Wealth management insights from Stifel's CIO Office

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Math doesn't lie – budget math and vote math. Keep that in mind as Congress engages in a tax debate in 2025.

Several parts of the Tax Cuts and Jobs Act of 2017 (TCJA) expire after 2025, and the Congressional Budget Office (CBO) estimated that extending these sunsets for 10 years would add almost $5 trillion to the debt. That is before inclusion of President-elect Trump's campaign promises of additional tax cuts, especially restoring full state and local tax (SALT) deductibility, are included.

Although Republicans swept Congress, their majority in the House will be significantly less than in 2017 when the GOP had 239 members, 12 of whom voted against the TCJA and three voted "present." The vote math will be much tougher this time.

Several key parts of the TCJA will expire after 2025, thereby forcing Congress to consider tax legislation during its next session. Since Republicans swept the election and control the White House and both chambers of Congress, they are expected to use the budget reconciliation process which will allow them to circumvent the Senate's normal 60-vote requirement and pass tax legislation in that chamber with a simple majority. However, budget realities, competing policy priorities, and a slim majority in the House mean passing a tax bill through both the House and Senate will be more challenging than it might appear. We expect Republicans will hold 221 or 222 House seats, which is significantly less than the 239 seats that the party held in 2017 when 12 House Republicans voted against the TCJA. Also, President-elect Trump picked three current House Members for his administration. Thus, Republicans will be without those votes, at least temporarily, until special elections to fill the vacancies are held later in 2025.

TCJA EXPIRING PROVISIONS SET UP TAX DEBATE AND COLLIDE WITH CAMPAIGN PROMISES

President-elect Donald Trump campaigned on numerous promises to cut taxes. It is unclear to what extent investors are expecting these tax cuts to be enacted, but the budget and vote math is daunting and will likely limit what Congress can do. In addition to promising to extend the expiring provisions of the TCJA, Mr. Trump also proposed several new tax cuts including:

- Cutting the corporate income tax rate to 16%;
- Reinstituting the domestic production activities deduction;
- Exempting tips and overtime pay from taxable income; and
- Restoring full deductibility of SALT from the current cap of $10,000.

The expiring provisions of the TCJA include:

- Lower individual income tax rates;
- The SALT deduction cap;
- Relief from the Alternative Minimum Tax;
- Section 199A deduction (small business pass-through deduction);

- 100% bonus depreciation (phased out starting in 2025); and
- A higher exemption from the Estate Tax.

In May, the CBO estimated that extending all these provisions for 10 years would add approximately $4.6 trillion to the national debt. Also, the Center for a Responsible Federal Budget estimated that allowing the cap on the SALT deduction to expire would add an additional $1.2 trillion to the national debt over 10 years. These estimates do not include the additional Trump proposals mentioned above.

Congressional Republicans will, in our view, want to keep the cost of extending the sunsets as low as possible, which will limit which new tax cuts might be passed. Cutting the corporate rate to 16% seems very unlikely. In fact, some Republicans think cutting the corporate income tax rate to 21% in 2017 was the most unpopular part of the TCJA, so we doubt they will want to spend political capital on cutting the rate further. Although we think a corporate tax increase is unlikely, we would not completely rule it out if congressional Republicans need revenue to pay for an extension of TCJA sunsets.

Inflation Reduction Act (IRA) tax credits will also be on the table. Mr. Trump and some Republicans have talked about repealing some of the IRA tax credits. Reuters and others have reported that the incoming Trump administration will propose ending the electric vehicle (EV) tax credit. There appears to be widespread Republican support for ending the EV credit, but we think there will be less support for ending other IRA tax credits. The EV tax credit is seen as benefiting mostly upper income taxpayers. Other credits, however, will be used by corporations to finance the construction of manufacturing facilities which, in turn, will employ workers – especially workers in Republican areas. We expect some Republicans will resist eliminating IRA tax credits other than the EV credit because they want to protect the jobs those credits could support in their districts. Because of the budget situation, Congress will scramble to find offsets for extending the sunsetting tax cuts, so it is possible that Congress might cap the value of IRA tax credits. Repealing them, however, seems unlikely.

TAX SCENARIOS

It has been less than two weeks since the election, and it is too soon to know exactly how the tax debate will play out. There are multiple scenarios for the endgame, and a straightforward, long-term extension of the tax cuts is only one of them. As we explained above, the budget and political math will make this option difficult. In another scenario, Congress might decide to let some of the sunsetting provisions expire. For example, it is possible Congress will let the top individual income tax bracket reset as scheduled while extending the remaining sunsets. In addition, Congress might fail to reach a comprehensive deal and kick the can down the road for a short time. Under this scenario, Congress might simply extend the expiring provisions for two years and fight about it after the midterm elections. Some might think this scenario does not make sense and, certainly, in the Republicans' euphoria following the election it seems unlikely, but the political environment will evolve and the climate in mid-to-late 2025 could be much different than today.

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