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Monthly Investment Outlook: U.S. Tax Policy Takes Center Stage

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Title graphic: Individual Taxes

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The last major reform of the U.S. tax code was passed in 1986 under President Ronald Reagan. The goals of the Trump administration to simplify the tax code are largely the same as those three decades ago: reduce the number of tax brackets and allowable deductions while also lowering overall rates.

As tax policy is debated and negotiated in Washington over the coming weeks and months, U.S. investors are watching closely for key policy choices, including: what the income cutoffs are for the new proposed brackets, whether there will be a bracket for higher-income taxpayers, the size of the child tax credit, possible limits on state and local tax deductions, and the amount that can be invested tax-advantaged in 401(k) plans.

Lower individual tax rates could give households more cash to spend, potentially benefiting consumer goods and service companies. Housing could be negatively impacted if the mortgage deduction is less than the new standard deduction for many taxpayers.

Title graphic: Corporate Taxes

U.S. corporate income tax rates are among the highest in the world. So lowering them would potentially enable U.S. companies to be more competitive globally. We think it’s likely we will see a corporate tax rate dipping to 25% or lower from the current marginal rate of 35%. Smaller firms would likely benefit more than larger ones from this reduction, just as U.S.-based firms would likely benefit more than multinationals.

One area where we see some bipartisan support is repatriation of overseas profits, in which multinational companies that have parked their foreign profits overseas bring them back to the U.S. for usage and taxation. Some policymakers have already proposed incentives to encourage companies to repatriate these overseas profits.

Shareholders of multinationals with large overseas assets, particularly U.S.-based technology companies, are poised to benefit from repatriation.

In addition, if a corporate tax package includes a deduction for capital spending, that could really boost corporate earnings.

Title graphic: Investor Implications

Our modeling of equity market earnings indicates widely different market outcomes, depending on how these policy choices are settled. We expect to narrow down the outcomes as tax negotiations progress.

Already, though, financial markets are discounting some progress on tax reform. Be sure to follow the Wells Fargo Investment Institute for the latest tax policy developments and investor implications.

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