to banks to lend and hold assets such as municipal bonds." If Camp's plan prevails, the excise tax would come at a time when banks have increasingly become buyers of munis, he noted.

Columbia, South Carolina Mayor Steve Benjamin, the new chair of the Municipal Bonds for America coalition, which consists of state and local officials and broker-dealers, said in a release, "We oppose proposals, whether from Congress or the White House, that cut, cap or limit the tax exemption for municipal bonds, including private-activity bonds, and significantly limit our ability to borrow at affordable rates and invest in America's future competitiveness."

"Congress and the administration have a decision to make: is America just going to survive or are we going to thrive?" Benjamin asked. He noted tax exemption is a "100-year old covenant" and that PABs "are a valuable, trusted and efficient tool that provides access to capital for nonprofits, affordable housing, hospitals, energy providers, manufacturers, and many other job generating, private sector investment catalyzing projects."

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