# Trump's Tax Bill Outlook:

## Chance of Passing Increases and May Catalyze Bull Run

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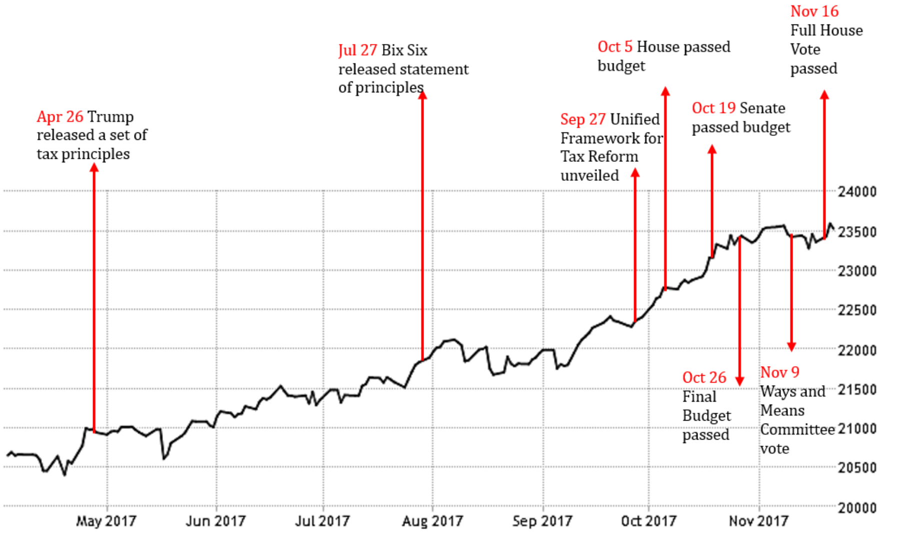
Viewed as the most important legislative effort by President Trump and the Republicans, the tax reform has been a major uncertain factor for the global market. Stock prices fluctuate as reactions to each of the major steps on the tax overhaul path. The Trump tax reform is intended to entail significant changes to American taxation structure and may have profound impacts upon the U.S. and global economy, making it the most significant tax reform since 1986. Here are some crucial issues that we should focus on before the initial Senate vote around early Dec: Where is the tax bill now? How likely is the Republican tax plan to become law? And more importantly, what are the potential impacts on the market and the U.S. economic growth?

❖ **Where Is It Now:**

**Unusually Fast in Both Chambers While Substantial Differences Remain**

On 16 Nov, House Republicans moved a major step closer to the winning they are so eager to get, by passing the tax bill with a 227-205 margin. It was the first major legislative triumph for President Donald Trump. It made the hope still alive that the Senate will give green-light to the bill and President Trump is able to see it on his desk by Christmas. Soon later on 21 Nov evening, the Senate released a 515-page text of its sweeping tax legislation for the first time. At this stage the Republican leaders plan to hold a floor vote on it within 10 days.

**Figure 1: Dow Jones Industrial Average Index & Timeline of Tax Reform**




*Source: Dow Jones, CMBIS*

We noticed that in the recent three weeks, both the House and Senate have unusually speeded up the legislative process. Now the Republican race to overhaul the tax code has begun to put on a sprint to pass it.

Economic Research

Overall, the House and Senate tax plans are similar in some key areas such as a repeal of deductions for state and local taxes, a doubled standard deduction and a 20 percent corporate tax rate. Either plan is estimated to cost $1.4 to $1.5 tn government revenue in 10 years.

**Figure 2: Estimated Cost of the House and Senate Tax Plans**

| *Policy* | *House* | *Senate* |
|---|---|---|
| *Individual Tax Cuts* | *$3.3 tn* | *$3.5 tn* |
| *Individual Tax Increases* | *-$3.1 tn* | *-$3 tn* |
| *Business Tax Cuts* | *$2.4 tn* | *$2.3 tn* |
| *Business Tax Increases* | *-$1.3 tn* | *-$1.4 tn* |
| *Reduce and/or Repeal Estate Tax* | *$151 bn* | *$94 bn* |
| *Total* | ***$1.4 tn*** | ***$1.5 tn*** |

*Source: Committee for Responsible Federal Budget, CMBIS*

Meanwhile, the version that the House recently passed is quite different from the Senate's. The House's plan seems more radical by reducing the brackets from seven to four and the corporate tax cuts will be effective soon in 2018. The Senate version proposes to delay corporate tax restructuring until 2019, sunset individual tax tweaks at the end of 2025 and completely wipe out state and local tax deductions.

**Figure 3: Major Discrepancies between the House and Senate Tax Bills**

| *Tax Item* | *House* | *Senate* |
|---|---|---|
| *Individual Brackets* | *Collapse 7 brackets to 4 (12, 25, 35, 39.6%)* | *Remain current 7 brackets(10, 12, 22.5, 25, 32.5, 35, 38.5%)* |
| *Top Rate* | *Keep 39.6%* | *Reduce to 38.5%* |
| *Child Tax Credit* | *Increase from $1000 to $1600* | *Increase from $1000 to $2000* |
| *Estate Tax* | *Repeal estate tax after 2024* | *Double the basic exclusion; does not repeal the tax* |
| *State and Local Tax Deduction(SALT)* | *Repeal SALT deduction for income and sales taxes; caps property tax deduction at $10k* | *Repeals full SALT deduction* |
| *Corporate Tax Cuts* | *Begin in 2018* | *Begin in 2019* |
| *Pass-throughs* | *25% flat rate with caveats* | *Above 30%* |

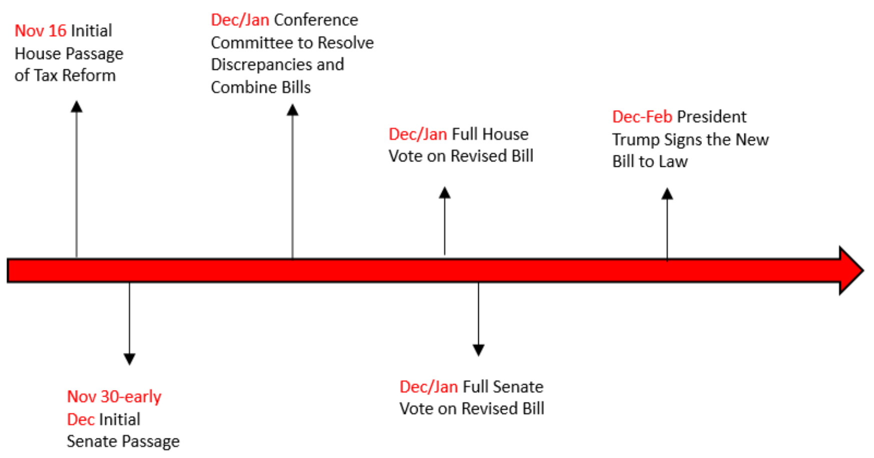
*Source: Tax Cuts and Jobs Act, CMBIS*

### ❖ What to Expect:

**Hurdles Remain but Likelihood of Passage Raises**

The tax reform promises have finally been turned into concrete measures. Looking forward, the hurdles remain in the Senate because only more than three wayward Republicans would kill the bill. In the near term, once the Senate passes the bill, lawmakers would have to reconcile the discrepancies between the two versions. The Conference Committee will be assembled to work out a final piece of legislation. Due to the substantial differences between the two versions of bills, the procedure to combine bills may not be simple and quick. As a result, it is not very likely the final bill can be ready by Christmas for President Trump. If the reconciliation process by the Conference Committee goes smoothly and quickly, the chance of the final passages will further rise.

**Figure 4: CMBIS Estimated Timeline of Tax Reform**




*Source: CMBIS estimates*

The Republicans need this victory; therefore, President Trump now is more focused on getting the bill pass than making the contents more worth passing in the first place. And the recent unusually fast moves in both chambers have raised the expectation of passage. After a comprehensive analysis on the bargaining powers of both parties and recent updates as of this writing, we assign an 80% probability of the tax legislation passing in the end.

### ❖ What Does It Mean to Market and Economy?

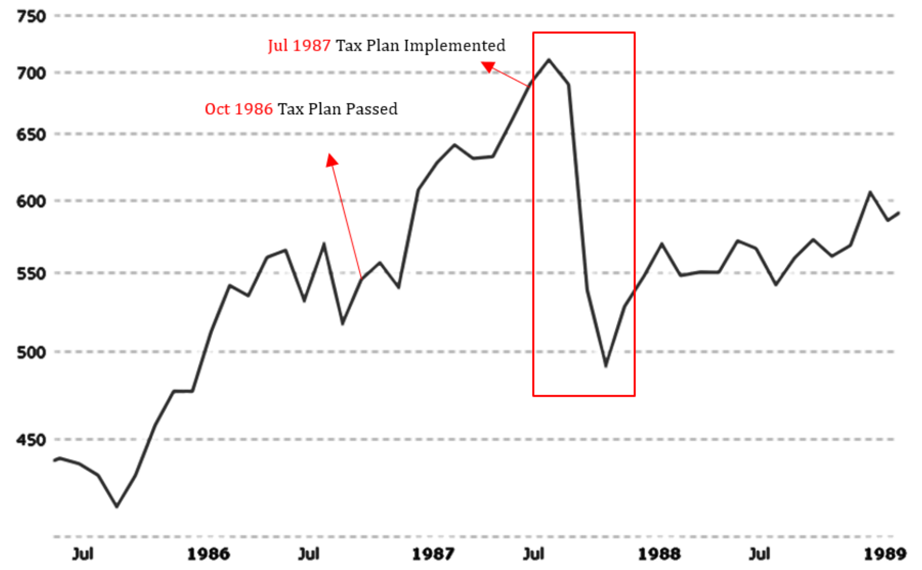
**(1) To Market: May continue engine Trump Rally in short-term, especially for small and mid-caps**

The odds of the tax reform becoming a reality are rising, and the markets may just be starting to realize it, which means there is still room for further price-in the expectation and more upside left. If there are any signs of compromise between two parties, the market will give positive responses, and prolong the Trump Rally.

The stocks rose in Trump's presidency up to now, which is called Trump Rally. But the president's policies alone cannot fully explain the bull. If we remove Trump from the equation, the general recovery of world economy leads global indexes high and rising. If the bill ultimately passes as we expect, it will be a catalyst that could prolong the bull run. Small and mid-caps would benefit more because of their higher domestic exposure. But if it fails, the stock would immediate dips as the market has already partially embraced and priced-in the reality that tax reform is likely to provide additional corporate earnings.

There is a growing sense of optimism, however, enough cautious are necessary. The point of maximum optimism may come quickly: perhaps more quickly than expectation. If we look back to another notable tax reform of the U.S. in 1986 by the Reagan Administration, passage of corporate tax cuts benefited the equities price quickly. The rally lasted until the implementation of the tax plan in Oct 1987, when the price slumped. One of the main lessons taken is to avoid rapid pricing in of the tax cuts, because its real impacts on corporate earnings are uncertain and may take longer to show up.

**Figure 5: S&P Rallied After 1986 Tax Plan Passed Before Implementation**




*Source: S&P Index, CMBIS*

**(2) To the U.S. Economy:**

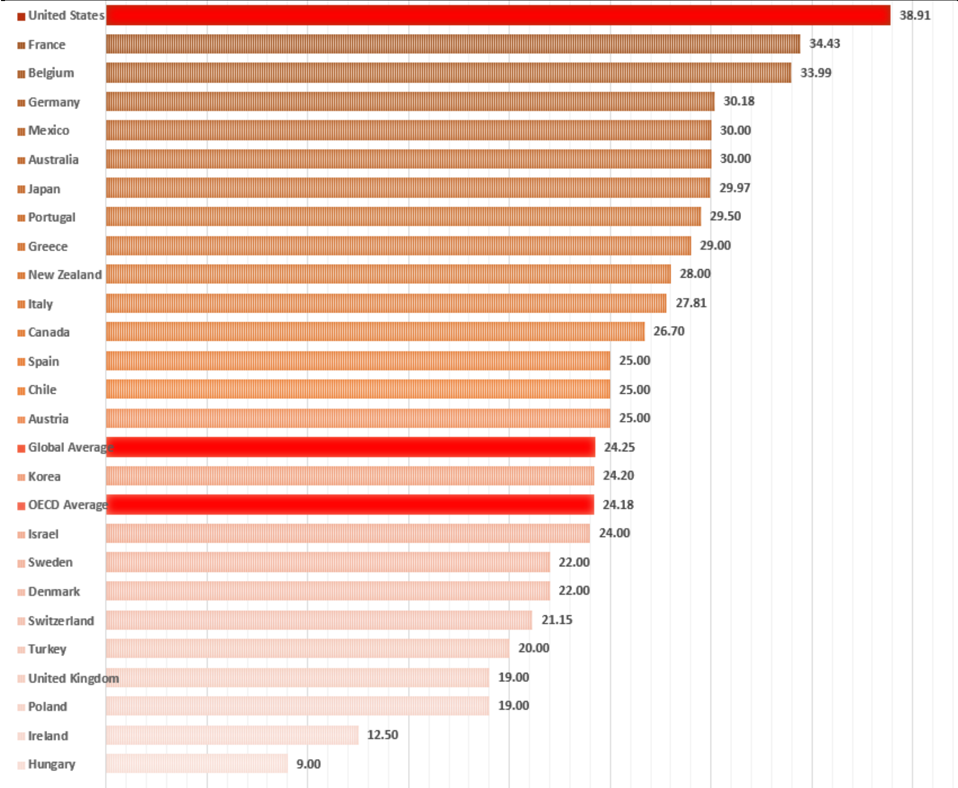
**Improve Competitiveness and Productivity**

The earnings eventually did surge by implementing the Reagan tax reform in the 1980s. The Trump tax reform is expected to improve U.S. competitiveness and productivity in many industrial sectors by three major boosters: lower business tax rates, a modernized international tax system, and incentives to invest in the United States.

The U.S. has the highest corporate tax rate among advanced economies. As the figure shows, the combined corporate income tax rate is nearly 39 percent in 2017, far more than other OECD countries and global average. The cutting of corporate tax rates from 35% to around 20% would pull the U.S. well away from the top of this list. It will decrease the cost of business in the U.S. and have a beneficial impact on most corporations' bottom lines.

The reform is proposed to simplify the cumbersome taxation system. It is widely believed that a modern, simple and efficient tax system will minimize administration and compliance costs, maximize tax-take and boost investment and growth.

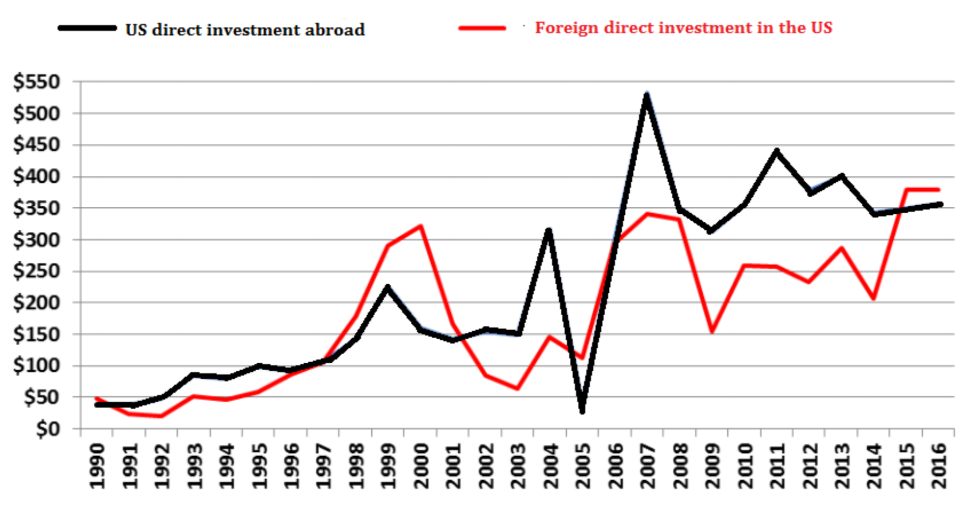
**Figure 6: The U.S Has Highest Corporate Income Tax Rate in OECD Countries**




*Source: OECD Tax Database, CMBIS*

The lower corporate tax rate will also lead to more investment projects and thus more aggregate economic activity. The U.S. direct investment abroad was much higher than the FDI it received from 2006 to 2014, but the lines reversed in recent three years. The tax cuts may continue this new trend by attracting both the U.S. and foreign investment.

**Figure 7: Comparison of FDIs in Both Directions**




*Source: Department of Commerce*

The tax cuts will boost the economy and in turn partially offset the fall in revenues. However, the status quo of U.S. budget deficit raises the concerns that the tax cuts will not pay for itself. The government has to come out budge cut proposals hand in hand with tax cuts plans, otherwise the huge deficit and debt may cause serious consequences for the U.S. economy in the long run.

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