Bond Case Briefs

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Congress Creates Bipartisan Municipal Finance Caucus.

The group's top priority will be preserving the tax-exempt status of municipal bonds, which President Obama wants to reduce for higher earners.

State and local governments have a new bipartisan set of advocates for their interests on Capitol Hill. This week, two congressmen launched the Municipal Finance Caucus to protect the municipal bond market.

U.S. Rep. Randy Hultgren, an Illinois Republican, and Rep. Dutch Ruppersberger, a Maryland Democrat, announced the formation of the caucus on Tuesday at the annual legislative meeting for the National Association of State Treasurers in Washington, D.C. They didn't say how many members they've recruited, but both have regularly rallied support on municipal finance issues from more than 100 of their Democratic and Republican colleagues.

"Our primary focus will be on telling the story of how important the current tax [status] of municipal finance is, and how risky, damaging and how harmful a change would be," said Hultgren. "So we're going to be very active, very vocal in telling these stories."

The development comes as President Barack Obama's budget once again aims to limit the tax-exempt status of municipal bonds.

It's a proposal fiercely fought by state and local government associations because it would likely lead to higher interest rates. States and localities sell bonds to raise capital, mostly for infrastructure and school projects. Because the investors that buy them don't get taxed on the interest, governments can offer a lower interest rate (as much as 30 percent lower), meaning it costs less for them to finance their projects.

Over the past five years, Obama has urged federal lawmakers to cap the tax-free interest of higher earning investors. Aimed at individuals declaring more than $200,000 in taxable income and couples declaring more than $250,000, the president's current proposal would cap the deductions those individuals can make to 28 percent of their income.

Currently, if a couple makes more than $250,000 — $100,000 of which is from muni bond interest — they don't pay taxes on that income from interest, which amounts to a $35,000 tax break. But under the administration's proposal, the couple would only get a break on 28 percent of that income, or $28,000. They would owe the federal government the remaining $7,000 in taxes.

Although the Obama administration argues that the proposal would only affect the nation's wealthiest earners — who theoretically could afford to pay more in taxes — government finance officials caution that states and localities would likely make up for the higher costs by raising sales and property taxes. That, in turn, would more adversely impact middle- and lower-income earners.

Alternatively, governments could simply invest less in infrastructure projects. That's equally concerning, as some estimate that state and local governments are behind by as much as $3.6

trillion in infrastructure investments.

At a speech to the treasurers group later on Tuesday, Jason Furman, who chairs the White House Council of Economic Advisers, conceded that they have “completely legitimate” concerns about who would end up paying for higher muni bond interest costs. But he also reminded them that Obama has asked for the interest cap only as part of a larger proposal that would ultimately increase infrastructure investment. For example, the president’s budget calls for a new $10-per-barrel fee on oil companies, which would help pay for $300 billion in new infrastructure investments.

“If you pick and choose a combination that would ultimately result in less infrastructure,” said Furman, “that’s not something the president would ultimately support.”

In reality, neither proposal stands much of a chance in a Congress that remains resistant to raising oil costs and has never debated the municipal tax exemption outside of committee.

Regardless, Hultgren warned that it would be wiser for state and local officials to continue actively lobbying against limiting the tax exemption.

“My fear always is what happens at two in the morning, and they’re drafting a bill and say, we need to find this much money to pay for this,” he said. “So it gets thrown in there, it gets rolled out and how do we roll it back?”

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BY LIZ FARMER | MARCH 2, 2016