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WEALTH TAXES, PUBLIC BENEFIT FRAUD, & WHAT MATTERS FOR MUNI BONDS

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Key Takeaways

- California's proposed wealth tax faces significant political, legal, and administrative obstacles and is unlikely to be enacted.
- In Minnesota (and other states), recent public benefit fraud allegations are unlikely to materially affect state credit quality given limited budget exposure, legal constraints on federal funding freezes, and established oversight frameworks.
- More broadly, the wealth tax debate and heightened fraud scrutiny reflect shifting fiscal attitudes that may support the long-term relative value of tax-exempt municipal income.



In the first two weeks of 2026, Breckinridge's municipal research team fielded several questions around the potential for a wealth tax in California and the investment implications of alleged public benefit fraud in Minnesota and several other states.

Breckinridge believes that California is unlikely to enact a workable wealth tax, but if it does, the state's credit quality would likely weaken. By contrast, recent fraud allegations have minimal investment implications.

CALIFORNIA'S PROPOSED WEALTH TAX

In November 2026, Californians may vote on a ballot initiative to impose a one-time, five percent tax on the “wealth” of residents with \$1 billion in assets. Initiative supporters must obtain 875,000 signatures by late June to ensure the measure makes the ballot. To pass, the measure needs 50 percent approval. The tax would apply to California residents as of January 1, 2026, and would be imposed on a mix of assets, including businesses, securities, art, collectibles, and intellectual property. It would exclude retirement accounts, pensions, or real estate assets.¹

Breckinridge expects the proposed initiative will not become law. If it does, it may be initially difficult to enforce and weaken the state's medium-term credit fundamentals. We note the following:

- Governor Newsom has consistently rejected the merits of the ballot measure, and he recently demonstrated his ability to shape a ballot initiative during an off-year election with the reinstitution of gerrymandering.²
- Opponents of the wealth tax initiative have filed competing ballot measures that would dilute, nullify, or make it more difficult to enact the wealth tax.³
- If the wealth tax passes, limited collections are likely in the near-term. Wealth taxes are sometimes difficult to administer; European countries have scaled them back in recent decades.⁴ In California, state regulators will need to establish definitions around valuing art and other intangibles.
- There are significant questions around the legality of a California wealth tax. For example, taxpayers who flee after January 1 of this year but before November may claim that the state lacks jurisdiction to tax their wealth, retroactively. They might also argue that the tax violates the Dormant Commerce Clause.⁵
- If the wealth tax proves workable, a meaningful proportion of California's wealthiest residents might depart the state, relocate their businesses, or both. California's Legislative Analyst's Office (LAO) believes the policy would have a negative fiscal impact: “It is likely that some billionaires decide to leave California. The income taxes they currently pay to the state would go away with their departure. The reduction in state revenues from these kinds of responses could be hundreds of millions of dollars or more per year.”⁶

Perhaps the more important takeaway for investors is that the wealth tax proposal highlights changing public attitudes around taxes and wealth. The potential for a wealth tax has remained entrenched in the public imagination for a few election cycles now. Such a tax may not be enacted in California in 2026, and it's very unlikely to pass at the federal level, in our view.

But such proposals highlight something more pedestrian: That marginal tax rates may rise at some point over the next several years. In that context, there may be more value in tax-free interest than today's already low municipal/treasury (M/T) ratios suggest.

1. [“California One-Time Wealth Tax for State-Funded Health Care Programs Initiative,”](#) Ballotpedia.
2. [“Newsom unloads on California wealth tax proposal: ‘Makes no sense’,”](#) Politico, January 12, 2026.
3. [“California’s Amended Wealth Tax Initiative Meets Five New Foes,”](#) Pillsbury State and Local Tax Group, December 15, 2025.
4. Hebous, Klemm, Michielse, Osorio-Buitron, “How to Tax Wealth”, International Monetary Fund, March 2024. Available at: [061-article-A001-en.pdf](#).
5. Baker Botts, “California 2026 Billionaire Tax Act”. December 12, 2025. Available at: <https://www.bakerbotts.com/thought-leadership/publications/2025/december/california-2026-billionaire-tax-act#:~:text=Equal%20Protection%20Clause.,classification%20under%20the%20California%20Constitution>.
6. Legislative Analyst's Office. A.G. File No. 2025-024. December 11, 2025. Available at: <https://lao.ca.gov/BallotAnalysis/Initiative/2025-024>.



FRAUD IN MINNESOTA & OTHER STATES

In late December 2025, federal prosecutors announced that up to \$9 billion in federal grants paid to Minnesota childcare providers since 2018 might be fraudulent.⁷ The potential scale of the fraud contributed to Governor Timothy J. Walz abandoning a campaign for a third term, and the Trump administration announced a freeze on certain federal grants to Minnesota and several other states (California, Colorado, Illinois and New York), mostly related to child care funding for low-income families.⁸

Breckinridge anticipates that recent fraud allegations are unlikely to impact investment fundamentals in any of the states. More broadly, the story highlights the potential for reduced spending on domestic social services programs.

As an initial matter, the programs involved represent small shares of each state's budget. For perspective, general fund spending across the five states subject to a potential grant freeze totaled \$433 billion in Fiscal Year (FY) 2025.⁹ The \$10 billion in threatened grants represents 2 percent of this figure.

It's also unlikely that the federal government can withhold funds as it desires. Federal rescissions typically run afoul of the Impoundment and Control Act of 1974 (the ICA). The ICA prohibits permanent spending freezes or deferrals, except upon a notification of Congress.¹⁰ New precedent around executive branch "impoundments" may be established over the next year or two, but for now the rules are pretty clear.¹¹

Certainly, when federal authorities discover that a state has misused grant funds, officials can halt payments. However, evidence must be provided first. The five above-mentioned states recently won a temporary restraining order (TRO) against the administration's attempted freeze, in part, by making exactly this point.

Likewise, Breckinridge has seen no evidence to suggest that fraud is currently more commonplace in the muni market or in specific states. To the extent that it is, issuers and investors may benefit from renewed public scrutiny of fraud and heightened enforcement of it. Program costs could fall while new legal claims are created in favor of affected states.

It's also likely that oversight is stronger than commonly appreciated by investors and taxpayers. Policing fraud is generally politically popular. Governors, states attorneys general, U.S. attorneys, journalists, and other stakeholders in the public square are strongly incentivized to investigate, prosecute, and uncover fraud. At the state level, most public programs are audited with some regularity, either by a third party, internally within the executive branch of government, or by another branch of government.

Independent auditing is embedded in the governing structure of all 50 states, often via an independently elected state auditor.¹²

Lastly, jointly administered state-federal programs like those implicated in recent weeks are explicitly subject to an annual "Federal Single Audit." The federal Single Audit Act of 1984 mandates that federal programs undergo a third-party annual audit whenever a state expends more than \$750,000 in federal funds.¹³ The results are included in issuers' financial reports. Breckinridge is unaware that any of the above states have failed their Single Audits as related to the affected programs.

7. ["Federal prosecutors probe \\$18B Minnesota medicaid spending, say 50%+ could be fraudulent. What US taxpayers need to know,"](#) Yahoo Finance, December 20, 2025.
8. State of New York, et al. v. Administration for Children and Families, et al., No. 1:26-cv-00172 (S.D.N.Y. Jan. 8, 2026). Complaint for Declaratory and Injunctive Relief. New York State Office of the Attorney General. <https://ag.ny.gov/sites/default/files/court-filings/state-of-new-york-et-al-v-administration-for-children-and-families-et-al-complaint-2026.pdf>.
9. National Association of State Budget Officers, 2025 Expenditure Survey.
10. Saturno, J. V. (2025, February 25). The Impoundment Control Act of 1974: Background and congressional consideration of rescissions (CRS Report No. R48432). Congressional Research Service. <https://www.congress.gov/crs-product/R48432>.
11. In September 2025, the Supreme Court partially stayed a preliminary injunction barring an impoundment of funds ostensibly owed to nonprofit groups paid through USAID. The case is ongoing. See: AIDS Vaccine Advocacy Coalition v. United States Department of State. 1:25-cv-00400
12. National Association of State Auditors, Controllers, and Treasurers, "State Auditors: Protecting American Taxpayers at All Levels of Government." Available at: https://www.nasact.org/files/News_and_Publications/White_Papers_Reports/NSAA_white_paper_for_web.pdf.
13. Single Audit Act Amendments of 1996, Pub. L. No. 104-156, 110 Stat. 1396 (1996). <https://www.govinfo.gov/content/pkg/PLAW-104publ156/html/PLAW-104publ156.htm>.



In Breckinridge's view, recent fraud allegations may prove most relevant to investors by reducing public support for social-services spending. As we have noted in our most recent annual Muni Outlooks, rising federal deficits have caused lawmakers to explore savings in a mix of policy areas. Policymakers may find it easier to reduce funding for states, cities, and schools by highlighting current weaknesses in fraud detection and enforcement.

CONCLUSION

While neither California's proposed wealth tax nor recent fraud allegations materially alter near-term municipal credit fundamentals, they highlight political dynamics that may shape fiscal policy, spending priorities, and investor sentiment over time. In this environment, we believe tax-exempt municipal bonds may continue to offer relative value, particularly if higher marginal tax rates and tighter oversight become more central features of the policy landscape.

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