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October 2024 Crescent Commentary

How will the election results impact your taxes?

Last month, we discussed the general impact of elections on financial markets. This month, we will take a deeper look at another aspect of the elections which could impact you financially, and that's the potential tax impact.

We're monitoring tax policy closely, because the large tax cuts on individuals, investments, and estates that were implemented in 2018 during Trump's first presidency, known as the Tax Cuts and Jobs Act (TCJA), will expire at the end of 2025. If Congress does not pass new legislation next year, tax rates will automatically revert to higher levels previously in place.

Some of the key tax provisions in play which could impact you directly include:

- The reduction of individual income tax rates
- The increase in the standard deduction
- Limits on the mortgage interest deduction
- The reduction of the alternative minimum tax
- The reduction of the estate tax

As a reminder, the estate tax exemption was increased to roughly $13mm per person, or $26mm per married couple, in 2018. Those numbers will fall to roughly half those amounts if Congress does not take action and the tax provision does sunset at the end of 2025.

President Trump proposes extending all of the low tax provisions in the TCJA beyond the year-end 2025 sunset date, including tax rates on individuals, estates, capital gains, and dividend income, among other provisions. He seeks to eliminate partial income taxation on Social Security retirement payments and to also remove tax on tips.

Another tax provision that could impact you is the corporate tax rate. The TCJA reduced the corporate tax rate from 35 percent to 21 percent. This particular tax cut does not have a sunset provision—meaning this low rate will stay in place until it is proactively raised or lowered in new legislation that is signed into law by Congress and the president. With the corporate tax rate, Trump previously advocated lowering the corporate rate from 21% to at least 20%. Recently, he called for reducing the rate to 15% "solely for companies that make their product in America". Because of Trump's views on the corporate tax rate, as well as Republican control of Congress, we see a lower risk of a corporate tax rate increase taking place over the next four years.

Congress has to pass any change to tax legislation. Given that both the House and Senate are Republican majority, we expect an easier time getting the tax cuts extended. The President plays a role through either approval or veto of the legislation, so there is some influence from the president. And if vetoed, Congress again has the ability to pass the legislation if the right voting thresholds are met.

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There's some added complexity here because Congress won't look at tax legislation in a vacuum. Tax deliberations would likely involve a broader policy debate in Washington about the federal budget, government spending, tariffs, and the impact to the already bloated federal deficit and debt.

One question you might have is how these tax policies could impact the economy. If Trump succeeds at extending the current tax cuts set in place six years ago, we see his presidency as a continuation of the status quo. There wouldn't be much of an economic impact from taxes specifically. If the tax cuts were not extended or any new tax laws were to get implemented, their economic impact would vary depending on several factors, such as: (1) the size and distribution of tax cuts versus hikes (2) how different household income segments and their spending power are impacted (3) what stage of the business cycle the economy is in when the tax changes happen (4) how the tax code changes impact federal spending and the federal budget.

As we've mentioned before, probably the most important economic factor is the current direction the economy is heading in before any tax changes take place. In previous Commentaries, we've talked about how the latest data show the U.S. economy has slowed, and we don't yet know if economic growth will settle into a slow but steady period of growth similar to the pre-covid economy, or continue to slow into a recession. Tax policy can have some impact on economic growth, but there will be a time delay since none of the changes can happen until the new government takes action next year.

And what about the impact of tax policy on financial markets? If the 2018 tax cuts are extended, we would expect little financial market impact since that would represent a continuation of the past six years. If the tax cuts were not extended, we would expect some financial market volatility since it would effectively represent a reduction of economic stimulus.

We will continue to monitor tax policy closely and communicate any financial recommendations to you based on any changes that take place.

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Sources:
(1) RBC Wealth Management