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Income Insights is a series designed to quickly describe important income tax concepts for advisors and their clients.

Holly Swan 8/27/2025 Tax Management

When comparing bonds, be sure to evaluate yields on a tax-equivalent basis to consider the impact of taxes on after-tax returns. Here we look at the tax-equivalent yield using a hypothetical scenario.

These married taxpayers—who file jointly—reside in Arizona and earn a combined $450,000 per year. Their federal marginal tax rate is 32%, and they're subject to the Net Investment Income surtax of 3.8%. They also pay a state tax of 2.5%, with a combined federal and state marginal tax rate of 38.3%. For this example, we assume an in-state municipal bond yield of 3.28%.

The formula for calculating tax-equivalent yield is:

tax-free bond yield ÷ (1 − marginal tax rate)

Below is how the tax-equivalent yield would be calculated for our hypothetical couple, comparing four types of bonds.

	IN-STATE MUNICIPAL BONDS	OUT-OF-STATE MUNICIPAL BONDS	U.S. TREASURY BONDS	CORPORATE BONDS
Subject to state or federal tax	Neither tax	State tax	Federal tax	State and federal tax
Calculation	3.28/(1 – 0)	3.28/(1 – 0.025)	3.28/(1 – 0.358)	3.28/(1 – 0.383)
Tax-equivalent yield	**3.28%**	**3.36%**	**5.11%**	**5.32%**

For this couple, a corporate bond must yield 5.32% to produce an after-tax yield equivalent to the in-state municipal bond yielding 3.28%. This hypothetical example highlights how taxes can affect investment returns and the importance of making informed decisions to maximize after-tax income.

ALL-08262025-4d3qeqtp