

The power of tax-equivalent yield

What is tax-equivalent yield?

The pretax yield a taxable bond needs to possess for its yield to be equal to that of a tax-exempt bond is the tax-equivalent yield. The tax-equivalent yield helps to fairly compare the yield of a taxable and tax-exempt bond. When considering an investment in a tax-exempt security, such as a municipal bond, an investor may forget that the yield on this type of security is not directly comparable to the yield on a taxable security. Unlike the yield on a tax-exempt security, which is not subject to federal income tax¹ and, in some cases, state and local income taxes, the yield on a taxable security reflects its pre-tax yield—which can create an unfair comparison to the benefits of a tax-exempt security.

Benefits of state tax-exempt securities³

Since tax-exempt bonds can potentially be both federal and state income tax free, an investor can combine both income tax rates to determine their overall tax-equivalent yield.

For instance, if an investor is in the 35.8% federal income tax bracket and lives in the state of New York, their combined income tax rate would be 46.5% (using the state income tax rate of 6.85% and the New York City income tax rate of 3.876%). When comparing a taxable bond with a 4.0% yield to a tax-exempt bond with a 3.5% yield, the tax-equivalent yield when using the combined income tax rate would be calculated as follows:

$$3.5\% / (1 - 0.465) = 3.5\% / 0.535 = 6.55\%$$

In this instance, the tax-equivalent yield of the tax-exempt bond (6.55%) is greater than the 4.0% yield of the taxable bond by 2.55%—highlighting the additional impact of state tax advantaged securities.

Tax-Exempt Investments Appear Attractive, Particularly in Higher Tax Brackets²

The chart below displays the additional yield an investor would need to earn from a taxable investment to equal the tax-free yield of a New York municipal bond.

						With a tax-free yield of:								
						1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%
Income (Single filers)	Income (Joint filers)	2025 Federal Income Tax Rate	New York State Income Tax Rate	New York City Income Tax Rate	Combined Income Tax Rate	You need to find a taxable investment yielding:								
\$0 to \$11,925		10.0%	4.50%	3.078%	17.6%	1.21%	1.82%	2.43%	3.03%	3.64%	4.25%	4.85%	5.46%	6.07%
	\$0 to \$23,850	10.0%	4.50%	3.762%	18.3%	1.22%	1.84%	2.45%	3.06%	3.67%	4.28%	4.89%	5.51%	6.12%
\$11,926 to \$48,475		12.0%	5.50%	3.819%	21.3%	1.27%	1.91%	2.54%	3.18%	3.81%	4.45%	5.08%	5.72%	6.35%
	\$23,851 to \$96,950	12.0%	5.50%	3.876%	21.4%	1.27%	1.91%	2.54%	3.18%	3.82%	4.45%	5.09%	5.72%	6.36%
\$48,476 to \$103,350	\$96,951 to \$206,700	22.0%	6.00%	3.876%	31.9%	1.47%	2.20%	2.94%	3.67%	4.40%	5.14%	5.87%	6.61%	7.34%
\$103,351 to \$197,300		24.0%	6.00%	3.876%	33.9%	1.51%	2.27%	3.02%	3.78%	4.54%	5.29%	6.05%	6.81%	7.56%
	\$206,701 to \$394,600	27.8%*	6.85%	3.876%	38.5%	1.63%	2.44%	3.25%	4.07%	4.88%	5.69%	6.51%	7.32%	8.13%
\$197,301 to \$250,525	\$394,601 to \$501,050	35.8%*	6.85%	3.876%	46.5%	1.87%	2.81%	3.74%	4.68%	5.61%	6.55%	7.48%	8.42%	9.35%
\$250,526 to \$626,350	\$501,051 to \$751,600	38.8%*	6.85%	3.876%	49.5%	1.98%	2.97%	3.96%	4.95%	5.94%	6.93%	7.92%	8.92%	9.91%
\$626,351 or more	\$751,601 or more	40.8%*	10.90%	3.876%	55.6%	2.25%	3.38%	4.50%	5.63%	6.75%	7.88%	9.00%	10.13%	11.26%

*Includes 3.8% Medicare surtax. The table assumes that federal taxable income is equal to state income subject to tax, and in cases where more than one state rate falls within a federal bracket, the highest state rate corresponding to the highest income within that federal bracket is used.

A New York Municipal Strategy May Provide Further Tax Benefits For In-State Investors

The chart below displays the additional yield a national tax-free municipal bond strategy (which takes into account Federal tax rate exemptions) would need to provide in order to equal the tax-equivalent yield of a New York municipal bond strategy(taking into account both New York state and New York city tax rates).

			A national strategy with a tax-free yield of:								
			1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%
Income (Single filers)	Income (Joint filers)	2025 Federal Income Tax Rate	Needs to provide this much additional yield to break even with a New York state-specific strategy:								
\$0 to \$11,925		10.0%	0.09%	0.14%	0.18%	0.23%	0.28%	0.32%	0.37%	0.41%	0.46%
	\$0 to \$23,850	10.0%	0.10%	0.15%	0.20%	0.25%	0.30%	0.35%	0.40%	0.45%	0.51%
\$11,926 to \$48,475		12.0%	0.12%	0.18%	0.24%	0.30%	0.36%	0.41%	0.47%	0.53%	0.59%
	\$23,851 to \$96,950	12.0%	0.12%	0.18%	0.24%	0.30%	0.36%	0.42%	0.48%	0.54%	0.60%
\$48,476 to \$103,350	\$96,951 to \$206,700	22.0%	0.14%	0.22%	0.29%	0.36%	0.43%	0.51%	0.58%	0.65%	0.72%
\$103,351 to \$197,300		24.0%	0.15%	0.22%	0.30%	0.37%	0.45%	0.52%	0.60%	0.67%	0.75%
	\$206,701 to \$394,600	27.8%*	0.17%	0.26%	0.35%	0.44%	0.52%	0.61%	0.70%	0.79%	0.87%
\$197,301 to \$250,525	\$394,601 to \$501,050	35.8%*	0.20%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
\$250,526 to \$626,350	\$501,051 to \$751,600	38.8%*	0.21%	0.32%	0.43%	0.53%	0.64%	0.74%	0.85%	0.96%	1.06%
\$626,351 or more	\$751,601 or more	40.8%*	0.33%	0.50%	0.67%	0.83%	1.00%	1.16%	1.33%	1.50%	1.66%

*Includes 3.8% Medicare surtax. The table assumes that federal taxable income is equal to state income subject to tax, and in cases where more than one state rate falls within a federal bracket, the highest state rate corresponding to the highest income within that federal bracket is used.



For more information

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- 1. Certain municipal bonds are subject to the Federal Alternative Minimum Tax.
- 2. The Federal Income tax rates are based on rates published as of October 2024. Actual tax rates will vary depending on the investor's income, investments, and deductions. The tax information shown is current but subject to change. These calculations are for illustrative purposes only, are hypothetical, not guaranteed, and are not representative of any specific investment.
- 3. Source: New York State Department of Taxation and Finance, Form IT-2105 - New York State Income Tax Rates, 2025.

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