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BDA Commentary: A Wrong-Headed Approach to Addressing the Nation's Infrastructure Needs.

BDA's CEO Michael Nicholas writes a commentary in *The Bond Buyer* regarding the latest tax policies in Washington.

March 12 - "One of these things does not belong" is a catchy slogan — and it comes to mind when looking at the latest tax policy ideas coming from Washington. The proposal by House Ways and Means Committee Chairman Dave Camp, R-Mich., puts a 10% surtax on tax-exempt bond interest for high-earners, throwing municipal bonds into the mix with other tax deductions and exemptions on which these earners would be taxed. One week later, the Administration — despite a large, united, multi-year effort from local elected officials, municipal market professionals and citizens to explain the dangers of tarnishing the tax exemption — repeated its call for a 28% limit on the exemption in its latest budget proposal. Simply put, both of these proposals throw apples and oranges together into a blender to reach a pre-determined budget or revenue target.

But one of these things does not belong in the blender: the municipal bond tax exemption. The exemption is not a result of the growth of a tax code designed to induce or reduce certain behaviors. Rather, it is the foundation for the flow of capital in a \$3.7 trillion dollar market required to efficiently finance the nation's infrastructure. Additionally, the exemption is part of the nation's original, 100-year old tax code, formalizing a doctrine of reciprocal tax immunity. America is defined by the reservation of state sovereign rights under the 10th Amendment to the Constitution. Accordingly it was determined that the state and local governments would not tax the federal government, and the federal government would not tax state and local governments. State and local decision makers would be afforded local control, and tax-exempt bonds would form the basis for raising capital.

Not all deductions and exemptions are created equally. It is clear to the State and local governments that issue municipal bonds and other industry participants that subjecting these bonds to income tax, whether in whole or in part, will increase interest rates paid by the State and local government borrowers—a partially tax-exempt bond is simply not as valuable as a tax-exempt bond. Unlike the other deductions and exemptions, in this case the tax impact is on the governmental borrowers, not the high the higher earners. Undermining the municipal tax exemption translates to increased costs to build roads, schools and bridges, airports, ports and affordable housing. Both the Camp surtax and the Administration's 28% limit would increase infrastructure costs by at least 15% — at a time that new and improved infrastructure needs, by all accounts, are not being met. In fact, the American Society of Civil Engineers has given the U.S. a D+ on the condition and performance of aging public infrastructure, and estimates the investment needed by 2020 at \$3.6 trillion. An increase in infrastructure costs would simply lead to less infrastructure investment, hastening this decline.

Every citizen will pay more, whether in terms of higher local taxes to make up for increased borrowing costs or failing infrastructure that reduces the nation's competitiveness. Municipal bond investors in all tax brackets will either demand higher interest rates on tax-exempt bonds or abandon tax-exempt bonds as an investment vehicle.

Policymakers have acknowledged this need for greater spending on infrastructure, but rather than focusing on preserving the “bread and butter” of the municipal bond market, they have recently turned to a discussion of infrastructure banks to address the nation’s needs. But to put these new bureaucracies that would result in perspective, past experience shows these federal creations can’t even begin to cover a fraction of a \$3.6 trillion need that touches highly diverse priorities.

The U.S. simply cannot afford to bear the burden of undercutting tax-exempt municipal bonds — the lifeblood of infrastructure and capital improvement financing — at a time that basic infrastructure needs are not being met.

In 2012, the Bond Dealers of America united with state and local governments to develop information for policymakers regarding the municipal bond market and the purpose and role of its tax exemption, helping form a coalition known as Municipal Bonds for America. Led by Columbia, South Carolina Mayor Steve Benjamin, the coalition is working continuously to ensure policymakers know the power and value of tax-exempt municipal bonds. Recent proposals show the work of this group is only beginning, and I would offer that for municipal market professionals and local elected officials looking to engage on this issue, membership is free and growing, and you can sign on — and sign a petition to preserve the tax-exempt status of municipal bonds — visiting www.munibondsforamerica.org.

I encourage the municipal bond community to work together to ensure that tax-exempt municipal bonds — a long-standing, vast, effective and efficient marketplace — is not treated just like every other tax code deduction or exemption.

Mike Nicholas is the chief executive officer of Bond Dealers of America.