April 14, 2015

The Honorable Orrin Hatch
Chairman
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Ron Wyden
Ranking Member
Senate Finance Committee
219 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Dean Heller
United States Senate
324 Hart Senate Office Building
Washington, DC 20510

The Honorable Michael Bennet
United States Senate
458 Russell Senate Office Building
Washington, DC 20510

Dear Chairman Hatch, Ranking Member Wyden and Task Force Leaders Heller and Bennett:

On behalf of the organizations listed above representing our nation's cities, towns and counties, we appreciate the opportunity to submit the following comments to the Senate Finance Committee as the committee begins work on examining the federal tax code. Our comments highlight three specific areas: (1) maintaining the federal tax exemption on municipal bonds to promote job creation and improve the nation's infrastructure; (2) ensuring that state and local governments retain the authority to set their own tax policy; and (3) opposing federal preemptions that would grant preferential tax treatment to certain industries and threaten the fiscal health of state and local governments.

We think it is important to continue the long-standing partnership between the federal government and state and local governments through the federal tax exemption on municipal bond interest. This long-standing federal tax policy, promulgated in 1913, is neither a loophole nor a special interest tagalong provision, but rather a fundamental component of our intergovernmental partnership and a safe and reliable investment. The exemption needs to be maintained in order to provide much-needed and irreplaceable resources to finance the nation's infrastructure needs. Through this critical financing tool, state and local governments are able to save approximately two-percentage points on their borrowing costs to finance the vast majority of all public infrastructure in our nation, which translates into a substantial savings to local taxpayers.

Our organizations share a long-standing support for the preservation of the well-established federal, state and local partnership embodied in federalism, and opposition to any preemption by Congress of state and local taxing authority. How to levy taxes fairly, how to ensure there is no discrimination among companies that provide different forms of the same service, and how to protect local government resources are all matters that should be resolved at the state and local level. Local governments exercise their taxing authority to the extent provided by state law. As a result, local taxing authority and practices differ from state to state, and from county to county and city to city within a state. This means that every local government tailors its tax policy by taking into consideration the interests of its residents and local circumstances, and how best to address them. More importantly, local officials making these decisions are immediately accountable to the voters and taxpayers in their communities for the expenditure of funds on public services. The residents of the communities we serve already have the power to change locally imposed taxes and do not need to be subjected to a one-size-fits all federal tax policy.

Finally, in today's difficult economic times, when local governments are still working to recover from the 2008-2009 national economic crisis, local taxing autonomy is crucial in helping to ensure that the needs of local citizens are met. The ability to make tax and other fiscal policy decisions at the local level, without federal interference, enables local officials to provide the quality services our shared citizens expect. In considering any changes to the federal tax code, we simply ask that you respect local authority and that you act to promote our intergovernmental partnership by authorizing the collection of local taxes already owed to state and local governments on Internet and mail-order sales. Accordingly, we call on Congress to immediately pass the *Marketplace Fairness Act* (S 698).

The following is a more detailed discussion of our policies related to these issues.

Maintain the Federal Exemption on Municipal Bonds

State and local governments of all sizes access the tax-exempt bond market to provide essential infrastructure. 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. State and local governments provide three-quarters of the total investment in infrastructure in the United States, and tax-exempt bonds are the primary financing tool used by over 50,000 state and local governments and authorities to satisfy these infrastructure needs. State and local governments issue approximately 11,000 bonds a year totaling roughly $300 billion on average. This has allowed state and local governments to finance more than $3.5 trillion in infrastructure investment over the last decade through the capital markets.

Our citizens, communities and public, private and non-profit sectors benefit in many ways from the issuance of these bonds, as they are used to build and maintain schools to support an educated workforce, and to build our roads, public transportation systems and airports, all of which are essential for supporting commerce. They also help to address the country's water infrastructure, public utilities, health care and affordable housing needs, as well as provide public safety infrastructure that ensures local and national security. Elected bodies at the state and local levels or the voters themselves approve these financings for specific long-term capital projects, not to support general government functions, such as maintaining employees or keeping the lights on.

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

- state and local governments that need the support of investors to finance critical infrastructure;
- taxpayers across the country who depend on this infrastructure for reliable transportation systems, schools, public health facilities, energy, clean water and affordable housing;
- the federal government, which gets quite a bargain on their partnership with state and local government to provide the nation's infrastructure through the exemption; and
- investors who buy bonds for many reasons, including the safe nature of these financial products.

With regard to the identity of municipal investors, 2010 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 all bond interest paid to individuals went to those with incomes of less than $250,000. Finally, it is worth noting that 72.4 percent of the total outstanding municipal debt is held by individual investors, either directly or through mutual funds and money market funds (Source - 2010 Thomson Reuters). These are people who want to support the long-term infrastructure needs of their communities through a direct investment, the financing proceeds of which cannot be replaced by any source, including the federal government, or state or local governments.

Proposals to reduce or repeal the tax exemption would have severely detrimental impacts on national infrastructure development and the municipal bond market, raising costs for state and local borrowers and taxpayers. For example, a 2013 report (included in Appendix A) released by the National Association of Counties, National League of Cities, U.S. Conference of Mayors and Government Finance Officers Association estimates that if a 28 percent cap on the tax exemption of municipal bond interest had been in place from 2003 – 2012, state and local governments would have faced an additional $173 billion in interest expense for infrastructure investment. If the exemption had been fully repealed during that same time period, the additional interest expense for state and local governments would have been $495 billion. 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.

Congress and national leaders often discuss the need to improve our country's infrastructure, and are currently engaged in such a discussion on the reauthorization of federal surface transportation law. The American Society of Civil Engineers reports that it will cost state and local governments $3.6 trillion over the next five years to meet our nation's physical infrastructure needs. At a time when infrastructure demands are great and direct federal assistance to state and local governments to support infrastructure development is shrinking, the ability of states and localities to issue tax-exempt bonds is critical. Without the exemption, the fate of national infrastructure financing will be uncertain, causing infrastructure construction and maintenance to stagnate. Businesses and communities that depend on infrastructure for commerce, public safety, job creation and the development of an educated workforce will suffer, no doubt jeopardizing the country's already fragile economic recovery.

Proposals to cap or repeal the exemption 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 102 years. Ultimately these investor concerns translate into demands for higher yields from and increased costs to state and local governments. If these entities are unable to satisfy investor yield demands, 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.

Meanwhile, as other proposals to replace tax exempt bonds with tax credit or direct subsidy bonds have also gained some attention, it is important to note that these proposals would also create uncertainty and instability in the market, and more importantly, the costs of issuance for a majority of governments, especially smaller governments, would rise should such proposals be enacted. These costs would then be passed along to taxpayers.

The tax exemption on municipal bonds is a smart, cost-effective and safe mechanism for state and local governments, investors and the federal government to partner in building and maintaining national infrastructure. No amount of appropriations or other financing tools exist that match their reliability or capital production capability to support each of our unique communities and the country at large. The cost to the federal government of not taxing these investments is insignificant compared to the overall benefit that tax-exempt bonds provide. In fact, tax-exempt bonds are the best way to implement the infrastructure needs of each community effectively, as the decision to issue bonds for various projects is determined and approved by either the citizens themselves or their elected legislative bodies.

Furthermore, as Congress looks to also address corporate tax reform, it is important to note that any actions that would further limit incentives for banks and corporations to purchase municipal bonds will actually negatively impact taxpayers, not solely the targeted private sector entities. In 1986 Congress limited the incentives for banks and corporations to purchase municipal bonds. This has resulted in a shrinking corporate investor base for municipal securities. If this base is further eroded, other investors will demand more yield, which will increase issuance costs, and curtail the attractiveness of municipal securities. This would result in the opposite goal of improving our nation’s infrastructure.

For these reasons we urge Congress to reject any proposals to tax interest income from local government tax-exempt bonds, including dong so indirectly by enacting caps or increased proration, which will diminish the value of the tax exemption to institutional investors and increase costs to state and local governments and taxpayers. Alternatively we recommend that Congress consider making modifications to the tax code to increase national infrastructure investment by incentivizing the purchase government issued tax-exempt bonds. While a significant appetite remains for these securities, modifying the 2 percent de minimus rule for financial institutions is one solution that would provide such an additional incentive.

Another recommendation to increase infrastructure investment, particularly in smaller and more rural jurisdictions, is to increase the bank qualified debt limit from $10 million to $30 million. Bank qualified bonds are particularly useful to smaller governments, as they have historically enabled these jurisdictions to finance infrastructure at lower costs than traditional bond financing. For example, bank qualified bond issuers save between 25 and 40 basis points on an average. On an average 15-year, $3.89 million bank qualified debt financing, an issuer could expect to save between $146,000 and $233,000. This is a substantial savings for our nation's smaller governments, which can be used to maintain and improve valuable community services and finance other much-needed capital improvement projects.

The tax exemption on municipal bonds has a long history of success, having been maintained through two world wars and the Great Depression, as well as the recent Great Recession. 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.

Preserve State and Local Authority to Set Tax Policy Based on Constituent Needs

Federal Deduction of State and Local Taxes

We oppose the elimination or reduction, phased or otherwise, of state and local tax deductions. The deductibility of personal state and local income, property and sales taxes on federal tax returns recognizes the historic relationship of the federal, state, and local governments and the fact that all levels of government provide vital services. The elimination or reduction of state and local tax deductions would only increase state and local taxes for citizens.

Since the federal income tax was adopted in the early 20th century, there has been recognition that independent state and local government tax structures should be respected. State and local tax deductibility has contributed to the stability of tax revenues that are reliable and flexible. As state and local governments must balance their budgets, any change that disrupts the stability of their tax structure could only harm their ability to provide essential services, especially during recessions. The deductibility of state and local taxes supports their efforts to set tax rates at levels that efficiently match the service demands of their residents across a range of incomes and needs. Deductibility of these taxes also minimizes unhealthy market swings during times of economic change.

One key example of the importance of state-local tax deductibility is housing. Housing is a highly valued asset for residents and communities. Should deductibility of property taxes be eliminated or reduced, more volatility would be introduced into the housing sector, and could well reduce property tax revenues if such a change further curbed housing sales and prices. Historically, the deductibility of the property tax has often been a positive element in stabilizing housing values and markets. The recent economic downturn and the related housing crises are important reminders that property tax deductibility can support a housing recovery and, in time, restore government property tax revenues.

Encourage Collection of Taxes Owed to State and Local Governments

As the increasing strength of electronic commerce creates exciting new marketplaces, it has also put traditional retail outlets at an unfair disadvantage because of outdated and inequitable tax and regulatory environments. The Supreme Court's decision in *Quill Corp. v. North Dakota*, 504 U.S. 298 (1992), left state and local governments unable to adequately enforce their existing sales tax laws on sales by out-of-state catalog and online sellers. But Congress, with its clear constitutional authority to regulate interstate commerce, can give states and local governments the option to require sellers who do not have a physical presence in their jurisdiction to charge and collect sales taxes from their customers.

We urge support for the *Marketplace Fairness Act of 2015* (S 698), bipartisan legislation introduced in the Senate by Senators Michael Enzi, Lamar Alexander, Richard Durbin and Heidi Heitkamp. The bill would give state and local governments the option to collect the sales taxes already owed to them under current law. Unfortunately, under current law, businesses on Main Street are required to collect state and local sales taxes but remote sellers (out-of-state companies such as Internet and catalogue mail-order companies) are not required to collect such taxes. This puts businesses on Main Street at a five to ten percent competitive disadvantage to remote sellers.

It is significant to note that customers are already required to pay taxes when they make online purchases, just as they are required to pay taxes when they make purchases in a store. However, most taxpayers are unaware of this responsibility, and states and localities do not have the resources they need to enforce the collection of taxes on remote sales. The *Marketplace Fairness Act* does not impose a new tax, but would provide states and localities a mechanism to require the collection of sales and use taxes on Internet and mail-order sales. This would help to level the playing field for brick and mortar stores on Main Street.

Some in the Senate have suggested that the *Marketplace Fairness Act* should only be considered in connection with tax reform. We strongly disagree since this legislation merely seeks to give state and local governments the option of requiring the collection of "state and local sales" taxes that are already due. This will not have any impact on federal revenues or expenditures. At a time when local governments are still facing tough choices to close budget gaps projected for fiscal years 2015 and 2016, collecting an estimated $23 billion owed in sales taxes a year would mean more resources for investment in local infrastructure and basic services, as well as additional funding to implement state and local economic development strategies to create jobs.

Although we have pushed for collection of remote sales taxes for over a decade, there is no time better than now for Congress to enact the *Marketplace Fairness Act of 2015* into law.

Oppose Federal Preferential Tax Initiatives That Would Harm State and Local Governments

State and local governments continue to witness a growing number of industries actively urging Congress to preempt state and local government taxing authority for their particular industry through federal legislation. As Congress continues to deliberate on comprehensive tax reform, it has been suggested that some of these measures should be included in the discussion. From the wireless telecommunications and rental car industries to online travel companies, businesses are asking Congress for preferential tax treatment at the expense of local communities, individuals and families. Some examples of these proposals that have been introduced in recent years include the *Wireless Tax Fairness Act of 2013, the End Discriminatory State Taxes For Automobile Renters Act of 2015 (HR 1528), the Digital Goods and Services Tax Fairness Act of 2015 (S 851)* and *the Business Activity Tax Simplification Act of 2013*.

The state and local government community strongly opposes any federal preemption of its taxing authority. If Congress were to grant any one industry's request for federally mandated tax favoritism it would set a precedent for other industries to request similar special exemptions or protections from state and local taxing authority. Such actions by Congress would tread dangerously into disruption of the federal, state and local structure of federalism, and cause great damage to fiscal health of state and local governments – solely for the purpose of providing tax preferences to various industries.

These preemption measures, particularly when taken together, would set a dangerous new standard for federal intervention into state and local government tax classifications. While they purport to address only "discriminatory" taxation, their standard for federal intervention becomes that every industry sector and every service has to be taxed at the same rate. Such a standard for "discriminatory" state and local taxes would mean, contrary to long-established precedent, that the federal government has the power to preempt all state and local tax classifications and to impose a federally-mandated state and local tax code of only a single rate for all businesses. This would result in the end of state and local tax classification authority, and significantly undermine the ability of state and local governments to balance their budgets. Such a precedent could also result in the redistribution of the tax burden among those taxpayers least able to bear the burden. The power of the federal government to preempt state and local taxes is ultimately the power to destroy state and local governments – a power that cannot be reconciled with our basic system of federalism. For these reasons we oppose consideration of any legislative proposals which would preempt state and local tax authority, such as those measures listed above, in the committee's development of a federal tax reform package.

CONCLUSION

In summary, our several organizations understand the need for tax reform to address the rising federal deficit and to promote jobs and economic growth. As you discuss various tax reform proposals, we would strongly urge you to consider the impact any changes will have on critical infrastructure that residents in all local communities have come to depend on - schools, water and sewer systems, hospitals, road, bridges and public transportation systems. Local governments have been able to finance infrastructure projects at a reasonable interest rate through issuing tax-exempt municipal bonds. Without this type of financing, the cost to taxpayers to support these much-needed projects would be significantly higher, and in many cases, would force local governments to delay essential projects that create jobs and economic growth. We therefore strongly urge you to continue to maintain the federal tax exemption on municipal bond interest.

It is also important to ensure that any federal tax reforms allow local governments to retain authority over their own tax policy. We urge that you maintain the deductibility of personal state and local property, sales, and income taxes on federal tax returns. This recognizes the historic partnership that exists between federal state and local governments. The elimination or reduction of these deductions would only increase the cost of state and local taxes for citizens. We would also strongly urge you to separately consider and immediately pass the *Marketplace Fairness Act of 2015* (S 698), a bipartisan bill that would assist state and local governments collect $23 billion that is already owed to them on Internet and mail-order sales. This would help state and local governments make needed investments in infrastructure improvements and other critical areas.

Finally, we would strongly urge you to oppose federal initiatives that would preempt state and local taxing authority and grant certain industries preferential tax treatment at the expense of other taxpayers. Granting any one industry's request for federally mandated favorable tax treatment would only welcome many other similar requests, which would further erode state and local revenues, undermine their tax policies and dismantle federalism.

We appreciate the opportunity to submit this testimony on behalf of this country's counties, cities and towns. If you have questions, please feel free to contact any of our associations' legislative representatives.

Sincerely,

National Association of Counties - Michael Belarmino, (202) 942-4254

National League of Cities - Priya Ghosh Ahola, (202) 626-3015

The United States Conference of Mayors - Larry Jones, (202) 861-6709

International City/County Management Association - Joshua Franzel, (202) 682-6104

Government Finance Officers Association - Dustin McDonald, (202) 393-8020

Cc: The Honorable Chuck Grassley
The Honorable Mike Enzi
The Honorable Debbie Stabenow
The Honorable Mike Crapo
The Honorable Sherrod Brown

APPENDIX A

Protecting Bonds to Save Infrastructure and Jobs 2013

A Report by the:

National Association of Counties
National League of Cities
U.S. Conference of Mayors
Government Finance Officers Association

February 2013

NACO National Association of Counties

NATIONAL LEAGUE of CITIES

THE UNITED STATES CONFERENCE OF MAYORS

Protecting Bonds to *Save Infrastructure and Jobs* 2013

REPORT BY:

The National Association of Counties
The National League of Cities
The United States Conference of Mayors

WITH ASSISTANCE FROM:

The Government Finance Officers Association

NACo National Association of Counties

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THE UNITED STATES CONFERENCE OF MAYORS

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Mayor of Philadelphia

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CEO and Executive Director

Assumptions and methodology

The issuance data contained in this report represent long-term, tax-exempt issuance by state and local governments and state and local agencies and authorities over the period 2003–2012 for the listed use of proceeds. The source is the Thomson Reuters SDC Platinum database. Taxable bonds and bonds subject to the individual alternative minimum tax are excluded.

Several assumptions were made in calculating the attached estimates. First, the average maturity of bonds is assumed to be 15 years. Bonds are assumed to have been issued at the rate of the median value of the Bond Buyer 20-Bond Index for the year of issuance. It is assumed that the proposal to cap the tax benefit of the tax exemption at 28 percent would have increased borrowing costs by 70 basis points and that the proposal to fully repeal the tax exemption would have increased borrowing costs by 200 basis points, based on various industry reports, including Municipal Market Advisors and Citigroup, and produced by the Government Finance Officers Association. For the estimates of increases in 2012 interest costs by city and county, the 2012 interest payment cost was provided by each government and then the assumptions were completed using with an average maturity of 15 years at the median value of the Bond Buyer 20-Bond Index over the 15-year period 1998–2012. Please note that individual results may vary by jurisdiction.

CHARTS

A Top six state and local infrastructure categories using tax-exempt financing
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C Municipal tax exemption loss and deduction cap impact
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E Infrastructure issuance volume by use
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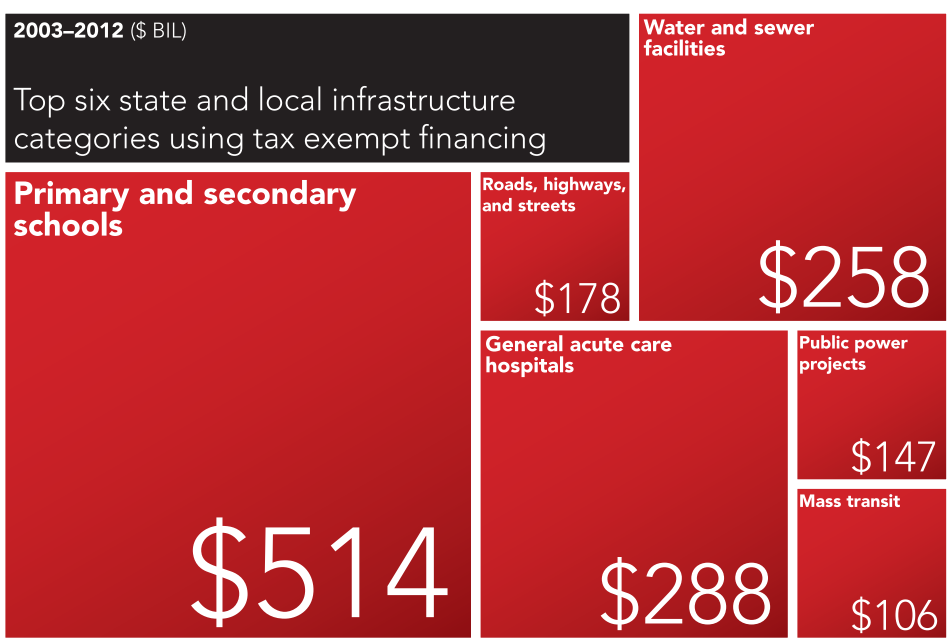
Introduction

Tax-exempt municipal bonds are the most important tool in the U.S. for financing investment in schools, roads, water and sewer systems, airports, bridges and other vital infrastructure. State and local governments financed more than $1.65 trillion of infrastructure investment over the last decade (2003–2012) through the tax-exempt bond market (**Chart E**).

During that decade, $514 billion of primary and secondary schools were built with financing from tax exempt bonds; nearly $288 billion of financing went to general acute care hospitals; nearly $258 billion to water and sewer facilities; nearly $178 billion to roads, highways, and streets; nearly $147 billion to public power projects; and $105.6 billion to mass transit (**Chart A**). These categories represent 90 percent of the total amount of municipal bonds used to finance infrastructure between 2003 and 2012.

In 2012 alone, more than 6,600 tax-exempt municipal bonds financed over $179 billion worth of infrastructure projects.

CHART A



The Impact of Proposals to Limit/Eliminate Tax-Exempt Financing

Under the federal tax code, investors are not required to pay federal income tax on interest earned from most bonds issued by state and local governments. The tax exemption for municipal bond interest has been in law since the federal income tax was promulgated 100 years ago, and tax-exempt bonds have financed trillions of dollars of infrastructure investment over that time. The effect of this tax exemption is that state and local governments receive a lower interest rate on their borrowing than they would if their interest was taxable to investors. In typical market conditions, the tax exemption can save states and localities up to two percentage points on their borrowing rates.

Several legislative proposals have been offered to curtail or eliminate the federal tax exemption for municipal bond interest. One proposal would impose a tax-benefit cap of 28 percent for certain taxpayers on many itemized deductions and exclusions, including tax-exempt interest. The effect would be a partial tax on interest that would otherwise be exempt from income tax. In effect, the tax-exempt bond market would no longer be entirely tax-exempt.

If the proposal to impose a 28-percent benefit cap on tax-exempt interest had been in effect during the last decade, it is estimated that this would have cost states and localities an additional $173 billion in interest expense for infrastructure projects financed over the past ten-year period (**Chart B**).

For an investor in the 39.6-percent federal tax bracket, the tax benefit cap proposal would equate to an 11.6-percent tax on municipal bond interest income, the difference between the 39.6-percent tax rate and the 28-percent benefit cap. While it may appear that this tax would fall on high-bracket taxpayers, in effect, it would be borne almost exclusively by state and local governments in the form of higher interest rates

If a 28-percent benefit cap on tax-exempt interest had been in effect during the last decade, it is estimated that this would have cost states and localities an additional **$173 billion** in interest expense for infrastructure projects financed over the past ten-year period.

on their borrowing. Market analysts have estimated that this proposed tax on municipal bond interest would raise state and local borrowing costs by up to 70 basis points (0.70 percentage point) or more. Because the tax would apply not only to new state and local borrowing but also to all outstanding bonds, investors would be taxed on investment which they reasonably expected would be tax-exempt as long as they are outstanding, an unprecedented form of retroactive taxation. As a result, investors would face the new risk that Congress could tax interest on outstanding bonds even more in the future, a risk that would raise state and local borrowing costs even more and create unprecedented uncertainty for investors in the municipal securities market.

Some have proposed an even more onerous full federal income tax on municipal bond interest. For example, the National Commission on Fiscal Responsibility and Reform (the "Simpson-Bowles Commission") in its 2010 deficit-reduction recommendations proposed full taxation for state and local interest for all newly-issued bonds. **If this proposal had been in place during the 2003–2012 period, it is estimated that the $1.65 trillion of state and local infrastructure investment would have cost governments an additional $495 billion of interest expense (Chart B).**

CHART B

Interest costs with and without tax exemption

$ MIL

	current law	with 28-percent cap		with full repeal	
	ESTIMATED INTEREST COST WITH TAX EXEMPTION AS IS	ESTIMATED TOTAL INTEREST COST	COST INCREASE	ESTIMATED TOTAL INTEREST COST	COST INCREASE
2003	114,128.55	130,876.97	16,748.42	161,981.19	47,852.64
2004	96,239.27	110,820.97	14,581.71	137,901.29	41,662.02
2005	121,966.14	141,458.44	19,492.31	177,658.44	55,692.30
2006	118,248.09	137,017.62	18,769.54	171,875.34	53,627.25
2007	125,282.78	145,214.14	19,931.35	182,229.50	56,946.72
2008	140,294.09	161,012.63	20,718.54	199,489.91	59,195.82
2009	110,288.35	126,890.90	16,602.55	157,724.20	47,435.85
2010	91,207.92	105,952.85	14,744.93	133,336.29	42,128.37
2011	83,022.35	95,965.70	12,943.35	120,003.35	36,981.00
2012	100,111.45	118,949.63	18,838.18	153,934.81	53,823.36
TOTAL			**173,370.87**		**495,345.33**

SOURCE: SIFMA ESTIMATES BASED ON THOMSON REUTERS DATA USING THE REPORT'S ASSUMPTIONS

Increased Costs to Select Jurisdictions

Partially or fully taxing the interest on municipal borrowing would have a direct effect on state and local budgets in the form of increased interest expense. Looking at interest expense incurred by some sample local governments in fiscal year 2012 (**Chart C**), it is estimated that individual cities and counties would have faced an increase of approximately 15 percent in interest costs in fiscal year 2012 if the 28-percent cap proposal had been in effect during the 15-year period 1998–2012.This additional financial burden reflects the direct pass-through effect of the additional federal tax if it had been in place when the bonds were issued.Taxing the interest on municipal borrowing for investors would have the same effect as taxing state and local governments directly.

The information in Chart C was determined by taking the amount of interest paid by each jurisdiction in the last fiscal year, with a median interest average of 4.69 over the past 15 years (Thomson Reuters), and applying a 70 BPS increase for what the interest costs would have been if the bonds were issued with a cap in place, and applying a 200 BPS increase for what the interest costs would have been if the bonds were issued without the exemption in place. The estimates have been rounded to the 000.

CHART C

Municipal tax exemption loss and deduction cap impact

2012

	current law	with 28-percent cap		with full repeal	
	ACTUAL 2012 INTEREST PAYMENT COST WITH TAX EXEMPTION AS IS	ESTIMATED TOTAL INTEREST COST	COST INCREASE	ESTIMATED TOTAL INTEREST COST	COST INCREASE
Akron, OH	$37,327,482	$42,898,000	$5,570,518	$53,245,000	$15,917,518
Athens County, OH	$44,993	$51,708	$6,715	$64,179	$19,186
Avondale, AZ	$4,975,700	$5,718,000	$742,300	$7,097,000	$2,121,300
Baltimore, MD	$83,361,980	$95,804,000	$12,442,020	$118,910,000	$35,548,020
Boston, MA	$131,000,000	$150,552,000	$19,552,000	186,863,000	$55,863,000
Burnsville, MN	$2,100,000	$2,413,000	$313,000	$2,995,000	$895,000
Charlotte, NC	$34,750,000	$39,936,000	$5,186,000	$49,568,000	$14,818,000
Chattanooga, TN	$32,080,143	$36,868,000	$4,787,857	$45,760,000	$13,679,857
Chicago, IL	$800,000,000	$919,403,000	$119,403,000	$1,141,000,000	$341,000,000
Cleveland, OH	$103,624,286	$119,090,000	$15,465,714	$147,813,000	$44,188,714
Columbia, SC	$14,689,802	$16,882,000	$2,192,198	$20,954,000	$6,264,198
Dallas, TX	$183,165,993	$210,504,000	$27,338,007	$261,275,000	$78,109,007
Douglas County, NE	$2,730,088	$3,137,000	$406,912	$3,894,000	$1,163,912
Fairfax County, VA	$98,105,012	$112,747,000	$14,641,988	$139,941,000	$41,835,988
Grand Traverse County, MI	$821,279	$943,857	$122,578	$1,171,000	$349,721
Houston, TX	$159,025,000	$182,760,000	$23,735,000	$226,839,000	$67,814,000
Linn County, IA	$628,226	$721,991	$93,765	$896,126	$267,900
Louisville, KY	$592,370	$680,783	$88,413	$844,979	$252,609
Mecklenburg County, NC	$91,136,163	$104,738,000	$13,601,837	$130,000,000	$38,863,837
Mesa, AZ	$52,115,271	$59,893,000	$7,777,729	$74,339,000	$22,223,729
Montgomery County, MD	$94,200,000	$108,259,000	$14,059,000	$134,370,000	$40,170,000
New Haven, CT	$24,500,000	$28,156,000	$3,656,000	$34,947,000	$10,447,000
Oklahoma City, OK	$60,051,714	$69,014,000	$8,962,286	$85,660,000	$25,608,286
Philadelphia, PA	$356,404,987	$409,599,000	$53,194,013	$508,390,000	$151,985,013
Prince Georges County, MD	$53,800,000	$61,829,000	$8,029,000	$76,742,000	$22,942,000
Racine, WI	$4,045,739	$4,649,000	$603,261	$5,771,000	$1,725,261
Sacramento, CA	$54,544,102	$62,685,000	$8,140,898	$77,803,000	$23,258,898
Salt Lake City, UT	$13,826,914	$15,890,000	$2,063,086	$19,723,000	$5,896,086
Seattle, WA	$192,000,000	$220,656,000	$28,656,000	$273,876,000	$81,876,000
Taney County, MO	$902,030	$1,036,000	$133,970	$1,286,000	$383,970
Wake County, NC	$86,324,566	$99,208,000	$12,883,434	$123,136,000	$36,811,434
Wichita, KS	$41,214,518	$47,365,000	$6,150,482	$58,790,000	$17,575,482

SOURCE: AS PRODUCED BY GOVERNMENT FINANCE OFFICERS ASSOCIATION

The Broad Use of Tax-exempt Financing

Tax-exempt financing is used widely across the country by communities large and small. The $1.65 trillion of infrastructure financed by state and local governments in 2003–2012 was spread across nearly 58,000 individual transactions, with an average transaction size of $29 million (**Chart D**). Bonds financed everything from large, multibillion transportation projects to school expansions of several hundred thousand dollars and are used by governments ranging from the largest states to the smallest towns and school districts. Because the interest on municipal bonds is usually exempt from state income taxation for residents of the states in which they are issued, investors tend to buy bonds issued within their states. In that manner, local investment is often financed to a significant degree by local capital.

In the last decade (2003–2012) state and local governments financed more than **$1.65 trillion** of infrastructure projects through tax-exempt bonds.

CHART D

Infrastructure borrowing by state

LONG-TERM, TAX-EXEMPT
2003–2012

STATE	$ mil	# of issues	avg size ($ mil)
Alabama	16,984.5	724	23.5
Alaska	4,529.2	69	65.6
Arizona	36,128.0	808	44.7
Arkansas	10,089.9	1,421	7.1
California	232,831.4	4,600	50.6
Colorado	33,869.9	951	35.6
Connecticut	11,659.6	256	45.5
District of Columbia	5,846.7	64	91.4
Delaware	2,897.7	50	58.0
Florida	103,081.0	1,250	82.5
Georgia	40,975.6	676	60.6
Guam	909.8	8	113.7
Hawaii	4,675.0	48	97.4
Idaho	3,625.8	214	16.9
Illinois	59,454.8	2,927	20.3
Indiana	35,905.1	1,594	22.5
Iowa	9,280.2	1,471	6.3
Kansas	14,103.7	899	15.7
Kentucky	18,882.9	1,420	13.3
Louisiana	16,091.7	659	24.4
Maine	2,974.6	89	33.4
Maryland	19,221.8	268	71.7
Massachusetts	37,931.1	592	64.1
Michigan	46,304.3	2,130	21.7
Minnesota	27,593.8	2,309	12.0
Mississippi	5,604.1	383	14.6
Missouri	27,056.6	2,353	11.5
Montana	1,717.2	202	8.5
Nebraska	16,483.5	2,216	7.4
Nevada	19,750.7	253	78.1
New Hampshire	2,900.4	94	30.9
New Jersey	62,502.0	1,559	40.1
New Mexico	9,432.0	441	21.4
New York	149,790.1	3,581	41.8
North Carolina	28,390.8	449	63.2
North Dakota	1,992.6	392	5.1
Ohio	49,473.5	1,855	26.7
Oklahoma	12,851.5	2,209	5.8
Oregon	17,044.2	545	31.3
Pennsylvania	76,471.1	3,579	21.4
Puerto Rico	20,847.6	38	548.6
Rhode Island	3,535.3	101	35.0
South Carolina	28,590.3	681	42.0
South Dakota	2,518.9	357	7.1
Tennessee	18,892.7	574	32.9
Texas	193,415.7	6,524	29.6
Utah	14,070.1	401	35.1
Vermont	864.2	31	27.9
Virgin Islands	232.2	5	46.4
Virginia	25,828.5	359	71.9
Washington	49,529.8	1,264	39.2
West Virginia	4,442.5	132	33.7
Wisconsin	20,545.7	1,631	12.6
Wyoming	1,223.1	48	25.5
TOTAL	**1,661,845.0**	**57,754**	**28.8**

SOURCE: THOMSON REUTERS DATA, FEBRUARY 2013

Conclusion

Tax-exempt municipal bonds are the country's most important source of financing for infrastructure investment. Municipal bonds represent a partnership among the federal government, state and local governments, and private investors in contributing to public infrastructure which creates jobs and improves economic efficiency. The proposals to limit or eliminate the federal tax exemption for municipal bond interest would substantially impair the federalist system of government that currently exists and shift unnecessary cost burdens to local taxpayers. Tax-exempt bonds maintain decision making and project selection at the state and local level, where citizens and elected officials can best determine where needs are greatest and where investments will generate the maximum return. Finally, tax-exempt bonds force market tests of investment projects, since investors will not commit capital until they are convinced the credit behind the borrowing is financially sound. The default rate on borrowing by states and localities is near zero.

Congress should preserve the tax exemption for interest on municipal bonds. The tax exemption has successfully provided trillions in low-cost financing for infrastructure investment. Curtailing or eliminating the tax exemption would raise costs for financially-strapped state and local governments and would result in less investment in infrastructure at a time when jobs are scarce and the physical state of our public works is deteriorating.

CHART E

Infrastructure issuance volume by use

LONG-TERM, TAX-EXEMPT, $ MIL

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	totals
Airports	3,366.2	2,950.7	5,446.5	2,191.0	4,029.8	3,393.3	6,581.9	13,844.1	3,051.1	4,471.0	49,325.6
Bridges	2,721.7	1,213.4	706.9	3,228.2	1,957.7	2,471.0	1,698.1	1,362.0	1,424.2	3,380.3	20,163.5
Combined utilities	1,746.8	2,894.4	1,526.6	1,071.5	1,094.3	1,079.8	1,420.4	647.3	787.4	1,947.4	14,215.9
Fire stations & equipment	230.0	215.4	296.3	357.4	312.2	230.8	319.6	193.6	276.5	212.6	2,644.4
Flood control	6.2	0.0	0.0	0.0	1.0	0.0	1.6	4.4	5.4	0.0	18.6
Gas	0.7	352.6	397.7	515.2	2,957.2	3,477.3	2,210.6	1,322.5	186.8	2,176.6	13,597.2
General acute care hospitals	19,295.3	17,303.2	28,642.1	29,182.3	36,241.6	53,343.2	37,021.3	23,652.3	19,025.6	24,198.8	287,905.7
General purpose/public improvement	71.3	101.9	235.8	58.6	87.1	170.1	215.3	211.0	75.3	0.0	1,226.4
Government buildings	8.0	0.0	25.3	0.0	2.0	0.0	22.2	0.1	186.8	0.0	244.4
Mass transportation	9,011.7	9,922.6	11,627.9	13,775.1	8,405.5	12,635.7	8,348.2	5,607.3	9,143.2	17,146.0	105,623.2
Multifamily housing	7,055.1	3,585.1	2,923.6	1,826.1	952.3	2,357.5	3,216.7	3,141.3	2,539.0	3,439.7	31,036.4
Police stations & equipment	170.0	255.7	51.6	538.8	151.4	119.1	381.3	33.5	74.5	143.2	1,919.1
Primary & secondary education	51,432.5	54,059.4	72,570.7	59,218.1	62,631.5	47,084.3	40,915.7	34,221.0	37,375.3	54,548.3	514,056.8
Public power	15,834.3	6,524.2	12,983.8	21,190.4	19,717.1	19,762.0	11,743.8	17,137.1	9,905.7	12,194.2	146,992.6
Recycling	112.7	258.4	3.8	0.0	10.0	21.7	0.0	0.0	0.0	2.5	409.1
Sanitation	1,084.2	552.8	465.4	731.8	1,205.1	465.5	731.9	219.8	564.6	275.4	6,296.5
Seaports/marine terminals	1,062.8	276.4	328.6	790.0	1,889.4	1,211.4	719.7	1,821.7	943.6	100.1	9,143.7
Solid waste	1,091.2	815.8	522.7	755.5	819.2	1,724.1	703.4	1,602.2	846.2	387.6	9,267.9
Toll roads, highways, & streets	29,946.9	26,903.1	17,478.1	13,963.1	17,717.8	17,141.5	13,743.7	13,668.5	9,413.9	18,000.3	177,976.9
Tunnels	0.0	0.0	800.0	0.0	0.0	99.6	0.0	0.0	0.0	240.3	1,139.9
Water & sewer facilities	15,261.2	10,688.3	28,607.6	29,364.4	29,640.2	30,531.5	28,124.1	21,738.2	27,444.9	36,546.9	257,947.3
TOTALS	159,508.8	138,873.4	185,641.0	178,757.5	189,822.4	197,319.4	158,119.5	140,427.9	123,270.0	179,411.2	**1,651,151.1**

SOURCE: THOMSON REUTERS DATA, FEBRUARY 2013

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