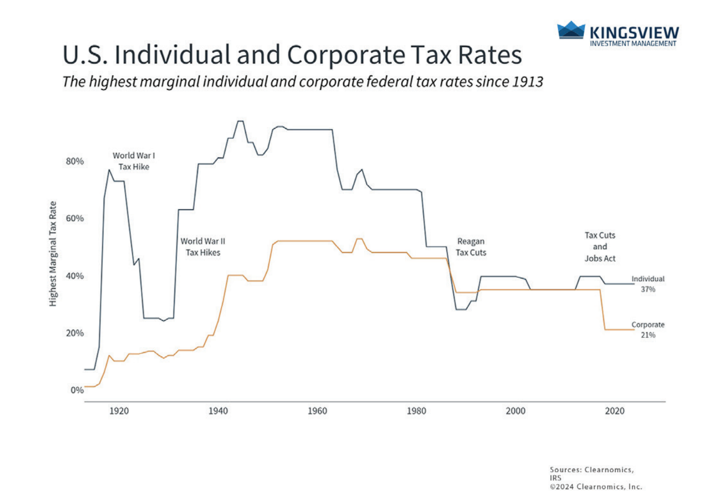
Portfolio Manager Insights

How Tax Proposals and the Election Impact Investors
Weekly Investor Commentary | September 11, 2024
Investment Committee

IT'S IMPORTANT TO MAINTAIN PERSPECTIVE THIS ELECTION SEASON



With less than two months until the presidential election, the policy platforms for President Donald Trump and Vice President Kamala Harris are gradually forming. Through speeches and debates, each candidate is laying out what they stand for and how they would change existing policies. For investors, perhaps the most scrutinized area is taxes, and there are concerns over how changes to tax rates could impact both Wall Street and Main Street. **How can investors maintain perspective as we approach November 5?**

Tax policy is an extremely complex subject, so it's always important to work with a trusted advisor. In addition, both candidates' platforms are still subject to change despite the short timeline until election day. While it's impossible to cover all the details here, many of the key differences on taxes between the candidates and their parties come down to the future of the Tax Cuts and Jobs Act (TCJA).

Before discussing the details, it's important to maintain perspective around tax policy since these issues can be politically heated. Taxes are intertwined with politics and reflect our polarized political climate. Regardless of which side of the aisle we might be on and what our personal preferences may be, it's important to stay objective so we can clearly focus on our financial goals.

While taxes have a direct impact on households and companies, they do not always have a straightforward effect on the overall economy and stock market. This is because taxes are only one of the factors that influence growth and returns, there are many deductions, credits, and strategies that can reduce the statutory tax rate, and spending and investment patterns often adjust to work around taxes. In other words, lower taxes do not automatically result in an economic boom and higher tax rates do not necessarily result in a crash.

Additionally, election rhetoric and actual policies can be quite different. Candidates often make promises based on their political leanings that may not fully materialize once in office. Even once a candidate is elected, Congressional partnership and approval is still required to pass new tax laws. Historically, the president's party tends to lose seats in Congress in their second term, and their approval rating tends to decline. This process can alter or water down initial proposals.

For example, during the 2016 presidential campaign, President Trump promised a complete overhaul of the tax system. While the Tax Cuts and Jobs Act was a significant change to the tax code, it also retained many existing elements. Similarly, President Biden criticized the TCJA during the 2020 election cycle and discussed raising taxes on high income earners and corporations. While the Inflation Reduction Act of 2022 did impose a 15% minimum corporate tax rate, this is far from the sweeping changes discussed during the election. The truth is that tax rates have been quite low by historical standards for decades. Even if there are no changes in the next presidential term, with the federal debt continuing to expand, many economists worry that taxes will have to rise to close the gap in the future.

The TCJA took effect in 2018 and included reducing individual income tax rates with the highest rate declining from 39.6% to 37%, nearly doubling the standard deduction, dropping the corporate tax rate from 35% to 21%, and implementing a territorial tax system for corporations. The TCJA also lowered estate taxes, eliminated personal exemptions, and adjusted several other deductions and credits.

As discussed above, the Inflation Reduction Act of 2022 introduced a 15% minimum tax on large corporations with annual profits over $1 billion. It also implemented a 1% excise tax on stock buybacks for publicly traded companies.

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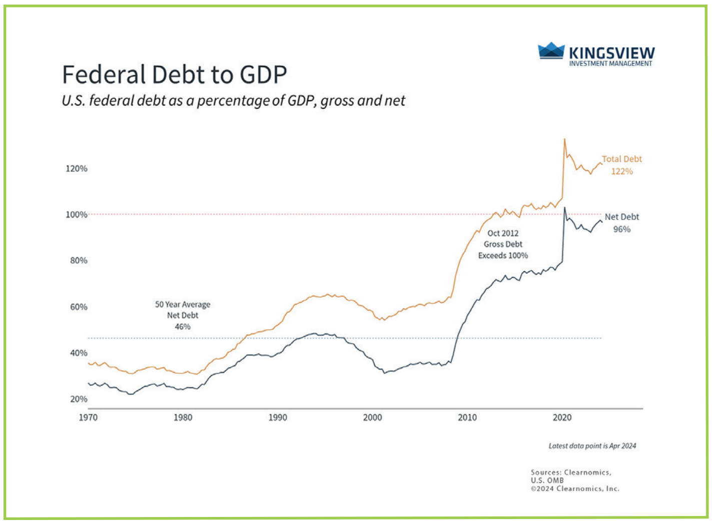
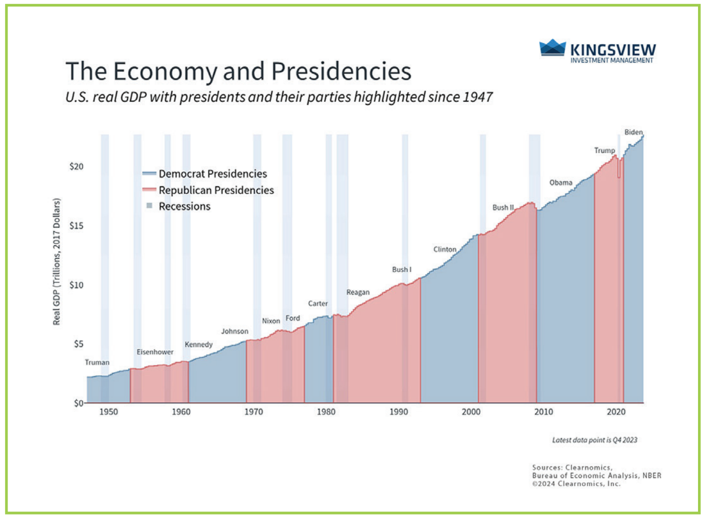
Unless action is taken by the president and Congress, many provisions of the TCJA will expire for the 2026 tax season, creating a so-called "tax cliff." This makes taxes especially contentious this election season. Here are some of the items the candidates are discussing:

- Trump proposes cutting corporate taxes further from 21% to 15% for some companies, including manufacturers who make their products domestically. Harris is in favor of increasing the corporate tax rate to 28%, in line with President Biden's position.
- Trump has discussed extending the TCJA's individual tax rates, but specifics are still unclear. Harris supports allowing the top marginal rate to revert to 39.6%.
- Harris proposes raising the capital gains rate from 20% to 28%. Along with an increase in the "net investment income tax" introduced with the Affordable Care Act, the top capital gains rate would rise to 33%, the highest since 1978.

THE FUTURE OF THE TAX CUTS AND JOBS ACT AND NATIONAL DEBT IS UNCERTAIN



THE ECONOMY HAS GROWN UNDER BOTH PARTIES



- Both candidates propose new enhanced child tax credits and not taxing tips. Trump has discussed eliminating taxes on Social Security for seniors.
- Harris proposes expanding the startup expense deduction from $5,000 to $50,000 and $25,000 in support of first-time homebuyers making down payments.
- Harris proposes a new tax on unrealized capital gains for those worth $100 million or more. Such a tax would be historic. The recent Moore v. United States case in the Supreme Court loosely touched on this by allowing a provision in the TCJA that imposed a one-time tax on unrepatriated foreign earnings.

Unfortunately, the annual budget deficit remains high and the national debt is likely to grow regardless of who occupies the White House. While studies on the matter differ and should be taken with a grain of salt, many suggest that either candidate would add trillions to the debt in the coming years.

However, it's also the case that the economy has grown over history under both political parties. As discussed earlier, it's important to remember that who occupies the White House is not the most important factor for the economy and markets, regardless of how counterintuitive that may seem. Policy changes tend to be gradual due to checks and balances in our political system. Perhaps more importantly, neither candidate is proposing a return to pre-Reagan era tax levels when the top marginal rates reached as high as 94%.

So, while taxes do play an important role in financial plans, they do not necessarily impact investment portfolios and economic growth the way some might imagine. Investors should continue to work with a trusted advisor and focus on their long-term goals this election season. By maintaining a balanced perspective and avoiding politically driven decisions, investors can better position themselves for success across the evolving political landscape.

The bottom line? As the election season heats up, it's important for investors to maintain perspective amid heightened political rhetoric and divergent economic proposals from the candidates. While Trump and Harris may propose changes to the tax code, it's important to maintain objectivity when crafting financial plans.