PRATO CAPITAL

Effects of Corporate Tax Changes

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The Biden administration recently announced a tax plan that would increase corporate taxes to help pay for the infrastructure plan that was also proposed. Any plan that includes changes to tax laws can be divisive and this is no exception. Can past changes to corporate tax provide any insight into what we can expect in the future concerning GDP growth or stock market returns?

Looking Back on Corporate Taxes

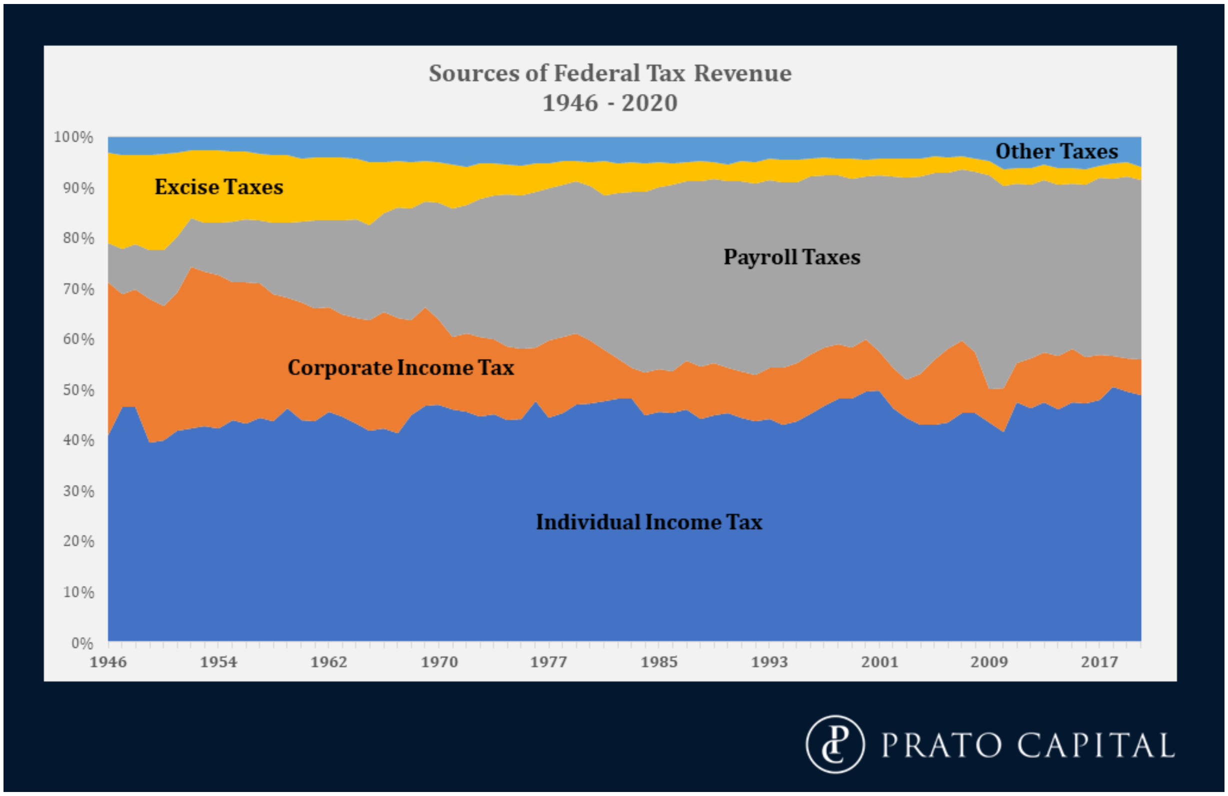
Corporate tax rates in the United States have changed 14 times since the end of World War II. Nine times tax rates have decreased and five times they have increased. Corporate tax rates over the past 75 years have seen rates as high as 53% in 1968 and 1969 to the lowest rate of 21% that began in 2018. Table 1 below shows the history of corporate tax rate changes since the end of World War II. President Biden's administration has proposed a corporate tax rate of 28%, which would be an increase of 7% from the current level.

Table 1: History of Corporate Tax Rate Changes (1946 – 2021)[i]

Year of Change, Maximum Corporate Tax Rate, and Percent Change			
1946	38% **(-2%)**	1970	49% **(-4%)**
1950	42% **(+4%)**	1971	48% **(-1%)**
1951	51% **(+9%)**	1979	46% **(-2%)**
1952	52% **(+1%)**	1987	40% **(-6%)**
1964	50% **(-1%)**	1988	34% **(-6%)**
1965	48% **(-2%)**	1993	38% **(+4%)**
1968	53% **(+5%)**	2018	21% **(-17%)**

Since 1968, the corporate tax rate has generally decreased, and it is much lower than at any other time since World War II. As the rates have decreased, one could surmise that would lead to the amount of tax collected from corporations as a percentage of Federal tax revenue decreasing also. Figure 1 below shows that is the case with tax revenue collected from corporations accounting for only an estimated 7.1% of Federal tax revenue in 2020. Individual income tax and payroll taxes are estimated to account for over 84% of Federal taxes last year.

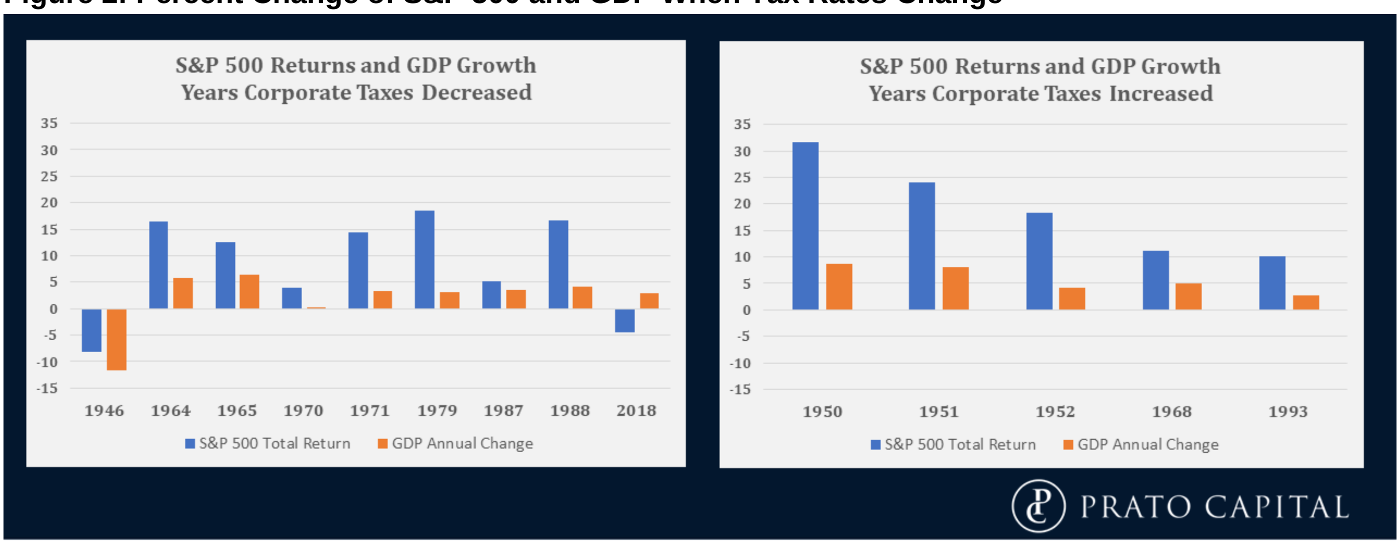
Figure 1: Sources of Federal Tax Revenue by Percentage. 1946 - 2020[ii]



Corporate Taxes, the Economy and the Stock Market

Figure 2 below, shows the S&P 500 and GDP percentage change when corporate tax rates changed. During the years of tax increases the US GDP grew an average of over 5.7% and the S&P 500 total returns, which include dividends, increased an average of 19%. When the tax rate was decreased, the GDP grew an average of 2.0% and the S&P 500 gained 6.5%.

Figure 2: Percent Change of S&P 500 and GDP When Tax Rates Change[iii]



With so few instances of tax changes over the past 75 years, it would be unwise to conclude that raising taxes caused greater GDP growth and higher stock returns than when taxes were decreased. Since many economic factors, not just tax rates, affect the growth of GDP and stock returns, maybe the correlation with corporate tax rate changes is not as pronounced as many believe. This is also a great example to not make investment decisions on hunches or feelings about what stock prices will do in the future.

Corporate Taxes and Infrastructure Legislation

As part of the Biden administration's "America Jobs Plan", the infrastructure plan announced recently, the change to corporate tax rates will be used to pay for the plan over 15 years. It is important to remember that there is not a consensus in Congress to pass this plan now. Not just Republicans are voicing concern, a group of Democratic legislators has announced concerns as well. To become law, this does require Congressional approval, and as negotiations between the White House and Congressional leaders continue the details may change. It is unlikely the administration will receive everything they are asking for in the final bill.

As for how all of this will affect the economy and the stock markets, there will probably be some companies and industries that benefit greatly from the infrastructure spending part of the plan and there may be some companies and industries that are affected more negatively by the tax increase. Until the final version of the legislation is passed, the outcome is unknown.

Conclusion

Nobody likes to see taxes increased. But, when we look back in history, we can see that tax changes did not have as dramatic an effect on the growth of our economy or on the equity markets as headlines would like us to believe. And when we look back at the corporate tax rates in the past, the proposed 28% rate is still much lower than we have seen since the end of World War II.

Having a balanced portfolio of stocks and bonds that is diversified across many sectors of the economy will be best positioned to capture the stock gains from companies that will benefit from the "America Jobs Plan". It may seem we repeat the same story every month, but having a sound investing strategy as part of a Financial Life Plan is still the best way to accumulate wealth and reach future financial goals.

As a reminder, the deadline to file the 2020 Federal tax returns is May 17, 2021. We are working on an update to the personal tax changes, including capital gains, that was announced on April 28. Check our website and social media for updates.

A tax loophole is "something that benefits the other guy. If it benefits you, it is tax reform."

— Russell B. Long, U.S. Senator

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[i] Source: www.irs.gov/statistics/soi-tax-stats-historical-data-tables
[ii] Source: www.whitehouse.gov/omb/historical-tables/
[iii] Source: S&P 500 data: www.slickcharts.com/sp500/returns, GDP data: fred.stlouisfed.org/series/GDP