Tax Policy in 2025: Risks and Opportunities

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The Tax Moment of 2025

TCJA Expirations:

- All individual rate cuts
- Pass-Through provisions
- Higher estate tax thresholds
- Many business provisions in flux (expensing, R&E, GILTI, FDII, interest)
- Full extension over 2026-2035 window costs **$5-6 trillion**

Policy Context:

- CBO deficit and debt forecasts are brutal; deficits now rising sharply
- Highly uncertain policy environment

TCJA: Good, Bad, and ??

Worth Keeping/ Rearranging Deck Chairs

- Swap between higher standard deduction / child tax credit &repealed personal exemptions
- Swap between greater reach of AMT and SALT deduction CAP

Not Worth Keeping

- 199A : pass-through business deduction
- Estate tax cut
- Unaffordable rate cuts

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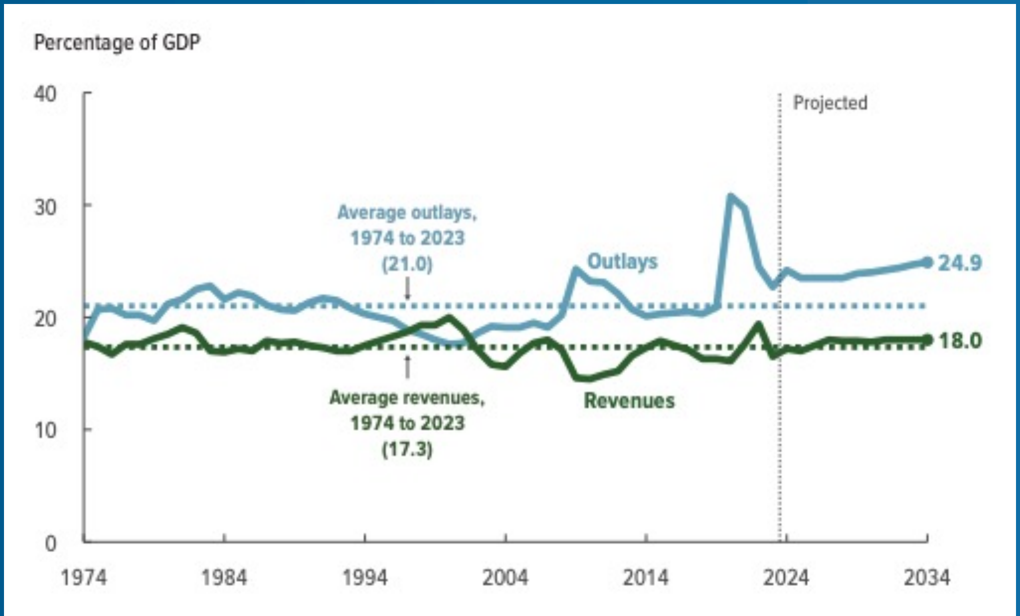
The Tax Moment of 2025
Risk #1 = Ballooning Deficits and Debt

<u>Trump Campaign:</u>

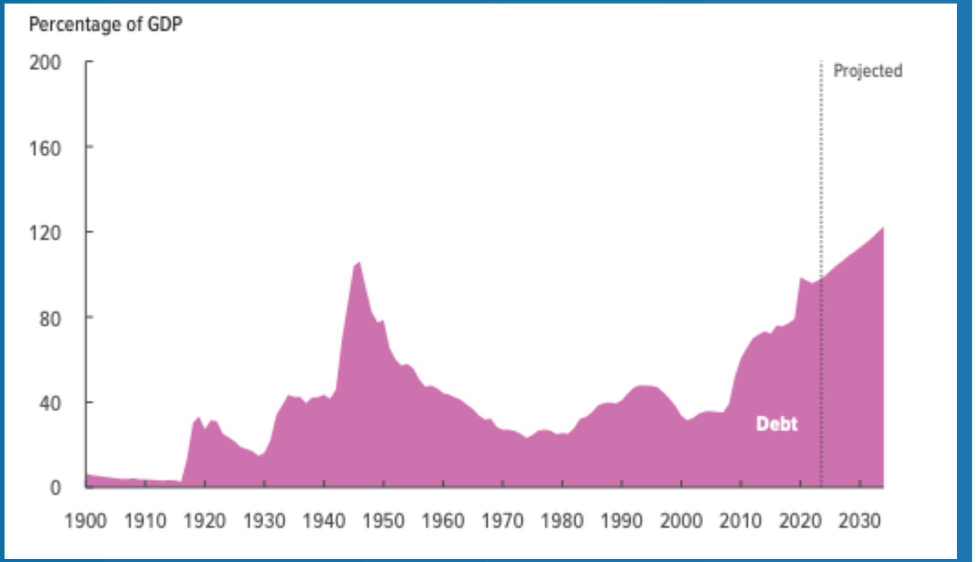
- TCJA Extensions ($5-6 trillion)
- 15 percent corporate rate ($600 billion)
- No taxes on tips, overtime, social security (>$2 trillion)
- No SALT cap ($1.5 trillion)
- Tariffs, Tariffs, Tariffs (likely revenue about $2 trillion over ten?)

Implications: Deficits and Debts

June 2024 CBO Deficit Forecast



June 2024 CBO Debt Forecast



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Why care about high deficits?

Context:

- Neither party cares that much about deficits; politics of wishful thinking
- Simpler to extend bad elements of TCJA than to (re)think
- the "*number*" for budget reconciliation will shape priorities, but budget gimmicks will continue => non-permanent policy

Consequences:

- More policy uncertainty
- Higher interest rates; crowding out and stronger dollar
- Less fiscal space for next emergency/recession
- Opportunity cost of spending $X trillion this way

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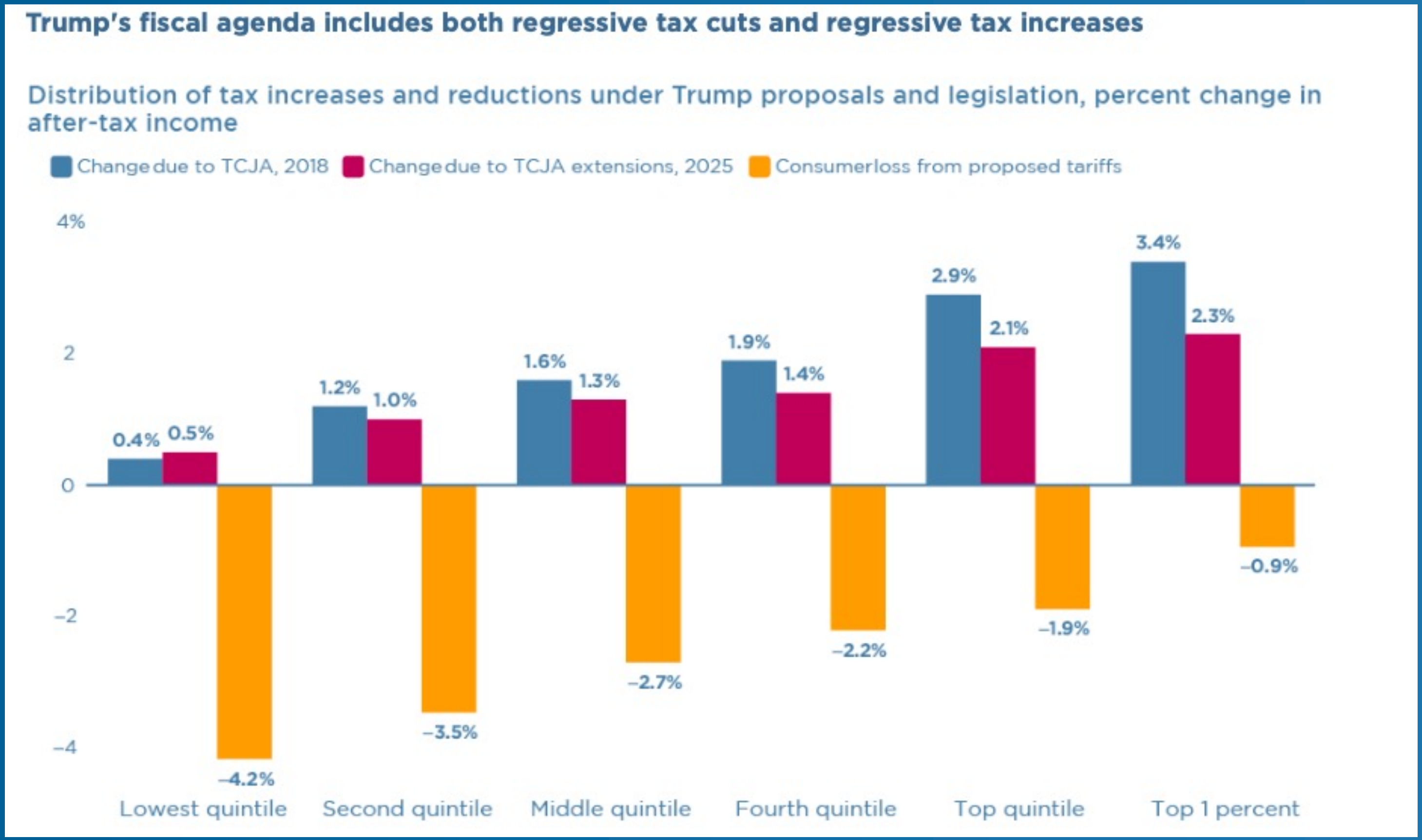
Risk #2: Rising Resentment



Source: Clausing and Lovely (2024), using Tax Policy Center analysis of TCJA and authors' analysis of tariffs.

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Bipartisanship Opportunity #1: Reign in Tariffs

Trump is an enormous fan of tariffs for basically any policy problem.

What are tariffs? A tax on imports.

Who pays for tariffs? The country levying them.

What is the rationale for tariffs? Distinguish Three.

1. National Security (makes sense in some cases)
2. Infant Industry/Industrial Policy (rarely first best)
3. Fiscal Policy (very bad idea)

Do tariffs fall on Americans?

Yes.

Foreign sellers are unwilling to sell for lower prices in US market than they receive abroad, so vast majority of cost borne by US buyers of importers.

With market power, some of burden can fall on foreigners, in theory. But this is limited. And evidence is clear that didn't happen in case of Trump/Biden tariffs.

Who pays?

In the short run, the buyers of imports (and those goods that compete with them).

Other Tariff Concerns

- Distortion away from export sectors and toward import-competing sectors
- Shocks to production of any good that requires imported inputs
- Harm to workers from shocks and retaliation
- Large negative effects on international relations in a time of many vexing global issues and ascendent nationalism

Bipartisan Opportunity #2: Corporate Tax Reform

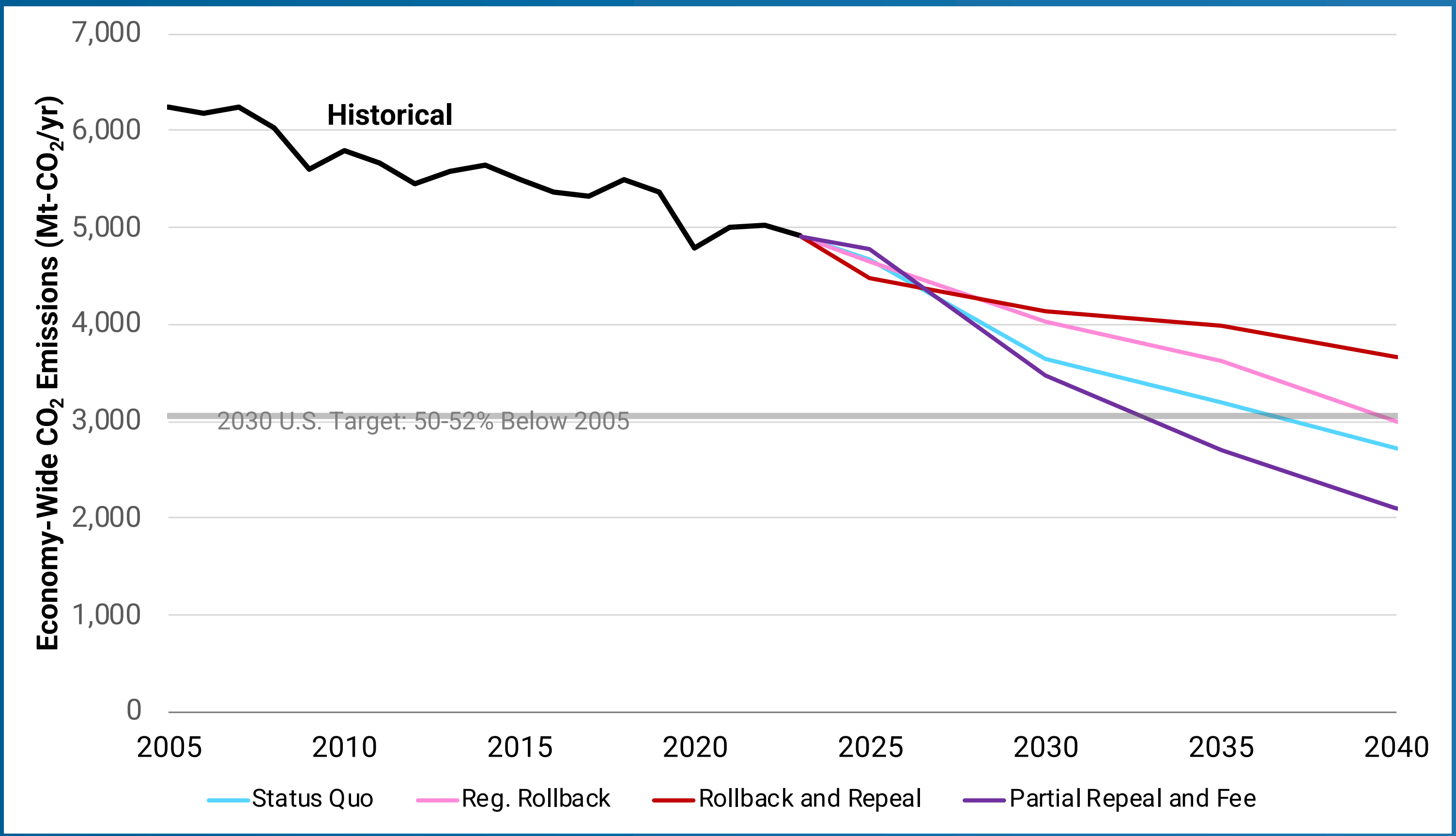
Business Tax Desiderata from TCJA Design
- Expensing is phasing out over five years (2023-2027)
- R&D moved from expensing to amortization in 2023
- GILTI and FDII rates scheduled to increase in 2026
- Interest limits became more binding in 2022

Other Business Tax Desiderata
- CAMT unloved
- International Tax Agreement => multitude of tax regimes
- Lower rates?

A Compromise:
International Tax Agreement Conformity

- Other countries raising rates is an opportunity, not a problem
- Conformity would help rationalize a multitude of min tax regimes: GILTI, BEAT, CAMT, and foreign UTPR => Reformed GILTI
- Opportunity to improve R&D credit
- Can be designed to hit positive or neutral revenue target
- Also, room for compromise around "Pillar 1" issues

Bipartisan Opportunity #3: Climate and Tax



Source: Bistline, Clausing, Mehrotra, Stock, and Wolfram (2024).

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Bipartisan Opportunity #3: Climate and Tax

Scenario	2035 Economy CO_2 (Decline from 2005)	Fiscal Costs to 2035 ($ billion)	Revenue from Carbon Fee to 2035 ($ billion)	Average Abatement Cost ($/t-$CO_2$)	2035 Household Energy ($/yr)
Status Quo	49%	$1,570	$0	$43	$3,770
Regulatory Rollback	42%	$1,330	$0	$69	$3,790
Rollback & Repeal	36%	$70	$0	N/A	$3,900
Fee & Part.Repeal	57%	$840	$660	$18	$3,930

Source: Bistline, Clausing, Mehrotra, Stock, and Wolfram (2024).