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Dan White
Dan.White@moodys.com
Director of Government Consulting and Finance Research

Contact Us

Americas
+1.212.553.1658
clientservices@moodys.com

Europe
+44.20.7772.5454
clientservices.emea@moodys.com

Asia (Excluding Japan)
+85 2 2916 1121
clientservices.asia@moodys.com

Japan
+81 3 5408 4100
clientservices.japan@moodys.com

Tax Day Changes in U.S. Could Spell Trouble in Muniland

Introduction

The most recent Fed move is not enough to guarantee liquidity for all issuers. Fiscal policymakers need to step in.

More work to do

This past week the federal government and several state governments pushed back the deadline for paying tax year 2019 income taxes from April to as late as July. The intent was to provide taxpayers and preparers some near-term breathing room from COVID-19 disruptions, but a side effect may be to starve some less-liquid governments of much-needed cash.

The Fed's decision on Friday to expand some short-term liquidity facilities into the muni market will help most issuers stay solvent, but the assistance won't be enough for everybody.

Each year, about a third of all income tax collections roll into state and local government coffers in April and May. That means that most governments are typically running lean on cash at the end of March. Without healthy reserves or access to near-term credit, this can mean late payments to vendors, missed payrolls, or in extreme cases even default or bankruptcy.

The overwhelming majority of states and local governments that collect income taxes are more than liquid enough to handle even a three-month delay. Those that may not have enough cash on hand will still have access to near-term credit through revenue anticipation notes, or other short-term liquidity facilities.

However, for a material number of issuers that already have borderline credit profiles and thus may not have access to even near-term lending options, this type of liquidity shock can be just the thing to push an issuer into technical default. States and the federal government will need to be extra vigilant in their stimulus plans to make sure all issuers are able to stave off major problems.