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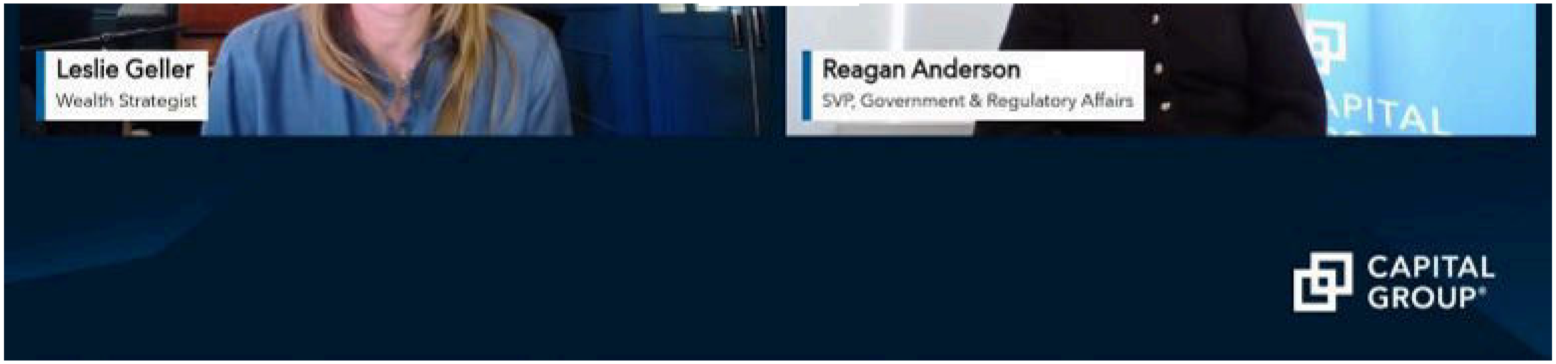
In an unprecedented election, 3 precedents still matter

Leslie Geller and Reagan Anderson

October 31, 2024

5 MIN ARTICLE



A close presidential race between very different candidates makes future tax policy a mystery. That makes it challenging for advisors to give meaningful guidance to clients who may be anxious about how changing tax laws will affect their financial plans.

In a recent webinar, we discussed the unprecedented 2024 presidential election from a new perspective – focusing on what is *not* unprecedented and is in fact somewhat predictable.

It's almost impossible to know what's coming next from a political perspective, and it's tempting to focus on what we don't know. But some aspects of the way our government works won't change, and understanding those realities will be helpful to advisors in the coming months.

1) Congress holds the power of the purse

Among many policy issues, the one issue that surfaces most as a top concern for investors is the future of the 2017 Tax Cuts and Jobs Act. That law reduced income tax rates, roughly doubled the exemptions for gift and estate taxes and put a limit on deductions for state and local taxes. It is scheduled to expire at the end of 2025 and that expiration is seen as the likely impetus for new tax legislation.

Some perspective: as much as we're hanging on every word the presidential candidates say, it's important to remember that Congress holds the power of the purse. Any changes in tax policy will need to get through

Congress and congressional committees. That's a long and complicated process that has historically required a lot of negotiation and compromise.

It's not clear whether the new president will enjoy working majorities in both houses of Congress. And even if the election produces a "red wave" (in which Republicans win the White House and Congress) or a "blue wave" (in which Democrats do the same), thin Congressional majorities rarely have the cohesion to rubber-stamp broad presidential initiatives. It's worth remembering that Democrats controlled Congress and the White House after the 2020 election, but still couldn't muster the momentum to pass tax legislation.

2) Tax policy will have to wait its turn

Another reality of the way the federal government works is that Congress will almost certainly deal with two contentious budget issues before it turns its attention to tax policy: first a continuing resolution to keep the government funded, then an increase in the debt ceiling to accommodate the ever-rising federal debt.

Feedback

Those issues have become annual cliff-hanger dramas that often test Congressional leadership and demonstrate just how difficult it is for Congress to reach agreement on any fiscal issue. Congress generally passes big fiscal bills at the very last minute – or votes for extensions that delay the last minute. This means it's likely Congress will not pass new tax legislation until late December 2025. Which in turn means the uncertainty investors feel over gift, estate, income and local taxes will likely last another 14 months and quite possibly longer.

Bottom line: Investors should be prepared for a short-term extension of the 2017 bill, which won't really give us a resolution on this. Based on past events, something will eventually get through Congress, but advisors and their clients need to accept the reality that we're going to have continued short-term uncertainty about tax rates.

3) Don't forget the $30 trillion elephant in the room

A third important reality the presidential election will not solve is the mounting federal deficit and debt. The current deficit is approaching $2 trillion per year and the total federal debt is approaching $30 trillion.

The current deficit is unsustainable, but we've had this unsustainable problem for decades. The solution is so unpopular that it's probably going to take some kind of outside event to catalyze action on this. For example, at some point international investors may signal they're unwilling to continue to finance the U.S. deficit. But when that outside event happens, it will be a crisis and Congress will be forced to act.

In the meantime, the deficit will cast a shadow over every fiscal debate, and we believe this increases the chances of net increases in overall taxation, at least for certain taxpayers such as high earners and corporations. Put more definitively, we do not expect taxes to go down. Knowing that the deficit effectively puts a floor under taxes, we encourage advisors to work with their clients now to make sure their portfolios are as tax-efficient as possible.

It's very hard to know what's coming in federal policy, but we think it's a safe assumption that tax efficiency will become more and more important to investors, so our guidance to advisors is to get ahead of that trend today.

Feedback

Leslie Geller *is a senior wealth strategist at Capital Group. She has 17 years of industry experience and has been with Capital Group since 2019. Prior to joining Capital Group, Leslie was a partner at Elkins Kalt Weintraub Reuben Gartside LLP. She received an LLM in taxation from New York University School of Law, a juris doctor from Boston College Law School and a bachelor's degree from Washington and Lee University. Leslie is based in Los Angeles.*

Reagan Anderson *is a senior vice president of government & regulatory affairs. She has 23 years of investment industry experience. She holds a bachelor's degree in journalism from Ohio University.*

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