
Camp's Plan Spells Trouble for Munis in Future Tax Reform Efforts.

WASHINGTON — Don't dismiss Rep. Dave Camp's draft tax plan as a non-starter. It's going to be a foundation for tax reform and most of the bond proposals it contains have already been made and will continue to be made by lawmakers, administration officials, deficit reduction groups, and tax experts.

This was the warning issued on Thursday by several long-time municipal bond market players who participated in the development of the 1986 Tax Reform Act that imposed the biggest restrictions ever made on munis.

The plan by the chairman of the House Ways and Means Committee chair, released Wednesday, would hit munis from all angles. The Michigan Republican would end the tax exemption after 2014 for both private-activity bonds, which are used for charitable and other public projects that have some private involvement, and advance refundings, which state and local governments use to obtain interest rate savings. He would do away with bank-qualified bonds, which help small localities access the bond market through local banks, and he would adopt or revise tax provisions to discourage banks, insurance companies and other financial institutions from buying municipal bonds.

Camp also would dampen retail investor demand for munis by limiting the value of tax exemption to 25% for the wealthy. That proposal is not unlike the 28% cap that President Obama has proposed in his last two budget requests.

Camp threw down his marker on PABs Wednesday, saying in a summary of his plan, "Taxpayers across the country should be not forced to subsidize borrowing by state and local governments that provide a direct benefit to private individuals and entities."

Toby Rittner, president and chief executive officer at the Council of Development Finance Agencies, said "this is about the worst case scenario for the private-activity bond industry" and that many local development corporations will go out of business if they can't issue tax-exempt PABs.

But Rittner added, "We don't see any traction for it." And several market participants echoed him, saying they were not worried because it was not going to go anywhere.

Ben Watkins, Florida's bond finance director and chairman of the Government Finance Officers Association's debt management committee, said Camp's plan puts the muni exemption "on the radar screen" to become under "a constant long-term threat." But he said, "I don't think you'll see as loud a call to arms" as with previous threats, though it doesn't mean muni issuers " care any less."

Sen. Chuck Schumer, D-N.Y. called the plan "dead on arrival" and Camp, who is term-limited and must step down as committee chairman at year's end, couldn't even get his Republican colleagues behind the plan while Senate leaders said there will be no tax reform this year.

But Frank Shafroth, director of the Center for State and Local Leadership at George Mason University who represented issuers in the 1986 tax reform debates, said Camp's plan plays to those such as President Obama who want tax simplification and Republicans who want lower tax rates.

"For the first time, you actually have a foundation for the committees to use and for the next Congress," Shafroth said. "It's going to be used to raise enormous amounts of money between now and November. But if you're serious about reducing income tax rates, these are the kinds of cuts that will be required."

At least two major deficit reduction groups, one of which was presidential, issued reports in 2010 that recommended eliminating tax exemption for either all munis or PABs, said Shafroth and Howard Gleckman, a resident fellow at the Tax Policy Center. State and local officials should notice: "There's a pattern here and the pattern's pretty consistent," Gleckman said.

In order for tax reform to be distributionally neutral and to lower rates for the wealthy, you have to cut tax preferences, Gleckman said, adding, "There are only so many targets of opportunity and state and local finance is one of them." He said he thinks the tax-exemption for munis, PABs and the state and local tax deduction will continue to be targets for revenue raising.

"We take [Camp's] package very seriously," said Michael Decker, co-head of municipal securities for the Securities Industry and Financial Markets Association.

Shafroth, Decker, and Micah Green, a partner at Patton Boggs, pointed out that several tax reform plans were floated from 1983 through 1985, some of which have eliminated tax-exempt PABs and advance refundings. The resulting 1986 Tax Reform Act was less harsh, creating volume caps for PABs and limiting those kinds of bonds that could be tax-exempt. The act also restricted issuers of governmental bonds to two advance refundings.

Green, Decker, and John Buckley, former chief tax counsel for the Democrats on the House Ways and Means Committee, each said Camp has proposed muni bond curbs are carefully analyzed and scored revenue raisers that can be used anytime in the future.

"Any revenue opportunity articulated by a tax-writing committee chairman, whether or not it's enacted, becomes a revenue raiser on the shelf that can be pulled off and used anytime in the future," said Green.

"Now that the details are out, the various provisions could be picked up by other legislators as revenue raisers or offsets that can be moved separately," said Decker. "That risk grows when the provisions have the support of the House Ways and Means Committee chairman."

"In the long run, this could be seen as a menu" of revenue increases for deficit reduction, said Buckley.

Bill Daly, director of governmental affairs for the National Association of Bond Lawyers, said that if muni issuers and other market participants don't explain how Camp's proposals would hurt the muni market, "these could gain some traction."

"It is incumbent on the tax-exempt bond community to make the case that the current tax treatment of munis has economic benefits," said Decker.

Meanwhile, state treasurers said it has "strong concerns" about some provisions of Camp's plan. "The proposals in this discussion draft do not respect the authority of a sovereign state and changes the tax treatment of these bonds that have existed for over 100 years," said Utah Treasurer Richard

Ellis, the president of the National Association of State Treasurers. He was particularly concerned about the 25% limitation, also called a 10% surtax on muni bond interest earned by individuals with modified adjusted gross incomes of more than $400,000 and couples with more than $450,000.

U.S. Conference of Mayors chief executive officer and executive director Tom Cochran said the 10% surtax "is an all out attack on local governments and our ability to raise funds for local investments in highways, bridges," and other projects that is "economically ill-informed."

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