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THE FUTURE OF TAX EXEMPTION FOR MUNICIPAL BONDS

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This isn't about Clinton or Trump. Whenever there is a change in the Presidency and/or Congress, this question gets revived: should municipal bonds continue to be exempt from federal income taxes?

Since 1913's federal income tax law, interest on state and local bonds has been tax-exempt. The principle was that the federal government cannot impose taxes on income derived from state activities. That principle was overturned in laws that stripped many municipal bonds of their tax exemption from 1982-1986 during President Reagan's administration. In the last 30 years, debates continue whether this tax exemption is valid/useful, or should be repealed in favor of comprehensive tax reform. I'm not a lawyer, nor a political expert, but it seems to me that if a new administration/congress is serious about radical tax reform, tax exemption for munis will be in the "cross-hairs".

My first observation is that if there were to be serious changes in the tax code for municipals, it would not be imposed retroactively but be imposed on a "going-forward" basis. The alternative would be disruptive and roil the bond markets for cities and states.

Second, as stated in 1988's Anthony Commission Report on Public Finance, municipal bonds are not merely tax-loopholes for the wealthy:

"Tax exempt bonds are the basic tool used by states, cities, counties and towns to fund...necessary capital improvements. The ability to sell debt with interest exempt from federal taxes has been a significant benefit to state and local government borrowers, directly reducing the tax burdens that citizens would otherwise have to shoulder to finance essential services."

It's a zero-sum game: eliminating tax exemption on municipals increases costs for taxpayers, whether they pay federal, city or state taxes.

About the Author

RICHARD P. LARKIN, Stoever Glass & Co., Inc.

Richard Larkin, a recognized 40 year industry veteran, has joined SG & Co. as Director of Municipal Credit Analysis. Mr. Larkin began his career in credit rating analysis at Standard & Poor's in 1975. After rising through the ranks in various analytical and management positions, Dick left S&P as its Chief Municipal Rating Officer, responsible for municipal rating policy, practices, governance and criteria. In 1998, Mr. Larkin joined Fitch Ratings as Chairman of its Public Finance Criteria Committee.

"Dick will be a unique resource to Stoever Glass' municipal clients. His knowledge in specific issues and areas of the municipal bond industry will aid our representatives and their clients in making educated decisions, in a sector where this type of research is unique," said Roland Stoever of Stoever Glass.

Disclosures: