Municipal Bonds for America

Statement for the Record
of the
Municipal Bonds for America Coalition
to the
House Committee on Ways & Means
Subcommittee on Tax Policy
Hearing on Tax Legislation

May 12, 2016

This statement is submitted on behalf of the Municipal Bonds for America (MBFA) coalition, a diverse group of local elected officials, financing authorities, and other organizations, to reaffirm our opposition to legislative proposals targeting municipal bonds, including private activity bonds. Investment in schools, education loans, transportation, housing, healthcare clinics, non-profit hospitals, electrical facilities, water and wastewater treatment systems, police, fire, ambulance services, and other public infrastructure is critical to a growing and well-functioning economy. For over 100 years, tax-exempt municipal bonds have served as the primary financing mechanism for public infrastructure and attempts to curb or repeal the municipal exemption would dramatically increase the cost of infrastructure to the public and undermine the efforts of America's state and local governments to move their communities forward.

Chairman Boustany, we strongly urge you and the Ways and Means Committee to retain the current system of tax-exempt financing that has worked well for America and through over a century of tax code precedent. You will find our positions on issues related to the municipal tax exemption below.

Fiscal Pressures

One factor driving tax reform is the fiscal pressure the federal government faces. Annual budget deficits have been declining, but under current policies are expected to begin growing in several years and eventually put the nation on "a path that would ultimately be unsustainable."[1] As a result, some budget and/or tax reform proposals have suggested taxing municipal bond interest, in whole or in part, or replacing tax-exempt municipal bonds with alternative financing vehicles. MBFA strongly opposes any proposal that would alter the current law status of tax-exempt municipal bonds.

Taxing municipal bonds will do nothing to address the underlying issues causing our nation's fiscal problems, but, instead, shift federal costs onto state and local governments and, ultimately, the American public. The same is true of new financing tools being proposed as a replacement for municipal bonds. They may change who is lending the money to finance projects, or even who operates and maintains the projects, but they do nothing to reduce fiscal pressures on the federal government—other than shifting costs to state and local governments and taxpayers.

[1] CONG. BUDGET OFFICE, THE 2014 LONG-TERM BUDGET OUTLOOK, 3 (July 2014).

Simplification

Federal tax laws significantly limit the entities that can issue tax-exempt bonds, the purposes for which the bonds may be issued, and the investment of bond proceeds. While certain bond-related tax rules could be simplified, imposing a new tax on municipal bond interest would increase complexity by upending more than 100 years of legal precedent and unsettling long-standing, stable markets. Such a tax would hurt millions of Americans for whom municipal bonds are an incredibly simple and efficient means of securing a steady income stream in and near retirement. It would hurt municipal bond issuers, who could be forced to seek financing in the taxable bond market, a world in which the median municipal bond issue size ($7 million) would be a fraction of the median corporate bond issue size ($200 million). A partial tax could even be more complicated, as the tax status of a municipal bond would change with its holder's income, and the bond's value in the secondary market would depend on investors making similar calculations based on their estimates of their future income.

Infrastructure

Many policymakers are not satisfied with the current level of investment in infrastructure in the United States and are considering a variety of new investment tools as a result—tax credit bonds, direct-payment bonds, infrastructure banks, and a full spectrum of legal and regulatory changes to spur public-private partnerships. These new tools may encourage new sources of capital to finance these projects, including hedge funds, institutional investors, and offshore investors. They might also entice non-governmental entities to seek to construct and/or maintain these projects. In fact, some of these new tools are variations on existing tools—qualified private activity municipal bonds—currently used with great success by some of our coalition members.

Changing who lends the money to finance these projects, or who will build and/or operate these projects, will do nothing to change who, ultimately will pay for these projects—state and local residents. None of these alternatives change whether state and local residents can afford to pay the price. Conversely, it is absolutely certain that taxing municipal bonds, in whole or in part, will reduce the amount of infrastructure investments state and local residents can afford and be willing to undertake. This is true whether the new tax is intended to offset the cost of one of these new tools or simply to raise revenue for the federal government.

Class-Based Criticisms

Some critics say the exclusion for municipal bond interest is an inefficient windfall for wealthy investors. These arguments rely on the assumption that tax treatment is the sole factor driving investor behavior. Nationwide, about 72 percent of bond interest is paid to individuals, either directly or through mutual funds and similar investment vehicles. About 60 percent of household municipal bond income goes to investors aged 65 and older; and about half of household municipal bond income goes to investors with adjusted gross income of less than $250,000.

Households purchase municipal bonds because of the stability of the municipal bond market and the safety of the investment. The federal exemption of municipal bond interest protects this income from federal tax. As a result, investors accept a lower rate of return on these bonds in exchange for the benefit of the tax exemption—reducing or eliminating any tax "windfall."

Finally, a new tax on bonds would affect all Americans, not just "wealthy" investors being targeted. In fact, there is virtually no disagreement that all taxpayers will pay the price if Congress were to upend the 100-year precedent of exclusion to tax municipal bond interest. And when state and local governments go to issue new debt, the cost of the new tax will not be borne by the investor, who will be compensated with higher rates for any taxes he or she pays, but rather by state and local residents forced to pay billions more every year in additional financing costs. Effectively, a new tax on bonds would result in a locally imposed federal tax.

For over 100 years, municipal bonds have been an efficient, market-oriented way to finance infrastructure projects at the local level to keep America connected and competitive. Roughly 75% of today's infrastructure was financed with the help of municipal bonds. Over time, municipal bonds have built four million miles of roads, 500,000 bridges, 16,000 airports and 900,000 miles of pipe in water systems. It is no exaggeration to say that municipal bonds build America. Any proposal to target the tax-exempt status of municipal bonds would severely undercut this critical financing tool and deal a severe economic blow to America's communities and their citizens.

We would be happy to answer any questions you or Subcommittee members may have in relation to our perspective as laid out above, and we look forward to working with you on this important issue.

Executive Committee of the Municipal Bonds for America Coalition

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