Don’t Mess With Our Bonds Coalition

July 24, 2013

The Honorable Harry Reid
United States Senate
522 Hart Senate Office Building
Washington, DC 20510

Dear Senator Reid:

Following up on the Senate Finance Committee leadership’s June 27 Dear Colleague letter requesting guidance on Senators’ priorities for inclusion in the chamber’s comprehensive tax reform package, the organizations listed below are writing to request your assistance in urging Senate Finance Committee leaders to maintain the federal tax exemption on municipal bond interest. Maintaining the tax-exemption is essential to addressing national infrastructure priorities, helping our national economy grow, creating jobs and serving the unique needs of each of our communities.

The federal tax exemption on municipal bond interest was included in the country’s original income tax code in 1913. As such, it is a central component of the “blank slate” tax code referred to in the committee leadership’s June 27 Dear Colleague, and should be maintained as a starting point in the committee’s tax reform discussions. This provision of the code is so fundamental in part because it reinforces the basic compact of reciprocal tax immunity and respect that exists between the federal, state and local governments. For over 100 years our federal system has respected this essential principle: the federal government does not tax state and local bond interest, while federal borrowing is exempt from state and local taxes. Proposals to replace the tax exemption with investor deduction caps and limitations would destroy this long-standing compact, and unravel over a century of synchronized and mutually beneficial federal, state and local tax policy.

Through the tax-exemption, the federal government continues to provide critical support for the federal, state and local partnership that develops and maintains essential infrastructure, which it cannot practically replicate by other means. Three-quarters of the total United States investment in infrastructure is provided by state and local governments, and tax-exempt bonds are the primary financing tool that are used by over 50,000 state and local governments and authorities to satisfy these infrastructure needs. On average, state and local governments issue nearly 10,000 bonds a year totaling $300 billion. This has allowed state and local governments to finance more than $1.65 trillion in infrastructure investment over the last decade through the tax exempt market.

Our citizens, communities, private businesses, and non-profit sectors benefit in many ways from the issuance of these bonds. Municipal bonds build and maintain schools to support an educated workforce; build our roads, public transportation systems and airports to speed commerce; build utilities to supply our communities with clean, safe water, power and natural gas; build hospitals and clinics to keep our communities healthy; build affordable housing; and build public safety infrastructure that keeps our communities and our nation secure. These municipal bonds are approved by elected bodies at the state and local levels or by the voters themselves for specific long-term projects, not to support general government operations, such as maintaining staff or keeping the lights on.

As the federal government continues to develop policies to reduce the deficit, several proposals have been offered that would replace, limit, or eliminate the tax exempt status of municipal bonds. To support these proposals it has been suggested that those who truly benefit from the municipal tax exemption are wealthy investors. These claims mischaracterize municipal investors and the true beneficiaries of municipal bonds, who are –

- State and local governments who need the support of investors to finance critical infrastructure;
- Taxpayers across the country who depend on this infrastructure for reliable transportation systems, schools, access to health services, energy, clean water and affordable housing;
- The federal government, which has relied on its partnership with state and local government to provide the nation's infrastructure; and
- Investors who buy bonds for many reasons, including tax concerns, the interest in the investments being financed, and the safe nature of these financial products.

With regard to the identity of municipal investors, 72.4 percent of the total outstanding muni debt is held by individual investors, either directly or through mutual funds and money market funds (Source - 2010 Thomson Reuters). Further, IRS data indicates that 57 percent of tax exempt income is reported by earners over the age of 65. These are individuals who are largely on fixed incomes, expecting the secure return on investment that municipal bonds provide. Municipal bonds are the second safest investment, aside from U.S. Treasuries, with state and local governments having nearly a zero default rate. 2010 IRS data also indicates that 52 percent of bond interest paid to individuals went to those with incomes of less than $250,000. These are people who want to support the long-term infrastructure needs of their communities through a direct investment that cannot be replaced by any source, including the federal, state or local governments.

Proposals to reduce or repeal the tax exemption would have severely detrimental impacts on national infrastructure development and the municipal market, raising costs for state and local borrowers and creating uncertainty for investors. For example, it is estimated that if the proposal to impose a surtax on municipal bond interest (so as to "cap" the tax value of the exemption at 28 percent) had been in place over the last 10 years it would have cost state and local governments an additional $173 billion in interest costs. Fully taxing municipal bond interest would have cost state and local governments over $495 billion in additional interest costs. Given the severe budget constraints that state and local governments have faced since the national financial crisis of 2008, it is very likely that many of the infrastructure projects funded through tax exempt bonds would not have been possible.

Furthermore, capping or eliminating the exemption on municipal bond interest will adversely impact job creation. A recent IHS Global Insight report estimates that proposals to replace the exemption with a 28 percent cap on investor deductions would result in the loss of almost 312,000 jobs annually and $24.7 billion in GDP. The report also estimates that full repeal of the exemption would result in the loss of nearly 892,000 jobs annually and $70.7 billion in GDP.

Proposals to tax municipal bond interest, in whole or in part, would also introduce uncertainty into the municipal market, causing investors to fear additional federal intervention in the market where none has existed for the past 100 years. Ultimately these investor concerns translate into demands of higher yields from, and increased costs to, state and local governments. These increased costs will mean that either needed infrastructure projects will not move forward or the increased costs of these projects will be passed on directly to state and local tax and rate payers. Meanwhile other proposals to replace tax exempt bonds with tax credit or direct subsidy bonds have also gained some attention. These proposals would also create market uncertainty and instability and increase the state and local borrowing costs, especially smaller governments. Again, these costs, either in the form of reduced services or higher taxes and rates, would then be passed along to taxpayers.

Just as federal borrowing has been exempt from state and local taxes for over a century, the municipal tax exemption has a long history of success, having been maintained through two world wars and the Great Depression, as well as the recent Great Recession, and it continues to finance the majority of our nation's infrastructure needs for state and local governments of all sizes when no other source exists to do so. We cannot afford to abandon the great success of this important instrument now.

For these reasons we hope you will include the critical need to maintain the tax exemption on municipal bond interest in your discussions and correspondence with Senate Finance Committee leadership on comprehensive tax reform. Thank you for your consideration of this request and your continued commitment to supporting federal tax law that supports national infrastructure maintenance and development needs.

Sincerely,

Airports Council International – North America
American Association of Airport Executives
American Association of State Highway and Transportation Officials
American Concrete Pavement Association
American Concrete Pressure Pipe Association
American Council of Engineering Companies
American Hospital Association
American Planning Association
American Public Gas Association
American Public Power Association
American Public Transportation Association
American Public Works Association
American Society of Civil Engineers
Associated Equipment Distributors
Associated General Contractors of America
Association of Metropolitan Water Agencies
California Association of Sanitation Agencies
Council of Infrastructure Finance Authorities
Council of State Community and Economic Development Agencies
Distribution Contractors Association
Government Finance Officers Association
International Association of Fire Fighters
International City/County Management Association
International Economic Development Council
International Municipal Lawyers Association, Inc.
International Public Management Association for HR
Investment Company Institute
Large Public Power Council
National Asphalt Pavement Association
National Association of Counties
National Association of County and City Health Officials
National Association of Development Organizations
National Association of Health and Educational Facilities Finance Authorities
National Association of Regional Councils
National Association of Resource Conservation and Development Councils
National Association of State Auditors, Comptrollers and Treasurers

National Association of State Treasurers
National Association of Towns and Townships
National Center for Frontier Communities
National Community Development Association
National Council of State Housing Agencies
National Council on Teacher Retirement
National Latino Farmers & Ranchers Trade Association
National League of Cities
National School Boards Association
National Utility Contractors Association
Rural Coalition
The Council of State Governments
The National Association of Clean Water Agencies
The National Grange
Transmission Access Policy Study Group
The United States Conference of Mayors
Water Environment Federation
Water Infrastructure Network