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Municipal Bonds: Planning for the TCJA Sunset

Clients who invest in municipal bonds may require new strategies because of tax changes that lie ahead in 2026.

Since Dec. 31, 2021, when, within the depths of the COVID-19 pandemic, a five-year investment-rated municipal ("muni") bond paid only 0.6%, returns have significantly risen (e.g., the BVAL Muni Benchmark 5-Year yield was 2.55% on April 1, 2024) to levels that may make tax-advantaged municipal bond investing increasingly relevant for a broader segment of the investor community.

Even during the low-interest-rate environment of recent years, there were some potential new municipal bond investing opportunities, such as possible higher after-tax yields from private activity bonds (PABs) (see "Recent Developments for Municipal Bond Investors," JofA, Sept. 1, 2020). Subsequently, municipal bonds have resurged as an asset class, but there is concern about the pending but politically uncertain expiration after Dec. 31, 2025, of many provisions of the law known as the Tax Cuts and Jobs Act (TCJA), P. L. 115-97. Because of these events, now may be an appropriate time for advisers and clients to once again consider and evaluate strategies to optimally employ these tax-advantaged bonds within investment portfolios.

Municipal bonds are used to raise money for local and state projects such as building roads, schools, water systems, and libraries, as well as to fund day-to-day governmental expenses. Generally, interest paid on the bonds is exempt from federal income tax and, in many cases, state and local taxes if the investor resides in the state where the bond is issued. Often, states tax interest derived from out-of-state bonds. In addition, on disposition of the bonds, gain or loss is taxable.

This article focuses on the tax implications applicable to municipal bond investments of expiring provisions of the TCJA. It also briefly addresses other tax and nontax issues of potential concern to municipal bond investors.

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Journal of Accountancy

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June 1, 2024

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