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Know the Situations When Munis Don't Offer Tax-Free Benefits.

Many fixed-income investors gravitate towards municipal debt as an investment option because of the tax-free income; for some, this single benefit is enough to relinquish the potential for higher coupons on other alternatives like corporate debt or equity investments.

These alternatives may produce higher yields; however, the overall tax benefit with municipal debt is often enough to outweigh the higher yields offered on taxable debt. Most importantly, this tax benefit increases as an investor's tax bracket increases.

On the contrary, an investor purchasing municipal debt solely for its tax-free income benefit must be aware of situations where income from municipal debt holdings can be treated like normal interest income, creating a tax liability and cutting into the overall return of the security.

In this article, we will take a closer look at some of these situations and how investors can thoroughly assess their investment options before making any investment decisions.

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