Tax-Exempt Feature of Municipal Bonds

A key benefit of municipal bonds is that interest is generally exempt from federal, state, and local taxes. This feature can provide a meaningful benefit to investors, especially if their tax rate is particularly high. As a result of this tax-exemption, municipal bonds tend to trade at lower yields than taxable alternatives. **Taxable Equivalent Yield (TEY)** is used to determine what the after-tax yield of a taxable security would need to be to offset the yield of a tax-exempt investment.

How is Tax Equivalent Yield Calculated?

Tax-equivalent yield (TEY) is calculated by dividing the yield of a tax-exempt bond by one, minus an investor's federal income tax bracket.

$$\textbf{Tax Equivalent Yield (TEY)} = \frac{\textbf{Interest Rate}}{\textbf{(1 - Investor Tax Rate)}}$$

As illustrated in the table below, if an investor was in a 35% tax bracket, the tax equivalent yield of a tax-exempt bond yielding 4.50% is relatively the same as a taxable bond yielding 6.92%.

Basic Tax Equivalent Yield Chart

Tax Bracket	3.00%	3.50%	4.00%	4.50%	5.00%	5.50%	6.00%
24%	3.95%	4.61%	5.26%	5.92%	6.58%	7.24%	7.24%
32%	4.41%	515%	5.88%	6.62%	7.35%	8.09%	8.82%
35%	4.62%	5.38%	6.15%	6.92%	7.69%	8.46%	9.23%
37%	4.76%	5.56%	6.35%	7.14%	7.94%	8.73%	9.52%

For illustrative purposes only.

Investors should understand some municipal bonds will fall outside either the federal, state, or local tax exemption rules and may not be exempt from taxes. Most municipal bond offering documents – sometimes called “Official Statements” – will include a legal opinion establishing tax exemptions which may apply.

Relief from state and local taxes **often depends on whether the investor resides in the state** from which the municipal bond has been issued. If residents outside the state were to purchase the same municipal securities, they may be taxed at the state and local levels on interest earned. Investors are encouraged to understand the tax implications of their state of residence and its effect upon both in-state and out-of-state interest income. Investors should consult a tax advisor before purchasing any security.

To learn more about municipal bonds, contact your financial professional who can answer questions and provide access to current offerings, as well as assist you in structuring a portfolio that meets your individual investment goals and risk tolerance.

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