THE BOND BUYER

Corporate minimum tax in Build Back Better faces opposition

By

Caitlin Devitt

Published

November 16, 2021, 2:52 p.m. EST

The inclusion of tax-exempt income in a proposed federal corporate alternative minimum tax in the Build Back Better bill may have been an "oversight," municipal market lobbyists say.

And even if the AMT ends up becoming law, its impact on muni demand may be muted in an environment that has already seen many institutional buyers shift to the taxable market, buysiders said.

The corporate minimum tax as proposed in Build Back Better would be 15% of book income for corporations with financial statement income in excess of $1 billion. It reportedly would apply to around 200 companies. Estimated to bring in around $320 billion, the provision is among the bill's top revenue-raisers. The effective date is 2023.

The AMT is estimated to apply to institutional muni bond holders, largely banks and insurance companies, that hold almost 25% of muni bonds. The fear is that it would dampen institutional demand for the tax exemption.

"We think it was an oversight," said Emily Brock, the federal liaison for the GFOA, which, along with 27 issuer groups, sent a letter to Congress urging it to carve out tax-exempt income from the AMT. "They took a giant swoop at all the asset classes."

The House has said it would take up the $1.75 trillion bill as soon as this week, though the Congressional Budget Office is not set to release a full score until Friday. If passed by the House, the bill is likely to undergo significant changes when it lands in the Senate, and powerful business groups like the U.S. Chamber of Commerce and the Business Roundtable, which are lobbying against the corporate AMT, are hoping to see changes in the Senate version.

Most institutional buyers already moved to taxables, said Nick Venditti, which would blunt the impact of the proposed tax on the muni market.

Even if the provision became law, there may be some flexibility for tax-exempt income before it becomes effective in 2023, market participants said.

The proposal instructs Treasury to issue regulations and guidance on several unresolved issues. Some hope that may crack a window. Morgan Stanley, in an Oct. 28 brief, noted that Treasury's guidance "in theory" could clarify "that muni interest is not counted as taxable income."

In an Oct. 31 brief on the Build Back Better bill, PWC also noted that the provision grants Treasury "broad authority" to address a number of issues. "Because the CPMT will be effective for tax years beginning after Dec. 31, 2022, Treasury is likely to issue guidance with respect to many of these issues prior to the provision becoming applicable to affected taxpayers," PWC said, adding that the proposal overall would "add significantly to the complexity of corporate tax compliance and administration."

It may be a stretch to pin hopes on Treasury action, said a public finance attorney.

"It may be that there are aspects of the provision that Treasury needs to provide guidance on, but whether they would have the authority, and exercise the authority, to exclude types of income like tax-exempt income that are under the statutory law, seems like a stretch to me," the attorney said, adding "but stranger things have happened."

Even if the tax becomes law, however, some buysiders say it won't bring much of a market impact.

Since the Tax Cuts and Jobs Act of 2017, "most institutional buyers already transitioned away from the tax-exempt market to the taxable market," said Nicholos Venditti, senior portfolio manager at Allspring Global Investments, which recently acquired Wells Fargo Asset Management. "I would expect institutional buyers would continue to favor taxable paper relative to tax-exempt paper. I don't have any real worries from that perspective."

The corporate AMT replaced a proposal to increase the top corporate income tax rate, and the latest Build Back Better version has also dropped a plan to raise the top individual income tax rate. Those decisions may carry more of a market impact than the AMT, Venditti said.

"Ultimately, one of the justifications that the market has used to support muni bond prices at these elevated levels is that investors were just front-running their higher tax rates," he said. "Well, if tax rates aren't going up, then perhaps some of the justification supporting muni bond prices being this high falls away."

The proposal is also being tracked by the infrastructure investor community, said Tom Osborne, executive director of infrastructure at IFM Investors.

“The tax provisions are being very, very closely watched,” Osborne said. “It could increase the amount of taxes that infrastructure investors have to pay as holders of lease and concession agreements or as owners of private sector infrastructure. Higher taxes could impact the returns that would be available to investors for owning those assets.”

In addition to business groups, the American Institute of CPAs is urging Congress to drop the proposal. The provision would “substantially increase the complexity of the IRS code,” the group said in an Oct. 28 letter to Congressional leaders.

The group asked Congress to at least alter the provision to include only currently taxable income. The group has not heard any specific feedback in response to the letter, a spokesperson said.

Caitlin Devitt