A Tax on Municipal Bonds Would Be a Tax on All Americans

Municipal bonds are a stable financial investment valued for their security and ability to generate a steady stream of revenue—often for fixed-income households. Some investors purchase municipal bonds because the interest is exempt from federal tax. However, because of this tax treatment, investors also accept a lower rate of return on these investments, eliminating most of any “windfall” and reducing state and local borrowing costs.

- Taxing municipal bonds—either directly or through some “cap” on the value of the tax exemption—will hurt the value of all bonds (and so hurt all bond holders), even if the tax is designed to “target” upper-income earners.¹

- Historically, about half of municipal bond interest paid to individuals is earned by those with income of less than $250,000 (see below).²

- Senior citizens would be particularly hard hit — three-fifths of all bond interest is paid to households with a taxpayer aged 65 or older (more than four fifths to households with a taxpayer aged 55 or older).³

- Citizens and ratepayers of all income levels will pay higher taxes (or utility rates) if municipal bonds are taxed and, as a result, state and local borrowing costs increase.⁴
  
  o Assuming historic spreads between tax-exempt and taxable debt, local residents would be paying as much as $75 billion more a year in interest payments today.

¹ Michael Kaske, Bloomberg, “Tax Cap Threatens $200 billion Muni Loss, Citigroup Says” (Dec. 7, 2012)(reporting analysis that limiting the tax value of the exclusion for municipal bond interest will reduce the value of existing bonds in the secondary market); Brian Chappatta, Bloomberg, “Tax-Status Threat Fuels Worst Losses Since Whitney: Muni Credit” (Dec. 21, 2012).
³ Supra note 8.
⁴ Frank Sammartino, Congressional Budget Office, Testimony before the S. Comm. on Finance Hearing “Tax Reform: What it Means for State and Local Tax and Fiscal Policy” (Apr. 25, 2012)(Testifying that the vast majority of the benefit of the federal income tax exclusion for municipal bond interest results in lower borrowing costs for states and localities).