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U.S. Municipal Bond Market

Long-Term Capital Gains Potentially at 43.4%; This is Not New Information

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- Last week, it made news that President Biden plans to raise the highest overall long-term capital gains rate to 43.4% for those earning over $1 million. However, this proposal was not new. This suggestion has been part of the president's tax plan for some time.
- Re-releasing the details of the possible capital gains hike reengaged focus on the aggressive economic agenda the president is seeking. This time, the focus was mostly unhelpful. Voters and high-income taxpayers may not be ready.
- We note that generally, taxes are likely to go up for upper income earners, according to a Tax Foundation analysis after a study of the president's tax plan proposal. We'd like to see the specifics after they are presented Wednesday night. However, if the specific results are close to the Tax Foundation's October 2020 analysis, the value of municipal bonds are likely to increase because of increased demand and relative scarcity.

Included in President Biden's Tax Plan All Along

Last week, a Bloomberg report that shared President Joe Biden was eyeing an overall top long-term capital gains rate of 43.4% for those earning over $1 million surprisingly made news. But whether the announcement should have really made the news at all is a relevant question we should be asking. The answer is that this proposal has been included in President Biden's tax plans going back to before the election. A capital gains hike and other propositions like it should not come as a surprise. See the Tax Foundation's analysis, Details and Analysis of President Joe Biden's Tax Plan, for more details. The president's economic agenda has been aggressive all along.

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Revenue Effect of Select Items from Biden's Tax Plans ($ billions)

Proposal	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2021-2030
Tax capital gains and dividends at 39.4% on income over $1M and repeal step-up basis	$14.2	27.1	39.5	42.1	45.8	49.5	56.9	61.8	64.8	67.6	$469.4
Raise the corporate income tax to 28%	$40.9	78	96	106.3	115.8	117.4	118.5	122.7	125.8	128.9	$1,050.8

Source: Tax Foundation General Equilibrium Model (Oct. 2020) and HilltopSecurities.

Despite that, audiences seemingly overlooked that a capital gains hike was potentially in the cards. It is still worth reviewing the landscape, so let's consider some of the recent debate. This hike could end up being an important part of Biden's overall economic agenda. At issue is the possibility that the White House is poised to announce it is going to almost double the capital gains tax rate for those earning over $1 million to 39.6% (up from current 20%) to help pay for its recent infrastructure and other spending initiatives. When you add the 3.8% Obamacare tax on investment income, that means those investors could be paying a top rate of 43.4%.

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Last week, financial markets reacted briefly and since then, all kinds of pro and cons about the potential tax revision have been printed, broadcast over the airwaves, or flown through cyberspace. On Sunday's episode of Meet the Press, Chuck Todd televised word clouds that described why the president's approval rating is at 53%. "Not Trump" was the largest word cloud on the screen. This infers that the president may be overreaching in his economic and infrastructure agenda. An opinion piece in Tuesday's Wall Street Journal (WSJ) specifically says, "Elected as not Trump, Biden aspires to be the second coming of Franklin Delano Roosevelt" in America Voted for a Rest, Not a Revolution. Also on Sunday's Meet the Press, contributor and Wall Street Journal journalist Peggy Noonan explained that voters may react to the White House's tax and spending policies as "overdoing it." Noonan eluded to the fact that suburban voters might not go for the details. On Monday, the WSJ included a piece from the Editorial Board, The Dumbest Tax Increase. Also Monday, the WSJ ran a Lawrence Lindsey op-ed, Biden Taxes for Punishment's Sake. In general, the criticism centers on themes such as "temporary economic insanity" and "taxation purely as a form of punishment."

Both the Editorial Board and Lindsey focus on the revenue-maximizing rate for capital gains, which they indicate could be considered at a level more or less at 28%, up from the current 20%. An analysis by Princeton economists argues that 47% could generate the most revenue, according to the Tax Policy Center (TPC). However, the TPC notes that their revenue-maximizing rate is closer to that 28% mark. The TPC also reports that work by the Treasury Department, the Congressional Joint Committee on Taxation (JCT), and the Congressional Budget Office (CBO) "suggests those estimates [about 28%] are about right." The Editorial Board and Lindsey both cite the CBO numbers too.

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The White House defended the capital gains proposal on Monday. According to The Hill, "White House economic adviser Brian Deese said repeatedly at a press briefing that the capital gains tax proposal would only impact three-tenths of 1 percent of taxpayers, or about 500,000 households, and described it as a step to equalize taxation of 'work and wealth" and return fairness to the tax code." Deese continued, "The reforms that the president will lay out are focused on this top sliver of people and treating capital gains as the same as wages for that top three-tenths of a percent."

More Economic Agenda Details Could Come Together This Week

For now, trying to dissect this individual piece of the puzzle seems arbitrary. Although, we believe it is still interesting to note that the Tax Foundation reported this individual proposal could reduce overall economic output. It is probably more important to consider the impact of an entire tax plan. In that case, the Tax Foundation, again in October 2020, reported that, "Taxpayers in the top 1 percent would see their after-tax incomes reduced by around 11.3 percent due to higher taxes on income above $400,000. The top 5 percent would see a reduction in after-

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tax incomes of about 1.3 percent." This potential impact, all things being equal, increases the importance of tax-exempt municipal bonds. This dynamic could be even more meaningful if the amount of tax-exempt issuance falls in the last half of 2021 and in near-term years if a new taxable direct-pay infrastructure bond program is finally signed into law. This, however, is also not really news.

At the end of March, President Biden announced preliminary details for his American Jobs Plan, which was described as the first stage of his infrastructure agenda. On Wednesday, the president is scheduled to address a joint session of Congress, where he is expected to review the initial details of his American Families Plan. We could be in store for new material, however not until the president connects these two objectives and describes how he and his party plans to pay for them.

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