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# Federal Tax Reform: What's at Risk for the Bond Market?

In 2013, Congress will likely consider comprehensive revisions to the federal tax code. This will be the first major overhaul since the Tax Reform Act of 1986, under which eligible purposes for tax-exempt bonds were restricted – and this time, the overhaul will occur under strained economic and political circumstances. Significant cuts in corporate and individual tax rates, paid for by the elimination of popular tax exemptions, will be central to the debate. Tax exemptions once thought to be the very fabric of public policy will be reconsidered, from tax deferrals on 401(k)s to the mortgage interest deduction – and, the historic tax exemption on municipal bonds that finance public infrastructure.

**The municipal exemption is gaining attention as a target of tax reform.** Proposals from both parties recommend the limitation or replacement of tax-exempt bonds. These proposals are expected to form the basis for discussions in the tax reform debate. For example:

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| Obama Administration FY 2013 Budget | Limit the value of the municipal exemption to 28% |
| Romney Tax Reform Proposal | Advisors say muni tax exemption "on the table" |
| Bowles-Simpson Commission | Eliminates exemption for new bond issues |
| S. 727, Wyden/Coates Legislation | Replaces tax-exempt bonds w/tax-credit bonds |

Some policymakers claim that tax-exempt bonds are an inefficient way to subsidize state and local governments infrastructure, and that they favor wealthier investors. Some also claim that affordable borrowing costs lead local governments to borrow too much. There is no connection, however, between whether borrowing is affordable and whether budgets are balanced. Voters oversee their cities and often must approve new borrowing at the voting booth. Moreover, instances of cities failing to honor municipal bond debts is extraordinarily rare, as municipal bonds are supported by revenue such as tolls or by the powers of cities to impose taxes and impound property. The truth is, all taxpayers at all income levels benefit from public infrastructure – schools, roads, bridges, sewers – financed by tax exempt bonds. Limiting or replacing tax-exempt bonds with an investment product less attractive to investors could lead to higher financing costs for government issuers and ultimately, local taxpayers.

**What can I do?** Middle-market municipal bond dealers bridge local issuers of tax-exempt debt with investors focused on stability and security. Bond dealers and local issuers alike must explain to policymakers that municipal bonds are effective tools for financing critical infrastructure for the benefit of all. A task force is forming now, bringing affected groups together to inform and advise Congress and the Administration on why tax-exempt bonds must be protected as a cornerstone of finance for communities nationwide. For more information about the task force and how to get involved, contact:

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