

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 California, their combined income tax rate would be 45.8% (using the state income tax rate of 10.0%). 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:

$$3.5\% / (1 - 0.458) = 3.5\% / 0.542 = 6.46\%$$

In this instance, the tax-equivalent yield of the tax-exempt bond (6.46%) is greater than the 4.0% yield of the taxable bond by 2.46%—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 California municipal bond.

Income (Single filers)	Income (Joint filers)	2026 Federal Income Tax Rate	California State Income Tax Rate	Combined Income Tax Rate	With a tax-free yield of:								
					1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%
You need to find a taxable investment yielding:													
\$0 to \$12,400	\$0 to \$24,800	10.0%	2.0%	12.0%	1.14%	1.70%	2.27%	2.84%	3.41%	3.98%	4.55%	5.11%	5.68%
\$12,401 to \$50,400	\$24,801 to \$100,800	12.0%	6.0%	18.0%	1.22%	1.83%	2.44%	3.05%	3.66%	4.27%	4.88%	5.49%	6.10%
\$50,401 to \$105,700	\$100,801 to \$211,400	22.0%	9.0%	31.0%	1.45%	2.17%	2.90%	3.62%	4.35%	5.07%	5.80%	6.52%	7.25%
\$105,701 to \$201,775	\$211,401 to \$403,550	27.8%*	10.0%	37.8%	1.61%	2.41%	3.22%	4.02%	4.82%	5.63%	6.43%	7.23%	8.04%
\$201,776 to \$256,225	\$403,551 to \$512,450	35.8%*	10.0%	45.8%	1.85%	2.77%	3.69%	4.61%	5.54%	6.46%	7.38%	8.30%	9.23%
\$256,226 to \$640,600	\$512,451 to \$768,700	38.8%*	11.0%	49.8%	1.99%	2.99%	3.98%	4.98%	5.98%	6.97%	7.97%	8.96%	9.96%
\$640,601 or more	\$768,701 or more	40.8%*	13.0%**	53.8%	2.16%	3.25%	4.33%	5.41%	6.49%	7.58%	8.66%	9.74%	10.82%

* Includes 3.8% Medicare surtax. ** Includes 1% CA state mental health services tax. 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 California 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 California municipal bond strategy (taking into account California state tax rates).

A national strategy with a tax-free yield of:

Income (Single filers)	Income (Joint filers)	2026 Federal Income Tax Rate	Needs to provide this much additional yield to break even with a California state-specific strategy:								
			1.00%	1.50%	2.00%	2.50%	3.00%	3.50%	4.00%	4.50%	5.00%
\$0 to \$12,400	\$0 to \$24,800	10.0%	0.02%	0.03%	0.05%	0.06%	0.07%	0.08%	0.09%	0.10%	0.11%
\$12,401 to \$50,400	\$24,801 to \$100,800	12.0%	0.07%	0.11%	0.15%	0.18%	0.22%	0.26%	0.29%	0.33%	0.37%
\$50,401 to \$105,700	\$100,801 to \$211,400	22.0%	0.13%	0.20%	0.26%	0.33%	0.39%	0.46%	0.52%	0.59%	0.65%
\$105,701 to \$201,775	\$211,401 to \$403,550	27.8%*	0.16%	0.24%	0.32%	0.40%	0.48%	0.56%	0.64%	0.72%	0.80%
\$201,776 to \$256,225	\$403,551 to \$512,450	35.8%*	0.18%	0.28%	0.37%	0.46%	0.55%	0.65%	0.74%	0.83%	0.92%
\$256,226 to \$640,600	\$512,451 to \$768,700	38.8%*	0.22%	0.33%	0.44%	0.55%	0.66%	0.77%	0.88%	0.99%	1.10%
\$640,601 or more	\$768,701 or more	40.8%*	0.28%	0.42%	0.56%	0.70%	0.84%	0.98%	1.13%	1.27%	1.41%

*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.

This comparison reflects tax treatment only and does not account for differences in credit quality, duration, diversification, liquidity, or total return.



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 2025. 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: Taxfoundation.org – California Income Tax Rates, 2026. The State tax rates reflect the 2026-2027 tax year, using the highest possible rate for each federal tax bracket.

Municipal securities risks include the ability of the issuer to repay the obligation, the relative lack of information about certain issuers, and the possibility of future legislative changes which could affect the market for and value of municipal securities. Bonds are also subject to credit risk, in which the bond issuer may fail to pay interest and principal in a timely manner. Investments focused in a single state may be subject to increased geographic concentration risk.

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