

U.S. Municipal Bond Market

## Proposed Tax Increases Reinforce Tax-Exempt Municipal Bond Demand

- The House Democrats' draft proposal to pay for much of the \$3.5 trillion Build Back Better Jobs and Families proposals through tax increases reinforces the demand pattern we have seen for tax-exempt municipal bonds in 2021.
- Almost \$53 billion has flowed into municipal mutual funds in 2021 to date, per Lipper data. There were \$22 billion of net flows into municipal funds in 2020 and \$65 billion in 2019.
- SALT provisions have not been included in the Ways and Means proposal, although some lawmakers stand by their support for a repeal to the \$10,000 SALT cap.
- There remains a slim chance the \$3.5 trillion infrastructure plan will be passed into law.

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### Summary

In preparation for the ongoing budget reconciliation mark-up, the House Ways and Means Committee proposed \$1 trillion of tax increases on high-income households and another \$1+ trillion of other revenue raisers, according to data from Committee for a Responsible Federal Budget. The total \$2.26 trillion of revenue increases would help fund the Democrats' \$3.5 trillion Build Back Better legislative agenda. This proposal for a near-record level of tax increases, even though the political landscape would have to shift significantly for them to be passed into law, reinforces the strong demand we have seen in 2021 for tax-exempt municipal bonds.

*The House Ways and Means Committee's \$2.26 trillion of total revenue increases would help fund the Democrats' \$3.5 trillion Build Back Better legislative agenda.*

### Revenue Increases in Ways and Means Tax Proposal

Policy Category	Amount (\$ in billions)
Taxes on High-Income Households	\$1,000
Tax Compliance (Tax Gap Revenue)	134
Taxes on Corporations	946
Other Taxes and Changes	177
<b>Total</b>	<b>\$2,257</b>

Source: Committee for a Responsible Federal Budget and HilltopSecurities.

### How Democrats Propose to Pay for the \$3.5 Trillion Infrastructure Proposal, Draft

The House Ways and Means Committee is proposing what would amount to the largest tax increase in decades in order to help pay for the Democrats' \$3.5 billion Build Back Better legislative agenda. To fund this program, House Democrats are offering \$2.9 trillion of tax hikes and health care savings. The section-by-section summary titled Subtitle I – Responsibly Funding Our Priorities can be found on the Ways and Means website. Some of the major elements included in the proposal include revenue raisers such as:

- Raise corporate tax rate to 26.5%
- Raise top individual tax rate to 39.6%
- New 3% surtax on those earning more than \$5 million
- Raises top capital gains rate to 28.8% (includes the 3.8% surcharge) from 23.8%

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## Top Combined Rates, Status of SALT

The top combined rates for New Yorkers could reach 61.2%, and for those in California (whose voters just elected to keep Democrat Gov. Gavin Newsom in office), top rates could reach 59%. This strengthens the argument for some lawmakers who would like to repeal the State and Local Government Tax (SALT) cap limit of \$10,000. New York Congressman Tom Suozzi released a short statement this week on SALT indicating the view he has expressed since March has not changed. The release says, "No SALT, no deal!" However, this week's Ways and Means proposal did not include anything SALT related, despite some Democrats still arguing that they also still want the cap repealed.

## Municipal Bond Flows

It should be noted that these tax increase proposals are not a surprise. We have written before in our April commentary, Long-Term Capital Gains Potentially at 43.4%; This is Not New Information, and will reiterate that these types of tax increases (or more) have been a part of almost all tax policy proposals aimed for by then-candidate Joe Biden and now President Biden and in other party proposals. We believe this is one of multiple contributing reasons we have seen nearly \$53 billion of investor money flow into municipal bond mutual funds. If tax rates rise, the value of tax-exempt bonds will be higher.

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## Municipal Fund Flows Annual Net

Year	Amount (\$ billions)
2021	52.9
2020	21.9
2019	65.3

Source: Lipper and HilltopSecurities.

## Remember Likelihood of Passage Still Remote

We still do not believe that the political landscape has aligned to a point that will allow this proposal to become law. We have outline this view this week in our Sept. 13 commentary, Mostly Constructive News for Public Finance in Ways and Means' Build Back Better Markup, However the Path for Passage Remains Challenging, and in more depth in our Sept. 1 piece, Lawmakers moved Closer on Infrastructure in August, Still No Clear Path.

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## Recent HilltopSecurities Municipal Commentary

- [Mostly Constructive News for Public Finance in Ways and Means' Build Back Better Markup, However the Path for Passage Remains Challenging](#), Sept. 13, 2021
- [Lawmakers Moved Closer on Infrastructure in August, \[there is\] Still No Clear Path](#), Sept. 1, 2021
- [Economic Impact from Hurricane Ida Expected to be Modest, Municipal Credit Impact Likely to be Minimal](#), Aug. 30, 2021
- [Florida's Threats Cause Blowback to Municipals, Debt Service Not Currently at Risk](#), Aug. 23, 2021
- [The Virus Strikes Back: Our Municipal Credit Outlook in the Face of COVID-19's Fourth Wave](#), Aug. 19, 2021

Readers may view all of the HilltopSecurities Municipal Commentary [here](#).

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