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What Presidential Candidates' Tax Plans Mean For Munis

WASHINGTON – As the 2016 presidential race narrows down to a handful of candidates, it appears likely that business mogul Donald Trump and former Secretary of State Hillary Clinton will be the nominees with the most votes at the Republican and Democratic conventions.

Should Trump and Clinton secure the nominations, voters will be presented with two candidates whose tax plans share many similarities, but would have vastly different implications for the municipal bond market, in the eyes of some tax and muni bond experts.

Trump says his plan would simplify the tax code, cut taxes for the middle class and grow the economy without adding to the debt or deficit. But his plan, which would lower tax rates, could hurt munis, the experts said.

Clinton's plan, on the other hand, would maintain or raise tax rates for the highest earners, and that could spell positives for munis, they said. And as 2016 is a lame duck year, most experts agree that tax reform before January is not likely.

No matter who comes out on top in November, muni market participants will try to make sure they understand the importance of muni bonds. Bond Dealers of America CEO Michael Nicholas stressed that munis have funded critical infrastructure needs effectively for more than a century.

"They are the proven, economically efficient solution to the U.S. infrastructure problem that the presidential candidates have been discussing all across the country," Nicholas told The Bond Buyer this week. "BDA urges all the candidates to avoid eliminating or placing an unnecessary limit or cap on the value of the municipal bond interest exemption if they are truly serious about reducing fiscal burdens on localities while simultaneously putting people to work building roads, bridges, schools, and hospitals."

Donald Trump

Trump's plan is perhaps best defined by its across-the-board tax cuts, including an elimination of the individual income tax for 73 million households. The tax brackets would be reduced to four brackets from seven and set at rates of 0%, 10%, 20% with a top rate of 25%, according to Trump's campaign website. Those in the 10% bracket would keep all or most of their current deductions; those in the 20% bracket would keep more than half of their current deductions; and those in the 25% bracket would keep fewer deductions. The current top rate stands at 39.6%.

On the business side, Trump also calls for a reduction of the corporate income tax rate to 15 percent as well as an elimination of the death tax, the marriage penalty and the alternative minimum tax.

The Tax Foundation, a research think tank, estimated his plan would reduce tax revenues by $10.14 trillion, after taking into account an estimated 11% increase in GDP in the long term and an estimated 5.3 million new full-time jobs. The organization estimated a plan like Trump's, which would increase the federal deficit by more than $10 trillion on both a static and dynamic basis, would “greatly increase” the size of the U.S. economy in the long run.

Neither Trump nor Clinton mention municipal bonds specifically in their tax plans, but several experts have previously expressed concerns over what Trump’s plan could mean for the market. Frank Shafroth, the director of the Center for State and Local Government Leadership at George Mason University, warned that Trump’s plan would “lead to a fiscal double whammy for states and local governments and the nation’s public infrastructure” because it would reduce the incentives for purchasing munis, while increasing the federal debt and failing to offset spending reductions. This would create “significant, adverse” impacts on the muni market and “debilitating” effects on public infrastructure, he said.

Trump “would almost certainly force even deeper federal cuts in federal infrastructure programs – even as the dramatically reduced taxes proposed for the highest income Americans would equally reduce incentives for the purchase of municipal bonds,” Shafroth said.

The plan would be paid for by a one-time repatriation of overseas-held corporate cash at a discounted 10% tax rate; ending the deferral of taxes on corporate income earned abroad; and the reduction or elimination of several loopholes available to the most wealthy. He would steepen the curve of the personal exemption phaseout and the “pease limitation” on itemized deductions. He would also phase out the tax exemption on life insurance interest for high-income earners and reduce or eliminate other loopholes for the very rich and special interests.

Speaking at the 2016 National Association of State Treasurers Legislative Conference here earlier this month, David Burton, a conservative, called Trump’s tax plan “unusual,” adding that many financial analysts have estimated it would cost the country roughly $1 trillion per year.

The Tax Policy Center, in a December report, predicted increased government borrowing under Trump’s proposal would drive up interest rates and crowd out private investment, which could offset any positive incentive effects.

“Offsetting a deficit this large would require unprecedented cuts in federal spending,” the center wrote in the report.

Trump has said he would take the $4 trillion spent toward toppling various regimes and instead put it toward what he has repeatedly called a “crumbling” domestic infrastructure.

Still, Susan Collet, president of H Street Capitol Strategies, but doesn’t think the business mogul’s plan is well-developed enough to assess the likelihood of its potential positives for infrastructure spending. “He definitely wants to fix the infrastructure of the nation,” Collet said. “How to get there from his tax plan is a big question. The infrastructure spending has got to come from somewhere.”

“With deficits and debt climbing that high, the future White House and Congress are going to have to grapple not only with the tax code but also entitlements and spending,” she added.

“These federal cuts, and the resulting federal revenue losses would be unprecedented in U.S. history,” Shafroth said.

Hillary Clinton

Clinton’s plan is centered around a “Rising Incomes, Sharing Profits” tax credit that would award a two-year tax credit to companies that share profits with employees. The credit would be equal to 15 percent of the profits they share, and the profits would be capped at 10% on top of current employee wages.

The cost of the tax credit, estimated at $20 billion over a ten-year budget window, would be paid for through the closure of tax loopholes Clinton has said she will identity in the “weeks and months ahead.”

Hillary Clinton’s campaign recently released a detailed tax proposal, one that includes $1.1 trillion in tax increases. In its analysis of the report, The Tax Policy Center said the top 1% of households would pay more than three-fourths of Clinton’s increases, while the bottom 95 percent would remain relatively unaffected by any cuts. Citing Clinton representatives, The Tax Policy Center said it also anticipates a tax cut for low- and middle-income households to be released later in the campaign.

Clinton’s proposals are expected to raise tax revenue by $498 billion over the next decade, the majority of which would come from the Buffett Rule, or a cap on itemized deductions, The Tax Foundation estimated in January,

The $1.1 trillion the plan is expected to raise over the next decade would effectively reduce the economy’s size by one percent as a result of higher marginal tax rates on capital and labor income, the group said. Using its tax and growth model, the group projected a 1% drop in GDP and a 2.8% percent smaller capital stock.

A tax reform task force led by House Ways & Means Committee Chairman Kevin Brady, R-Texas, released a mission statement this month that stresses a limit of exclusions, deductions and credits in hopes of creating a stable tax code and a larger economy – quite the opposite from what experts believe would come from a Clinton tax plan.

As part of her plan to raise taxes on the wealthiest Americans, Clinton in January proposed a 4% surtax on those with an annual income of more than $5 million.

Howard Gleckman, a senior fellow at the Tax Policy Center, said that Clinton’s plan, which would raise rates for the highest earners, lends itself more to a thriving muni industry than Trump’s. He added that Trump’s plan, barring any unreleased planned spending cuts, would add enormously to the budget deficit and create a “big challenge” for state and local governments.

“The general rule of thumb is the lower the tax rate for the individual, the worse it is for tax-exempt bonds,” he said. “The higher the rate, the better it is.”

“Trump plans to dramatically lower the tax rates, giving people a much less reason to buy tax exempt bonds. Clinton, on the other hand, by raising tax rates for people at the top would make tax exempt bonds more attractive,” said Gleckman.

Other candidates

This week’s third incarnation of Super Tuesday saw Sen. Marco Rubio, R-Florida, exit the race after losing by double digits to Trump in his home state, leaving Trump with Sen. Ted Cruz, R-Texas, as the closest remaining competitor in a previously overcrowded GOP field.

The Tax Foundation, the tax research think tank, estimated Cruz’s plan would grow 10-year capital by 43.9%. Cruz, as he has mentioned throughout his campaign, has proposed a flat tax rate of 10%, and has plans to abolish the Internal Revenue Service. He would instead rely on a mail-in postcard tax payment system overseen by an office within Treasury.

He has proposed to replace the income tax with a consumption tax, which Shafroth said would cut taxes by an average of roughly $6,000, higher than any of remaining candidate. Cruz’s plan, which reduces both the corporate and individual tax rate, could very well push the tax system toward progrowth, according to Burton.

Shafroth said a Cruz or Trump presidency would spell many of the same problems for munis, but what stands out about Cruz's plan is what he called "disproportionately" proposed tax cuts – those in the top 1 percent would see an average federal tax cut of 26%, while middle income households would see just a 3.2 percent cut. This in itself, he said, would be disincentives for the purchase of general obligation and revenue municipal bonds both at the state and local level, Shafroth said.

Cruz has proposed an $8.6 trillion federal tax cut, roughly $1 trillion less than that of Trump.

"These two candidates would confront states, counties, and cities with much greater infrastructure or muni borrowing costs, even as federal investment resources for the nation's infrastructure would be depleted," Shafroth said.

The Tax Foundation said the plan of Sen. Bernie Sanders, I-Vt., the only other remaining Democratic presidential candidate, would result in a "substantial reduction" of the size of the U.S. economy in the long run. Sanders has proposed a number of increased payroll taxes and individual income taxes as well as four new income tax brackets for high-income households: 37%, 43%, 48% and 52%. The organization estimated that it would reduce the size of GDP by 9.5% in the long term, and increase federal tax revenues by $9.8 trillion over the next decade.

A report issued by the Tax Policy Center estimated Sanders' plan would cost the government roughly $13.5 trillion.

The likelihood of any of the candidates' plans coming to fruition is largely dependent on a number of factors, including the makeup of Congress and the Supreme Court, said the experts.

Chuck Marr, a self-described liberal and the director of federal tax policy for the Center on Budget and Policy Priorities, said at the NAST conference that the U.S. tax system is currently "bleeding," and speculated a divided Congress and more modest tax reform, specifically in the corporate sector should Democratic frontrunner Hillary Clinton win the presidency, and a "steamroll" effect in terms of implementing new tax measures should a Republican win.

"The highest probability for big change is if Republicans win and control a whole Congress and presidency. Then they'll have major tax cuts," he said. "They'll reduce rates on capital, and that is the most likely major action."

The Bond Buyer

By Evan Fallor

March 20, 2016