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Investment Strategy Insights

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Bridge to a New Tax Regime?

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Infrastructure Takes Center Stage

- **The American Jobs Plan.** President Biden recently unveiled the American Jobs Plan, focused on $2 trillion of infrastructure spending over an intended 8-year period. Key components of the plan meet traditional definitions of infrastructure, such as roads, bridges, ports, airports and transit systems. However, the plan goes a few steps further by including provisions for broadband internet access, green energy generation and affordable housing, among others.

- **Stimulus of a Different Kind.** Unlike the past few rounds of fiscal stimulus, which were designed to immediately put cash in the hands of struggling consumers and businesses, infrastructure spending typically faces a larger lag between implementation and disbursement of funds. It usually takes some time to plan out specific projects that will be undertaken. As a result, the plan's stimulative effects would likely be felt mostly beyond 2021, which could foster a more sustainable rebound in economic activity.

- **Balancing Costs/Benefits.** If passed as currently proposed, the infrastructure spending portion of the American Jobs Plan could result in an average boost of ~1.2% of U.S. GDP for the next 8 years. With that said, the corporate tax hike components of the bill will likely provide some offsetting headwinds, which could possibly be felt all at once if implemented at the start of 2022. The result may be a payoff pattern that has front-loaded costs to economic growth in the U.S. with lumpy spending tailwinds thereafter, as the proposed infrastructure plans begin to break ground.

The infrastructure spending portion of the plan could help smooth the path to a new, sustainable economic cycle

Down in the Details on Taxes

- **Corporate Tax Whiplash**. The Biden administration is calling for a higher corporate tax rate to pay for the infrastructure bill. In 2017, Congress slashed the headline corp. tax rate from 35% to 21% amid a slew of other changes to the tax code. The latest proposal calls for re-raising that rate to 28%. It will be crucial for investors to follow the comments of a handful of moderate Democrats in Congress, who may have the leverage to thin down some of the proposals given the party's narrow majority in both chambers.

- **A Worldwide Scope.** Another key feature of the Biden plan is a doubling of the tax rate applied to global intangible low-taxed income (GILTI). The GILTI tax was created to prevent multi-nationals from transferring intellectual property like patents to subsidiaries in low tax jurisdictions to lower their tax bills (i.e., IP-heavy companies like tech and pharma). Biden's plan also withdraws the deductibility of some of that income, which could end up affecting a larger swath of firms with large cross-border operations.

- **Going by the Book.** There can be a meaningful difference between the income firms report to shareholders and tax authorities, since accounting rules for tax and financial reporting differ. For example, a company can immediately deduct a new piece of machinery for tax purposes, but must depreciate its cost over time on their income statements (book income). The administration's plan seeks an alternative minimum tax rate of 15% on that book income, in cases where companies with more than $2 billion in income report profits to their investors while paying little tax.

The political process on changes to tax law has just begun, the details of which will warrant ongoing attention for investors

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Taxes & the Bottom Line

- **A Hit to Corporate Profitability.** The tax increases proposed in Biden's American Jobs Plan (AJP) would likely take effect in 2022, though it appears that may be subject to change. Before baking in any of the effects of rising tax costs, the S&P 500 2022 consensus earnings-per-share (EPS) growth estimate sits at 14.6%. After the AJP's tax changes are taken into account, that earnings growth expectation falls to 5.6%, representing a ~9% headwind from higher taxes, though that impact could be softened if the administration is forced to make key policy concessions.

- **Not All Sectors Affected Equally.** While the corporate tax proposal will likely have broad implications for domestic equity markets, not all sectors may be affected equally. The communication services and technology sectors may have the most to lose under the proposed tax rules, due to significant overseas earnings derived via patents and other intellectual property facing higher GILTI rates. On the flip side, more domestically-oriented sectors such as real estate, energy and materials would likely face less severe headwinds in comparison.

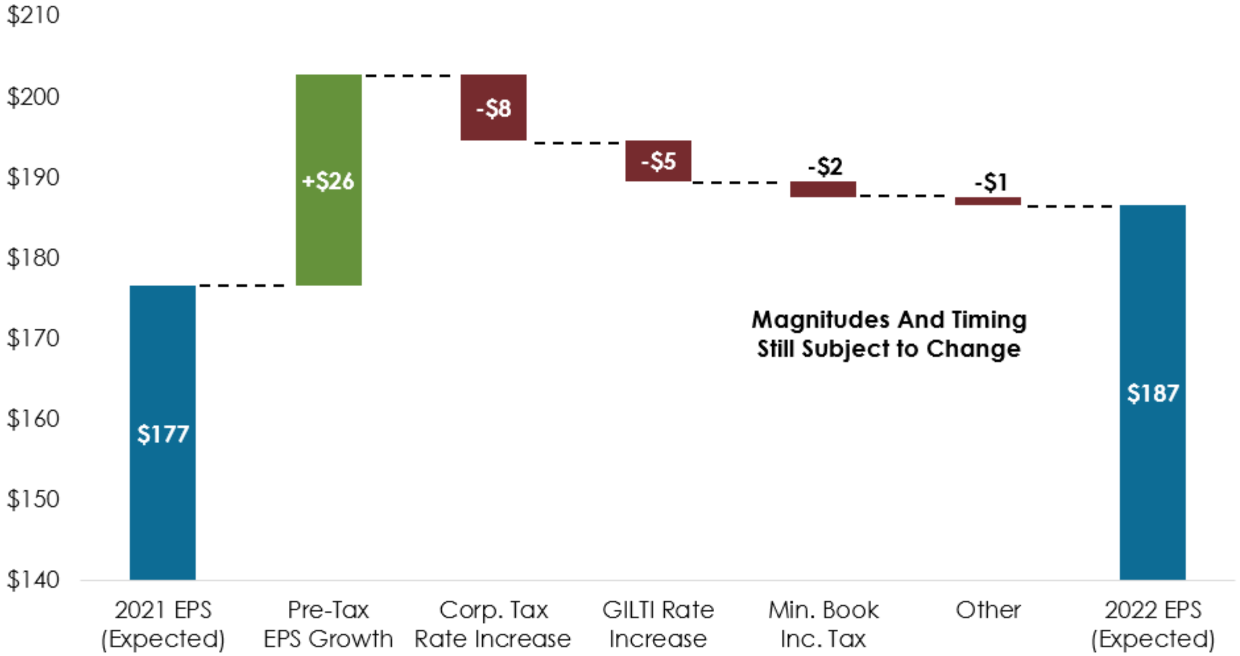
- **U.S. Open for Business?** There are a couple of fundamental characteristics that make certain nations more hospitable to business interests than others: robust property rights, a fair judicial system, transparent government practices, a sizable labor force, existing national infrastructure and friendly tax environments. Changes to the latter two are of particular importance vis-à-vis the American Jobs Plan, as a refreshed and modernized national infrastructure could offset a more onerous tax regime to some extent.

The specter of higher taxes is a looming risk to profits, though its eventual impact may be softened through political compromise

Chart of the Week:

As Proposed, the Biden Tax Plan Could Shave ~9% off '22 EPS

Expected Tax Change Impact on S&P 500 2022 EPS Estimates



Source: Glenmede, FactSet, Cornerstone Macro *Data through April 2021*

"2021 EPS (Expected)" refers to 2021 earnings-per-share estimates for the S&P 500. ""Pre-Tax EPS Growth" refers to expected EPS growth based on 2022 consensus estimates for the S&P 500. "Corp. Tax Rate Increase" refers to the impact of increasing the statutory rate from 21% to 28%. "GILTI Rate Increase" refers to an increase from 11% to 21% of the global intangible low-taxed income rate. "Min. Book Inc. Tax" refers to a proposed 15% minimum tax rate on the book income of corporations. "Other" refers to the total impact from additional tax changes likely to be included in the final tax bill. 2022 EPS (Expected)" refers to 2022 earnings-per-share estimates for the S&P 500. Corporate tax changes are based on estimates provided by Cornerstone Macro. Actual results may differ materially from figures shown.

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GLENMEDE CORPORATE FACTS

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