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BLOG POST
A Taxing Matter
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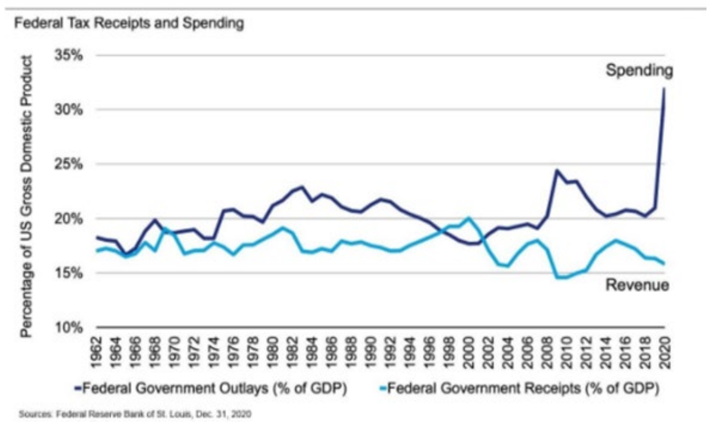
The Biden Administration has stated they would like to raise taxes by $2.1 trillion over the next 10 years according to the Tax Policy Center. This has been applauded by some and derided by others, claiming it will end the bull market in stocks. The “expert” opinions on how tax increases will impact the economy and markets are as wide ranging as opinions on global warming or the Affordable Care Act. Are higher taxes likely to be the culprit that sends stocks into a bear market? Ultimately it will depend on what type of tax increases are able to get passed.

There are generally four different types of taxes with very different economic impact for each. There are taxes on wages, taxes on corporate income, taxes on capital, and finally taxes on estates. Proposals to increase estate taxes are hotly debated but have virtually no economic or market impact. It has been estimated by the Brookings Institute that if you taxed the taxable estates at a rate of 100% it would only fund the government for a few weeks. The CBO estimates only 4,100 estate tax returns this year, so it would not move the needle for revenue or impact.

Taxes on the other three sources can impact markets far more. We are about to have a robust dialogue about the disparity between taxes on capital and income. It has been a long-held view that higher taxes on capital is counter-productive because it leads to less capital creation and fewer opportunities for the working class. The data is mixed and anything but certain, but you have to take into account that capital can be very mobile. When taxes rise above certain thresholds, it may look for a more friendly tax home.

Corporate income taxes are slated to go back to levels before the Tax Cuts and Jobs Act of 2017 reduced them to 21%, and this might ultimately be the more serious threat to the markets. It is undeniable that much of the stock market gains over the last 5 years have been the result of massive stock buybacks by corporations. Eliminate the buybacks and investors might experience a scenario where there are more sellers than buyers and prices plummet. Corporations, whose earnings have been flat in many cases, have increased earnings per share by simply repatriating cash at low rates and using it to reduce the amount of stock outstanding. This has been particularly effective for companies like Apple, Oracle, and Microsoft. Higher corporate taxes are likely to reduce the amount of buybacks and could become the pin that ultimately bursts the stock market bubble.



Not all tax increases will be negative for the economy or markets, especially if the increase in revenues result in productive spending like infrastructure. Eliminating tax loopholes that are exploited each year for billions in savings could generate much needed spending on roads, bridges, and water treatment plants.

The Administration has hinted at very large plans, but what is able to get passed seems likely to disappoint the Democratic party. I do not see any possibility of student debt forgiveness, a wealth tax, or taxes to support the Green New Deal getting through Congress. I will be watching closely the debate over ending the filibuster, as if that were to occur, I think the markets would implode with sellers rushing for the exits.

The national conversation about taxes must equally consider what are likely to be unintended consequences. Take private aviation for example. It is very possible generous tax breaks for corporate jets will be taken away under the guise it only benefits the ultra-wealthy. According to Forbes, more than 1 million people are employed in private aviation and the annual economic benefit is significant. There are over 5,000 airports in the U.S. and commercial airlines use just 500. A single corporate jet accounts for $2.5 million per year of economic impact where it is based. Teterboro in New Jersey employs 14,900 jobs with an economic impact of $2.3 billion each year, and Forbes states there are more than 15,000 business aircraft humanitarian flights each year.

Remember Newton’s Third Law -- for every action, there is an equal and opposite reaction. This tends to be very true with tax policy, as those who are the targets of higher taxes are often more nimble and quick to act than the governments trying to tax them. There is an entire industry devoted to helping the wealthy retain more of their income, and this is why tax increases often end up hurting the middle class they are intended to benefit.