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Tax Update

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# 2025 Tax Primer: Extending the Trump Tax Provision et al.

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We continue to believe that Congress is likely to pass a massive $5 trillion--plus tax bill that would extend the 2017 Trump tax cuts, known as the Tax Cut and Jobs Act (TCJA). We do expect the bill will add to the deficit over the duration of the bill. Recall that the TCJA added $1.45 trillion to the deficit over the 10-year budget window, which seems to us to be a ceiling for this year's tax bill. The largest yearly addition to the deficit was in 2019, when the bill was estimated to increase the deficit by $280 billion. The lowest is estimated to be 2026 when $40.6 billion is estimated to be added to the deficit.

We expect the bill to provide relief for the business community as well with enhancements to the **R&D tax credit**, **bonus depreciation** and **interest deductibility**, among other issues. Recall that the TCJA downgraded these three business tax breaks to help pay for the 2017 legislation. For the last few years, Congress has been looking to "fix" these provisions and take them back to where they were in 2018 as is shown in the table below.

| Tax Policy | Cost | Comments |
|---|---|---|
| **Allow full expensing of R&D expenditures in the year they occur** | ~$180 billion over 10 years. | R&D tax credit has wide support in both parties. We expect it to be part of any tax bill. |
| **All 100% Bonus Depreciation** | ~$400 billion over 10 years. | Second in popularity in Congress to the R&D tax credit. High cost means that 100% depreciation would expire after a few years. |
| **Allow business to deduct interest up to 30% of EBITDA vs EBIT today** | ~$69 billion over 10 years | Least popular in DC among these tax breaks but still strongly supported. Also, least costly. |

Source: Penn Wharton Budget Model; Tax Foundation; JCT

We are skeptical that any additional reduction in the 21% corporate tax rate occurs, though we might see a 15% rate for corporations who make their products in the U.S. However, even then the odds are currently only around 1-in-3 in our view.

We are also likely to see some corporate tax breaks eliminated as some, if not much, of the IRA green energy tax provisions are likely to be used as payfors. Top among the list of rollbacks are the EV tax credits as well as the wind and solar investment and production tax credits. Among the safest is the 45U production tax credit for existing nuclear plants, which should be a relief for **Exelon Corporation** (EXC), **Constellation Energy** (CEG), **NextEra Energy** (NEE), and **Duke Energy** (DUK).

If Republicans proceed with a single-reconciliation bill strategy, which appears likely for the time being, we think the tax legislation can be enacted by late Q3 but could easily fall into Q4. A two-reconciliation bill strategy would almost ensure the tax measure doesn't reach the president's desk until Q4. Recall that then-President Trump signed the TCJA on December 22, 2017, when Republicans had roughly 20 more House members.

If we are correct about timing, the GOP will likely need to find another legislative vehicle for extending the debt limit. We think it faces an uphill battle in a reconciliation bill, since more than a few House Republicans are likely to be strongly opposed to its inclusion. We think a more likely scenario is to try to add a debt limit extension to the FY25 omnibus spending bill that needs to pass by March 14 when the current short-term continuing resolution expires.

Speaker Mike Johnson (R-LA) promised to include $2.5 trillion in savings with a $1.5 trillion increase in the debt limit. However, that is unlikely to come to fruition if the debt limit is increased outside the reconciliation bill since Democrats, who would-likely be needed to pass the measure, are vehemently opposed. Johnson has set himself up in a real pickle.

**Capital Gains and Dividend Tax Rate, 15% Minimum Book Tax, 1% Stock Buyback**

We are skeptical that Trump will push to reduce the 20% top capital gains and dividend tax rate to 15%, as outlined in Project 2025, though there is interest and support for such a move. We also see the potential for Republicans to reverse other tax hikes that were passed during the Biden administration, including the 15% minimum book tax and the 1% stock buyback.

However, given the lack of low hanging, meaningful offsets to pay for the expensive tax bill in general, we think it's going to be tough to roll back these tax hikes. Alternatively, we might see Congress opt to trim these tax rates for a limited time to lower the 10-year cost.

| Tax Policy | Cost | Comment |
|---|---|---|
| **Lower Cap Gains and Dividend Rate to 15%** | Likely more than $100 billion over 10 years. | This might not be worth the political fight, especially since offsets for simply extending the TCJA will be tough to find. |
| **Eliminate the 15% Alternative Minimum Book Tax** | Likely more than $313 billion over 10 years. | This might be a bigger priority than cap gains and dividend rate. Availability of offsets will determine inclusion. |
| **Eliminate the 1% Stock Buyback Tax** | ~$85 billion over 10 years. | Corporations didn't lobby too much against this provision. Don't see it being a priority. |

Source: Penn Wharton Budget Model; Tax Foundation; JCT

**Child Tax Credit**

Increasing the child tax credit, which would likely boost low-end retailers such as **Walmart** (WMT), **Dollar General** (DG) and **Dollar Tree** (DLTR), has long been part of the debate over "fixing" the R&D tax credit, bonus depreciation and interested deductibility. In the past, Democrats refused to address these business tax breaks unless an increase in the child tax credit was included.

Even though Democrats are certainly not going to have any say in how this tax bill is written, many Republicans, including Vice President elect JD Vance, have supported an increase in the child tax credit.

However, the cost of expanding the child tax credit is extremely expensive, and therefore it will almost certainly be limited in both the credit's amount and duration, meaning it surely won't be permanent and would expire after a few years, punting the decision to another Congress and president.

As an example, Vice President-elect JD Vance and others support a $5,000 child tax credit, which could cost as much $3 trillion over 10 years; this is clearly something that isn't going to happen. The amount and duration, in our opinion, will have to be much lower and shorter for inclusion.

Note that the child tax credit, which now sits at $2,000, will drop to $1,000 if the TCJA expires at the end of 2025.

**Other Issues: Immigration, Energy and Defense**

If Republicans continue with the single reconciliation bill strategy, we expect provisions that were going to be in the first of the two bills to be included in an unifying all-encompassing reconciliation measure. We note that President-elect Trump could easily change his mind and opt for a two-bill approach.

For Trump to implement his immigration / deportation plans, he likely needs at least an additional ~$100 billion initially, much expected to be used for additional detention center beds, a positive for **GEO Group** (GEO) and **CoreCivic** (CXW). We think those funds are apt to be included, regardless of the reconciliation strategy.

Under the single bill strategy, the extra funding for immigration / detention beds is likely to be enacted later than it would under a two-bill approach, resulting in a delayed benefit to GEO and CXW. However, we should at least see the GOP plans for that additional funding as early as March, which would likely be a boost for the companies.

On the traditional energy front, congressional Republicans are focused on: 1) including **permitting reform** in reconciliation; and 2) opening up some federal lands to oil & gas drilling.

We are skeptical that much can be done on the permitting reform aspect under reconciliation since such changes are likely to violate the Byrd Rule, which prohibits items that produce a change in outlays or revenues that are merely incidental to the non-budgetary components of the provision.

However, we believe the Byrd Rule would allow provisions to open federal lands to drilling. Recall that the Senate parliamentarian allowed for drilling in the Arctic National Wildlife Refuge (ANWR)in the TCJA, which was a reconciliation bill.

Republicans have also talked about adding defense funding to the reconciliation bill. We think this is likely if GOP members fail to secure the desired increase in defense dollars in an expected omnibus appropriations bill, which will need to be passed by March 14. Remember, the upcoming spending bill needs Democrat votes in order to pass, despite the existence of a GOP trifecta. Ultimately, we still expect overall defense funding to come in at ~$920 billion for FY25 as opposed to the $895 billion passed in the National Defense Authorization Act (NDAA), whether as part of the omnibus, reconciliation or some combination of the two.

**Overall Cost/Payfors**

The overall 10-year cost of the tax and spending proposals in the reconciliation bill is expected to be well north of $5 trillion. Just extending the 2017 TCJA is likely to clock in at ~$4.5 trillion, but that doesn't include: 1) the anticipated modification to expand the SALT deduction; 2) an time-limited increase to the child tax credit; 3) immigration spending; 4) exempting tax on tips; 5) reduction in the capital gains and dividend top rate; 6) a cut in the corporate tax rate; or 7) various other potential provisions desired by Republicans.

Keep in mind that since Republicans are certainly going to pass this legislation via reconciliation, which means the bill will only need a simple majority to pass in the Senate, it cannot add to the deficit after the 10-year budget window.

To ensure the GOP does not violate that policy and "limit" the bill's cost is to have the provisions expire before the end of the 10-year budget window. However, we don't think that will be enough to reduce the overall price-tag of the measure. We also expect Republicans to try to incorporate some DOGE recommendations that meet parliamentary scrutiny to help pay for the bill. How much DOGE might come up with in savings is unclear, but we are skeptical it will reach $1 trillion over 10 years.

Republicans appear to have quashed the idea of using tariffs as an official partial payfor. While we were one of the first to point out that this might be part of the discussion, which it was, we didn't think it would make into the final bill since many congressional Republicans opposed the idea. We doubt it gets resurrected, but it's worth keeping an eye on, given that Trump is expected to raise tariffs anyway and GOPers will be looking for offsets.

**Healthcare as a Payfor**

There are also a few potential payfors in Medicaid and Medicare that we believe are likely to be included in a final bill. We think Medicaid is a bigger and more likely savings target for reconciliation than Medicare, but we don't rule it out and think it will be part of the legislative discussions throughout the next several months.

On the Medicaid front, our Healthcare team sees: 1) Medicaid work requirements (could raise up to $110 billion over 10 years); 2) reduction or elimination of the floor for federal Medicaid match (up to $604 billion over 10 years); and 3) further limits on state provider taxes (up to $526 billion over 10 years). While the savings seem considerable from these changes, the actual savings amounts could be much lower, if changes are more modest. Please see our note in the link here for more details.

While President Trump and Speaker Johnson previously said Medicare is off the table, we think they are primarily talking about cutting back benefits and eligibility. That leaves changes to Medicare reimbursement potentially in the crosshairs. The most attractive proposal from a reconciliation standpoint seems Medicare site neutrality for ambulatory services, i.e. lowering Medicare reimbursements for outpatient services to make them consistent across various outpatient settings and lower the rate to where the procedure is most commonly performed. The most aggressive version of the policy is said to raise ~$140 billion over 10 years.

**De Minimis Changes, SNAP and Other Payfors**

One unexpected payfor that we think is likely to be included in reconciliation is a change to the de minimis law, which if it occurs would be negative for **FedEx** (FDX), **UPS** (UPS), **Amazon** (AMZN), Temu's **PDD Holdings** (PDD) and privately held **Shein**, which is expected to list on the London exchange by Q2. Our recent note on the de minimis rule can be found here.

We also see cuts to SNAP, formerly known as food stamps, as a payfor, albeit not a large one. Republicans proposed a five-year $30 billion cut to the program in last year's failed Farm Bill, which we think is likely to be included in the reconciliation bill unless it is ruled to violate the Byrd Rule. The provision could create headline risk for **WMT**, **DG**, and **DLTR**, though as we point out in a previous note here, those cuts are likely to be hits to the *growth* of pay outs and wouldn't likely result in real reductions in payments to recipients.

Finally with regard to payfors, we expect dozens and dozens of more unknown payfors to arise some of which won't materially impact financial markets and some likely will, and we should see those emerge late Q1 or early Q2.

**Outlook for Various TCJA Provisions**

Finally, we expect most of the major individual tax provisions in the TCJA to be extended and below we give our thoughts on various proposals.

| Tax Provision | Comments |
|---|---|
| Keep the standard deduction at $12,000 for single files and $24,000 for married filers (before TCJA it was $6,350 and $12,700 respectively) | We believe this is very likely to be included. |
| Keep the individual tax rates of 10%, 12%, 22%, 24%, 32%, 35%, and 37% (before TCJA those rates were 10%, 15%, 25%, 28%, 33%, 35% and 39.6%) | There might be some slight changes, but we doubt it. Expect provisions to be extended. |
| State and Local Deductions (SALT) are currently limited to $10,000 | This will very likely change. We see at a minimum a $20,000 SALT deduction for married couples. |
| Pass-Through Tax Provisions | We think the current pass-through provisions, of which there are many, are likely to be extended pretty much as is. |

Source: JCT; Capitol Policy Partners

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