
Muni Tax Break Would Be Curbed Under House Republican's Revamp.

The tax break for some investors in the $3.7 trillion municipal bond market would be curbed under changes proposed by the top House tax writer, a shift that may diminish the appeal of buying local-government debt.

A plan released today by House Ways and Means Committee Chairman Dave Camp, a Michigan Republican, would tax some municipal-bond income for the highest earners as part of broader changes that would lower rates. It would also eliminate the exemption for debt sold by localities to finance private projects.

A change to the tax treatment of state and local debt could reduce the value of the securities, which sell for higher prices than other bonds because investors aren't taxed on the income. That pushes down the borrowing costs for states and cities, which have argued against taxing the debt that they sell to pay for schools, roads and other public works.

The Camp proposal is the latest challenge to the century-old tax exemption, which was targeted in tax plans previously released by President Barack Obama and his deficit-cutting commission. None of those plans have advanced, and Camp's effort faces a challenge in the divided Congress ahead of elections in November.

This week, Senate Minority Leader Mitch McConnell, a Kentucky Republican, and Majority Leader Harry Reid, a Nevada Democrat, said they saw little chance that major tax changes would be enacted this year.

Starting Point

The proposal may be the starting point for changes next year, said Susan Collet, a lobbyist with Bond Dealers of America, a Washington-based trade group that represents securities firms and opposes changes to munis' treatment.

"There's no chance of near-term passage," she said. "There are going to be a lot of shifting dynamics in the next Congress. But this is something that they will be able to grab."

Camp's changes would limit tax-exempt interest for the highest earners, those making more than $400,000 for individuals and $450,000 for couples, according to a description released by his office. It would also eliminate the exemption for new private activity bonds, a type of municipal debt typically sold by public authorities on behalf of a company.

Vikram Rai, a Citigroup Inc. analyst, said the proposal has had little influence in the municipal market, where prices have gained amid a dearth of issues by local governments. He said that could change if it looks like efforts to tax munis are gaining traction.

'Distant Threat'

“The muni market doesn’t need this kind of uncertainty,” Rai said. “It seems like a fairly distant threat as of now, but if it does become more imminent, we will see a negative impact on the market.”

The tax benefits of munis cost the Treasury about $39 billion in the most recent budget year, according to the Office of Management and Budget. The size of the break has made it a potential source of revenue for lawmakers looking to reduce the size of the deficit or find revenue to offset the cost of tax cuts.

The president’s deficit-reduction commission in 2010 proposed scrapping the muni tax break, and Obama has since proposed limiting the ability of high-income earners to benefit.

Both proposals have drawn criticism from groups representing state and local governments, which say taxing bondholders would raise costs because investors would demand higher yields.

Collet, the lobbyist from the dealers group, said taxing even some of that income may worry investors.

Any change would “put a cloud over the exemption,” she said. “What that means is that state and local governments would have to offer a higher yield to make up for that tax.”

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