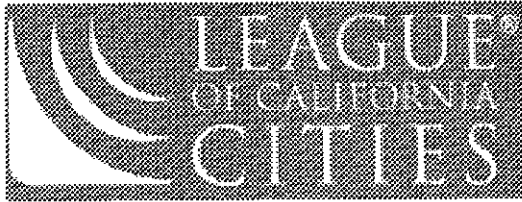



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## Cities Urged to Communicate Support for Preservation of Municipal Bond Tax Exemption

*May 21, 2013*

Last week U.S. Rep. Eric Swalwell (D-CA) signed onto a House resolution celebrating the history of municipal bonds after being asked to do so by representatives of the National League of Cities' (NLC) Asian Pacific American Municipal Officials and the Gay, Lesbian, Bisexual and Transgender Local Officials during their joint Capitol Hill lobby day.

The resolution celebrates the history of municipal bonds, the 100-year precedent of the federal tax exemption for municipal bond interest and the important contribution municipal bonds make to economic growth and well-being in each state and municipality. The resolution is seen as a barometer of support for traditional muni bonds by those on all sides of the issue.

NLC is mobilizing support to preserve the tax exempt status of municipal bonds and asks city officials to contact their representatives in the House to sign on as a co-sponsor of H. Res. 112. It is critical that cities demonstrate support for municipal bonds to help stop an effort to change the most important tool in the U.S. for financing investment in schools, roads, water and sewer systems, airports, bridges and other vital infrastructure as a part of a deficit reduction plan, a push for comprehensive tax reform, or as an offset for new spending.

Also last week, the Senate Finance Committee issued a white paper outlining federal tax reform options it may consider, including modifying or eliminating municipal bonds. While stating the ideas presented are not endorsed by Chair Max Baucus (D-MT) or ranking member Orrin Hatch (R-UT), they would significantly change existing law, and increase the cost for local taxpayers to fund public infrastructure, including highways, bridges, local streets, public transit, airports, water and sewer, general acute-care hospitals, primary and secondary schools, and jails.

## Take Action

Cities are encouraged to send in letters urging Congress to keep the federal exemption for municipal bond interest. The League has a sample letter for cities to use online at [www.cacities.org/federal](http://www.cacities.org/federal).

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## TALKING PONTS ON PRESERVATION OF THE MUNICIPAL TAX EXEMPTION

- **Tax-exempt bonds are the primary financing mechanism for state and local infrastructure projects—they have been used for more than 100 years and provide essential funding for states, counties and localities.**
- **Three-quarters of all public infrastructure projects in the U.S. are built by states and localities, and tax-exempt bonds are the primary financing tool utilized to satisfy these infrastructure needs.**
- **If the tax exemption is eliminated or reduced, states and localities will pay more to finance projects, leading to fewer projects and fewer jobs, or project costs will be transferred to local tax and rate payers.**

### IMPACT OF PROPOSALS TO REDUCE OR REPEAL THE TAX EXEMPTION

Over the last few years several federal proposals have been offered that would either completely remove the long-standing exemption on municipal bond interest or impose a 28% cap on the amount investors may exempt from their taxes.

- **IMPACT OF REPEAL** - If the proposal to repeal the exemption had been in place during the 2003–2012 period, it is estimated that it would have cost governments an additional \$495 billion in interest costs for the \$1.65 trillion in bonds used for state and local infrastructure that was completed during this period.
- **IMPACT OF 28% CAP** - With regard to the proposed 28% cap, if this proposal had been in place over the last 10 years, it is estimated that the \$1.65 trillion of state and local infrastructure investment that took place over that time would have cost governments an additional \$173 billion of interest costs.
- **IMPACT ON THE MARKET** - Federal proposals to cap or remove the exemption on municipal bond interest has already created volatility in the municipal bond market and this trend would only continue with severe repercussions if either of these proposals were enacted.

Investors would demand higher yields from state and local governments to due to the increased level of uncertainty about further Washington intervention into the municipal bond market both prospectively and retroactively (i.e., if the 28% cap goes into effect, then there is always a threat that Congress could make additional changes that would raise costs even more for state and local governments).

- **IMPACT ON TAXPAYERS** - If state and local governments are unable to satisfy investor demands for higher yields, then either needed infrastructure projects will not move forward or the costs of these projects will be passed on directly to state and local tax and rate payers.

## **THE TAX EXEMPTION IS A WIN-WIN-WIN-WIN!**

- A win for state and local governments who need the support of investors to finance critical infrastructure;
- A win for taxpayers across the country who depend on this infrastructure for reliable transportation systems, schools, public health facilities, energy, clean water and affordable housing;
- A win for the federal government who is able to provide a small tax benefit for a return of billions of dollars of infrastructure; and
- A win for investors who purchase bonds for many reasons, including the safe nature of these financial products.
- Further, elected bodies at the state and local levels or voters themselves approve whether an entity should issue bonds for specific long-term projects, not to support general government functions, such as maintaining employees or keeping the lights on.

## **THE TRUTH ABOUT MUNI INVESTORS**

Some have claimed that proposals to cap the investor deduction would solely impact wealthy investors. However, these claims are not accurate:

- The IRS' own data illustrates that 57% of tax exempt income is reported by earners over the age of 65.
- In 2010, 52% of all bond interest paid to individuals went to those with incomes of less than \$250,000.
- 2010 Thomson Reuters data indicates that 72.4% of the total outstanding muni debt is held by retail investors/households, either directly or through mutual funds and money market funds.
- These are critical points that give us a picture of who is investing in municipal bonds and why.
  - For example, those 57% of tax exempt income earners who are investing in muni bonds are investors with limited incomes that have chosen to invest in municipal bonds because they are a secure investment.
  - Muni bonds are an extremely safe investment, second only to U.S. Treasuries, with a nearly zero default rate.
  - Investors purchase municipal bonds without the expectation of a larger investment return from state and local governments because they know they are making safe investments.

## **ENOUGH ALREADY!**

- The federal government has asked state and local governments to sacrifice a lot over the years, with dramatic decreases in federal government funding for critical state and local programs such as CBGB, HOME, COPS, BYRNE/JAG and the CWSRF and DWSRF programs through annual appropriations cuts and sequestration. To also take away this advantage to low cost capital, is a double hit that would cripple national infrastructure development.
- The tax exemption on muni bonds has helped state and local governments pay for the vast majority of our country's infrastructure over the past 100 years, having been maintained through two world wars and the Great Depression, as well as the recent Great Recession. It works. It works for small governments and large governments.
- Why would Congress want to change something that works already for a majority of state and local governments of all sizes, and provides trillions of dollars in infrastructure funding that cannot be replicated or replaced?