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Groups Pleased White House to Keep Muni Exemption, But Want to See It In Writing.

WASHINGTON – Municipal market participants said Wednesday that while they are pleased that White House officials say the Republican tax reform plan will fully support the tax exemption for municipal bonds, they would rather see it in writing.

The nine-page framework for the tax reform plan does not mention either munis or the deduction for state and local taxes (SALT). But senior administration officials told The Bond Buyer Tuesday night that they would support the muni tax exemption and seek repeal of the SALT deduction.

"It's good the White House is saying that, but it would be better if it were explicit in the documents," said Bill Daly, director of governmental affairs for the National Association of Bond Lawyers.

He noted the plan talks about eliminating most exemptions, deductions and credits, with specific exceptions for only the deductions for mortgage interest and charitable contributions and the tax credits for research and development and low-income housing.

"We've heard indications that Congress does not intend to curtail the tax exemption, but the process will be fluid until a bill is signed into law," said Michael Decker, managing director and co-head of municipal securities for the Securities Industry and Financial Markets Association. "We still perceive a risk to the tax-exemption."

"We remain fully engaged with Congress to defend the value of the tax-exemption for municipal bonds to ensure that the benefits of the exemption to municipalities, U.S. infrastructure, and investors remains unaffected during the legislative process for tax reform,'' said Justin Underwood ,director of the Municipal Bonds for America Coalition.

The nine-page framework for tax reform released Wednesday proposes to eliminate both the individual and corporate alternative minimum tax (AMT), which would be a boost for private activity bonds because most of them are subject to the AMT.

"We welcome the repeal of the AMT," said Decker. "The individual AMT especially forces some municipal borrowers to pay higher interest rates — 25 to 50 basis points — with little or no revenue accruing to the federal government, since most taxpayers know when they make investment decisions whether they fall under the AMT."

Daly said the repeal of the SALT deduction would hurt state and local governments' finances and potentially their ability to issue tax exempt bonds because it would make it harder for many jurisdictions to raise taxes. Some bonds are backed by tax revenues.

State and local officials, meanwhile, said they are mobilizing to prevent the elimination of the federal tax deduction for SALT, which prevents double taxation.

Muni representatives and tax experts question whether the framework will ever be enacted,

predicting Republicans will encounter the same obstacles that prevented them from passing partisan legislation to repeal and replace Obamacare.

Democrats blasted the tax reform plan, which the Republicans plan to consider though a partisan fiscal 2018 budget resolution and reconciliation bill that would enable the Senate to bypass its filibuster rule requiring a 60-vote supermajority for passage and enact tax reform with a simple majority vote.

“When Donald Trump was talking about this plan over the last few days he talked about focusing on the middle class,’’ said Senate Minority Leader Chuck Schumer, D-N.Y. “The plan is a major disappointment because it so deviates from everything the president said.’’

Schumer predicted Republicans will face opposition within their own party to repealing the SALT deduction as they did during the 1986 debate over tax reform. “My guess is, you’re going to have 30, 40, 50 Congress members, Republicans, who say they can’t vote for it because ‘It raises taxes on my core constituency,’” he said. “That’s the lesson they learned in ’86. I was part of it.’’

The tax reform framework calls for increasing the standard deduction for individuals to $12,000 and for couples to $24,000. This is the basis for simplification of the tax system, with Republicans hoping the standard deduction will be high enough that taxpayers won’t miss itemizing deductions.

“Nine out of 10 Americans will be able to file their taxes using a simple postcard system,’’ said House Ways and Means Committee Chairman Kevin Brady, R-Texas.

But John Buckley, former chief tax counsel of the House Ways and Means Committee, said that, with the higher standard deduction and repeal of the SALT deduction, the plan would be “a de facto repeal of the mortgage interest deduction’’ which will put downward pressure on home values.

Realtors have already complained about this in congressional hearings, warning the plan will penalize homeowners and reward renters.

The plan would shrink the current seven tax brackets, which range from 10% to 39.6% to three brackets, with rates of 12%, 25% and 35%. There would be flexibility to add a fourth rate for the wealthiest taxpayers.

The corporate rate would be reduced to 20% from 35%. The maximum tax rate that could be applied to the business income of small and family owned businesses conducted by sole proprietorships, partnerships and S corporations would be 25%.

The proposed reduction in the corporate rate to 20% could hurt demand for munis from banks and property and casualty companies, said George Friedlander, a managing partner at Court Street Group Research.

“At 20% tax rate, corporations won’t care nearly as much about munis,” he said, adding, “But I can’t see them ending up with a 20% rate.”

The plan would allow businesses to immediately write off or expense the cost of new investments in depreciable assets other than structures made after Sept. 27, for at least five years. The deduction for net interest expense incurred by C corporations would also be partially limited, but rates were not provided.

The tax reform framework, Republicans say, is only an outline that will be fleshed out by the two tax-policy committees in Congress during the coming weeks.

Friedlander and others said there is still a lot of detail left out of the tax reform framework and that any bill that could be passed would have undergo a lot of changes.

“There are a lot of open questions,” said Friedlander. “How are they going to pay for this? What will the tax rates end up looking like? Nobody I have talked to believes that the corporate rate will be 20%.”

Market participants are relieved that the tax reform framework does not include a proposal that was in the Republican Blueprint that would have potentially made corporate bonds more attractive than munis. The proposal would have allowed families and individuals to deduct 50% of investment earnings such as capital gains, dividends and interest income.

“SIFMA supports favorable tax treatment for all investment income. However it is true that drastically lowered the tax rate for taxable investment income would have eroded the value of the tax exemption for municipal interest,” said Decker.

Tax experts have warned lawmakers that a partisan tax plan would not provide the same kind of long-term economic boost as bipartisan legislation.

Trump already has traveled to several states with Senate Democrats who face re-election in 2018 in the hope of pressing them to support tax reform.

The U.S. Conference of Mayors sent a bipartisan letter Monday signed by 130 mayors urging Congress to not eliminate SALT.

“According to a recent report by the Government Finance Officers Association, if the SALT deduction is eliminated, almost 30% of taxpayers – including individuals in every state and in all income brackets – would be adversely impacted,’’ the mayors wrote. “This would include over 43 million tax units representing well over 100 million Americans.”

Americans Against Double Taxation echoed that concern. “This plan should concern all taxpayers who itemize, including those who claim the mortgage and charitable deductions, because the loss of SALT will mean fewer households will be able to claim any deductions in the future,’’ the group said. “Taxpayers should not be lulled into a false sense of security as this proposal threatens all itemized deductions, even though its direct focus is on SALT.”

By Brian Tumulty & Lynn Hume

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