
[Bond Tax-Break Threat Recedes With Federal Deficit: Muni Credit.](#)

One thing is unlikely to change as Republicans take control of Congress: the century-old tax break for investors in the $3.6 trillion municipal-bond market, which has been threatened by proposals advanced in Washington during the past four years.

With the U.S. budget deficit shrinking and President Barack Obama in office through 2016, analysts at banks including JPMorgan Chase & Co. and Citigroup Inc. see little chance of a broad tax-code overhaul that could reduce the subsidies given to state and local government bonds.

The prospect of taxing muni-bond interest has been raised since 2010 as Obama and congressional Republicans looked to lower the deficit or pay for cuts to income-tax rates. Such a change would reduce the value of munis, which command higher prices than other securities because the interest has been exempt from the federal income tax since its creation in 1913.

"As for the risk of a near-term tax reform, it's very minimal," said Mikhail Foux, a municipal-market analyst with Citigroup in New York. "We're unlikely to see anything before the next presidential election."

Obama said during a press conference last month that he wants to reach an agreement with the new Congress to revamp the tax code. While Republicans will control both the House of Representatives and the Senate, they still don't have enough power to override a veto by the Democratic president.

Veering Away

Representative Paul Ryan of Wisconsin, the next chairman of the tax-writing House Ways and Means Committee, has said that focusing on business taxes may represent the best chance for success, given how far apart Obama and Republicans are over how to approach taxes on individuals.

That approach lessens the odds that Congress may alter the status of municipal bonds, most of which are held by individuals seeking tax-free income, said Dustin McDonald, Washington lobbyist for the Government Finance Officers Association, which represents local officials.

"That would require a lot of support from those parties that they've had trouble corralling," he said. "You're going to have to gore a lot of oxen to do that."

The tax break, forecast to cost the Treasury about $47 billion this year in foregone revenue, has been targeted along with dozens of other provisions in overhauls that failed to advance during the past four years.

In 2010, Obama's deficit-cutting commission proposed taxing munis to lower rates and increase revenue. Obama and Republican Representative Dave Camp, the departing head of Ways and Means, later endorsed taxing some interest income received by the highest-earning households.

Reaping Gains

The failure of the plans was welcomed by investors and state and local government officials, who said that changing the tax status of municipal bonds would depress prices because buyers would demand higher yields to offset the cost. On Dec. 31, benchmark 10-year munis yielded 2.11 percent, about 0.07 percentage points less than Treasury bonds, a reflection of the tax advantages.

Josh Gonze, who helps oversee $10 billion in municipal bonds for Thornburg Investment Management in Santa Fe, New Mexico, said he foresees scant risk that tax status of the state and local debt will be changed.

“It’s not on our radar screen,” he said. “This is something that has been discussed for the past 50 years. I don’t think there’s anything that’s happened that’s going to bring this to the forefront.”

Street Yawns

The perspective is widely shared on Wall Street. Since the elections last month, municipal analysts at brokers and banks including UBS AG, Janney Montgomery Scott LLC and Macquarie Group Ltd. have said the divide between Congress and the White House makes change unlikely.

“It’s definitely a good thing for the muni market,” said Foux, the Citigroup analyst. “For the most part, it’s priced in. I think most investors dismiss the risk.”

Governors, legislators and local officials have lobbied Congress to prevent any such change. More than 100 House Democrats and Republicans in 2013 signed a letter supporting the break. At a hearing on the issue in the Ways and Means Committee that year, lawmakers from both parties said taxing munis would push costs onto local governments and taxpayers.

The improving economy has eased the pressure on Congress to reduce the federal budget deficit, said Susan Collet, the president of H Street Capitol Strategies, who lobbied Congress on the issue for the Bond Dealers of America. In the year ended in September, the deficit shrank to $483.4 billion, about a third of the record $1.4 trillion hit in 2009.

“The immediate pressures that Congress would have to feel to put something that controversial on the table aren’t present,” she said. “It’s gone away for a while.”

(An earlier version of this story was corrected to reflect that the income tax code, not munis, dates from 1913.)

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