First Trust
Monday Morning OUTLOOK

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# Tax Hikes Are Coming

The federal budget deficit hit an all-time record high of $3.1 trillion last year. With the passage of the recent blowout "stimulus" bill, it's set to be even higher in 2021. Now we watch and wait for a potential infrastructure bill, which could run as much as an extra $4 trillion over the next ten years. A trillion here, a trillion there…you know how the old saying goes.

As night follows day, higher spending – unless offset with future spending cuts – is going to lead to higher taxes. That's certainly the course the Biden Administration looks set to follow.

So far, consistent with his campaign pledge, President Biden says he's not going to raise taxes on people making less than $400,000 per year. But that's not where the money is.

Let's say they raise the top personal tax rate of 37% back to 39.6%, which is where it was for eight years under President Clinton, the last four years under President Obama, and the first year of President Trump. That change would generate only an additional $20 billion in extra revenue per year, based on 2018 tax data. If they also raised the 35% income tax bracket to 39.6%, that would raise an extra $13 billion per year. And this year the 35% tax rate kicks in at $209,426 for singles and $418,851 for married couples, which means that path would violate the $400,000 promise. Either way, it's like trying to fill a swimming pool using a teaspoon.

If they were to go for broke and raise both the 35% and the 37% brackets to a *100%* tax rate, and people keep working and paying everything they made in taxes, that would have raised about $681 billion in 2018. Big money, but still not close to bridging the budget gap.

That's why we think Transportation Secretary Pete Buttigieg's trial balloon about taxing auto mileage has to be taken seriously. The big spenders in Washington, DC know that tapping into the incomes of people making less than $400,000 per year is necessary to pay for all their spending promises.

At this point, we think it'd be very tough to get to 50 Senate votes for a whole new federal tax system on mileage. The same goes for a Senator Elizabeth Warren-style wealth tax, which is also of dubious Constitutionality. And, unless they get rid of the filibuster, the same goes for applying the Social Security tax to wages and salaries above $400,000.

Instead, we think the tax hike, which will likely be implemented on January 1, 2022, includes the following parts.

1. A top rate back up to 39.6%
2. A corporate rate, now 21%, close to 28%.
3. A top rate on capital gains and dividends at about 24% versus the current 20%
4. A lower exemption for the estate tax.

The one thing we can say for sure about all this is that some of these projections will be wrong. But we think most of it'll be right. The Biden team has suggested getting rid of the step-up basis at death for capital assets, but we think that would be an administrative nightmare. Moderate Senators would listen to horror stories about trying to adjust the basis for small farms and business owners and say, no.

The Biden team has also supported applying the 39.6% tax rate to the capital gains and dividends of the highest earners. That's one proposal that, if enacted, could hurt the stock market and the wider economy. The long-term capital gains tax rate hasn't been that high since the late 1970s; the dividends rate since 2001. Raising them both that high at the same time? If you haven't already decided that all this spending is damaging to long-term growth and investments, this would certainly be worrisome. We see a rise to 24% as the compromise that gets the votes.

Bargaining on tax hikes has already started in Washington, at least behind the scenes. It's going to be a long process, but we can say with high conviction that taxes are going up.

| Date/Time (CST) | U.S. Economic Data | Consensus | First Trust | Actual | Previous |
|---|---|---|---|---|---|
| 3-31 / 8:45 am | Chicago PMI – Mar | 60.0 | **60.9** | | 59.5 |
| 4-1 / 7:30 am | Initial Claims – Mar 27 | 680K | **725K** | | 684K |
| 9:00 am | ISM Index – Mar | 61.4 | **61.0** | | 60.8 |
| 9:00 am | Construction Spending – Feb | -1.0% | **-0.3%** | | +1.7% |
| *afternoon* | Total Car/Truck Sales – Mar | 16.4 Mil | **16.4 Mil** | | 15.7 Mil |
| *afternoon* | Domestic Car/Truck Sales - Mar | 12.6 Mil | **12.6 Mil** | | 11.9 Mil |
| 4-2 / 7:30 am | Non-Farm Payrolls - Mar | 643K | **625K** | | 379K |
| 7:30 am | Private Payrolls – Mar | 635K | **605K** | | 465K |
| 7:30 am | Manufacturing Payrolls – Mar | 37K | **37K** | | 21K |
| 7:30 am | Unemployment Rate – Mar | 6.0% | **6.0%** | | 6.2% |
| 7:30 am | Average Hourly Earnings – Mar | +0.1% | **+0.2%** | | +0.2% |
| 7:30 am | Average Weekly Hours – Mar | 34.7 | **34.6** | | 34.6 |