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Although some of the reciprocal tariffs that were unveiled on April 2 have been rolled back, more tariffs are in the pipeline with trade investigations underway into imports of pharmaceuticals, semiconductors, and critical minerals. While there are potential offramps to the tariffs, the tax bill moving through Congress provides the best opening to sterilize the tariff impact if they're not rolled back.

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TAX LEGISLATION IS AN OPPORTUNITY TO STERILIZE THE TARIFF IMPACT

There are a few offramps from the current tariff regime:

- Reciprocal tariffs greater than 10% are on hold until July 9 so that the US and trading partners hit with those higher rates can negotiate concessions that could lead to lower tariff rates. The markets would view this as a positive sign, but we still expect the 10% tariff on nearly every country to remain in place.
- The president could back down on some of the tariffs as the impact of the tariffs hits the US economy.
- The courts could rule against the tariffs. Two legal challenges have been filed and there is a possibility that the courts rule against the administration's use of a national emergency to impose broad swaths of tariffs. However, that is not guaranteed, as the courts have provided deference to the president in the past to impose national emergencies. In addition, the president could use other authorities to impose the tariffs (with changes) if a court challenge is successful.
- Congress could rescind the national emergencies declared by the president to impose tariffs. This option is unlikely unless there is significant economic and political backlash from the tariffs as Congress would need to have a veto-proof majority in support of the move.

Absent one of the above offramps, Congress can use the tax bill under consideration to sterilize the tariff impact. If the 10% tariff on nearly every country remains in effect, the president has essentially created a new consumption tax system on top of the existing tax system on savings and investment. Such a move could cause a recession if taxes on savings and investment are not lowered.

Congress is set to pass a tax bill this year to extend the 2017 Tax Cuts and Jobs Act tax cut provisions that expire at the end of 2025. Although that legislation will prevent a large tax increase from going into effect on January 1, 2026, extending current policy will not add new stimulus to the economy. Members of Congress are considering including additional pro-growth policies in the tax legislation given the president's tariff agenda. Among the ideas under consideration are: 100% expensing for capital equipment purchases, accelerated depreciation for structures to incentivize factory construction, immediate expensing of research & development (R&D) costs, and/or a lower corporate tax rate for domestic manufacturers.

If the tariffs look likely to remain in place and the US economy weakens, Congress could also look at lowering marginal income tax rates, the overall corporate tax rate, and the capital gains tax rate to sterilize the tariff impact. Congress is not there yet. In fact, some members are discussing raising the top marginal income tax rate to offset spending cuts to Medicaid. We do not view it as likely that marginal income tax rates will be raised because pass-through businesses pay that rate, which would cause them to be potentially hit with tariffs and taxes. Yet the fact that some members continue to discuss it demonstrates that Congress has not yet come around to the magnitude of the impact the tariffs can have on the US economy.

It feels very much like February 2020 when it was clear that the US was going to shutter its economy, and yet policymakers were arguing for a $250 billion tax cut when the economy needed $4 trillion. Consumers have pulled forward purchases to get ahead of the tariffs, but demand is likely to slow once the price increases take effect. That is the point at which Congress will pay more attention. Depending on which additional tax cuts are included in the legislation, they can serve to nearly offset the entire tariff increase in year one of implementation. Therefore, the tax debate will play a key role as the White House's trade policy progresses.

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