Municipal Bond Legislation and Regulation

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The tax-exemption is under threat.

1. The political agenda is dominated by deficit and debt reduction and tax reform.

2. House and Senate tax writers are drafting tax reform legislation.

3. The tax exemption is facing threats from both sides.

4. Mini “fiscal cliffs” could still be a threat.
Numerous proposals have been floated to curtail or eliminate the tax-exemption for municipal bonds.

1. The Obama administration’s FY2014 budget would impose a 28-percent cap on the benefit to taxpayers of tax-exempt interest, including all outstanding bonds.
3. The Bipartisan Tax Fairness and Simplification Act of 2011 (S. 727, the “Wyden-Coats bill”) would replace new tax-exempt bonds with tax-credit bonds and prohibit advance refundings.
4. The National Commission on Fiscal Responsibility and Reform (“Simpson-Bowles”) proposed eliminating the tax-exemption on all new issues of municipal bonds.
5. The Bipartisan Policy Center’s Debt Reduction Task Force (“Domenici-Rivlin”) proposed eliminating the tax-exemption on all new issues of private-activity bonds.
6. The Obama administration’s deficit reduction framework proposed a contingent cap on the benefit of tax-exempt interest, including outstanding bonds, based on whether certain debt-to-GDP targets are met.
7. The Joint Committee on Taxation’s tax reform “experiment” document would repeal the tax-exemption for new issues after 2012.
8. The Congressional Progressive Caucus’ “People’s Budget” would replace tax-exempt bonds with direct-pay bonds.
1  On Feb. 26, House Ways and Means Committee Chairman Dave Camp released a draft of the Tax Reform Act of 2014.

2  Key provisions affecting the tax-exempt bond market:
   • 10-percent tax on tax-exempt income earned by couples with “modified adjusted gross incomes” greater than $450k and individuals greater than $400k. Applies retroactively.
   • Prohibition on advance refundings.
   • Prohibition on private-activity bonds (broad definition).
   • Elimination of bank qualified bonds.
   • Elimination of tax deferral for market discount bonds.
President Obama’s Budget

1 28-percent cap is back, based on tax rates. Begins at $226,850 of taxable income for couples (33-percent bracket for 2014).
2 “Buffet Tax” would not affect tax-exempt interest.
3 America Fast Forward Bonds: Build America Bonds with 28-percent subsidy rate. 501(c)(3)s would be eligible.
4 Market discount changes would have implications for issuers.
5 Repeal remaining elements of $150 million cap for non-hospital 501(c)(3) borrowers.
6 Arbitrage simplification: Eliminate yield restriction and expand small issuer exemption.
7 Permit private use of bond-financed research facilities.
8 Permit up to 35 percent of private activity bonds to be used for land acquisition.
9 Others.
Political landscape

1. Tax-exemption being characterized more as a benefit for wealthy taxpayers and less as a benefit for state and local governments.
2. Sense that all must “bear some pain” to address fiscal issues.
3. “Sacred cows” eroding.
   • Mortgage interest deduction
   • Charitable contribution deduction
4. Tax reform may be coming in 2015.
   • Focus will be lower rates and fewer preferences.
Tax-exemption: Key Talking Points

1. The tax-exemption has existed since the first federal income tax in 1913. It is not a loophole.
2. Eliminating tax-exempt finance would raise borrowing costs 200-300 basis points for state and local governments.
3. Investors already pay an implicit tax on municipal interest by receiving a lower pre-tax rate of return.
4. The administration’s proposal to impose a 28-percent cap on the tax-exemption would raise state and local borrowing costs by 50-100 basis points.
5. Tax-exempt bonds have financed trillions of dollars of the nation’s public infrastructure. Infrastructure is underfunded, and raising the cost will result in less investment.
6. A tax on municipal bond investors would be borne not by those taxpayers but by state and local governments in the form of higher borrowing costs.
SEC Municipal Advisor Rule

1 The SEC’s Municipal Advisor Rule was finalized in September 2013, takes effect on July 1, 2014.
2 Municipal advisors will be subject to a fiduciary duty.
3 Rule will also affect investment banking activity. A dealers could be considered municipal advisors unless:
   • The dealer is “engaged” by the bond issuer;
   • The issuer certifies that they have engaged an “independent, registered municipal advisor” and are relying on the advisor for advise; or
   • The dealer is responding to a request for proposals.
4 A dealer could also become a municipal advisor if providing advice on the investment of bond proceeds.
What to expect as the MA effective date approaches

1. Dealers may request to be “engaged.”
2. Dealers may request “IRMA letters.”
3. Dealers may request an acknowledgement that you have issued a RFP.
4. Dealers may ask you to certify that deposit and investment accounts do not contain bond proceeds.
MSRB Rulemaking for MAs

1. New proposed MSRB Rule G-42
   • Would prohibit “principal transactions” for municipal advisors;
2. Supervisory responsibilities
3. Qualifications and testing
4. Political contributions and gifts