

Business

Trump's tax plan may not be good for Canada

By **Veronika Chang**



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(May 16, 2017, 8:59 AM EDT) -- On April 26, 2017, the White House announced President Donald Trump's new tax plan which promises what he says would be one of the biggest tax cuts in American history. He also says it would simplify the tax code. While the plan only outlines core principles, it does promise significant tax cuts, especially for corporations.

Trump's plan proposes to drastically cut the corporate tax from the top rate of 35 per cent to 15 per cent. Currently, only corporations with taxable income of \$50,000 or less are taxed at 15 per cent and those with taxable income of over \$10 million are taxed at 35 per cent. Most income between \$50,000 and \$10 million is taxed at 34 per cent. As such, a 20 per cent cut will be welcomed by most U.S. businesses.

However, Trump's plan may not be such a welcome for non-Americans.

American companies have been minimizing U.S. taxes by moving out of the country and reincorporating in a lower tax jurisdiction. Ireland, with a corporate tax rate of 12.5 per cent, is a popular destination. In a typical "inversion" deal, an American company buys a target company in a lower tax jurisdiction and then moves its head office to the lower tax jurisdiction. In such inversions, key employees and operations often stay in the U.S., the result being that only the profits move abroad, so the new merged company can take advantage of the lower tax rate.

In 2015, Medtronic, the world's largest medical technology company based in the U.S., bought Covidien, a similar company headquartered in Ireland, and reincorporated in that country. In 2016, Pfizer attempted a similar manoeuvre which would have lowered its overall tax rate from 25 per cent to 17 per cent; it would have meant an annual tax saving of \$1 billion.

But as far as the U.S. government was concerned, this would have meant lost tax revenue of \$1 billion every year. The U.S. Treasury promptly issued a new set of rules just in time to foil Pfizer's attempt at inversion.

Trump has said that the number of American companies leaving the U.S. is "disgraceful" and has pledged to put American interest first. True to his America-first foreign policy, his tax plan would discourage such inversion deals and encourage American businesses to stay in the country.

In Canada, the federal corporate tax rate is 15 per cent, which is less than half the current federal rate in the U.S. Over the years American businesses have taken advantage of this lower Canadian corporate tax rate and moved their businesses north. A good example is Burger King's acquisition of Tim Hortons to form Restaurant Brands, which is headquartered in Canada.

If approved, Trump's plan may dampen Canada's competitive tax advantage and put an end to inversion deals which favour Canada over the U.S. In fact, we may even see the one-way inversion sign make a U-turn and point southward, which means that Canadian companies would either move their headquarters to the U.S. or invest there.

Trump's tax plan also provides for a one-time tax on overseas profits which would bring back trillions of dollars to the U.S. The tax rate is yet to be determined, but U.S. Treasury Secretary Steven Mnuchin has promised that it will be "very competitive." If it is, expect to see many

American companies with money invested elsewhere repatriate money to the U.S. to take advantage of the lower corporate tax rate there.

No doubt, a few U.S. corporations that have taken advantage of the lower Canadian corporate tax rate and invested money in Canada will move their money back south of the border. Trump's tax plan will also affect Canadian businesses expanding to the U.S. Generally, Canadians with American businesses have repatriated income earned in the U.S. to Canada in order to take advantage of our lower tax rate. But this, too, would change with a lower tax rate in the U.S.

Typically, a Canadian company expands into the U.S. by forming an American subsidiary. The income earned by the subsidiary is repatriated to Canada as a management fee, shifting the taxable income from the U.S. to Canada. With a lower U.S. corporate tax rate, there is less pull to repatriate funds to Canada. This means Canadians may opt to park their money in the U.S. and invest there instead of bringing money back here.

But it may not be all doom and gloom for Canada. If the lower tax rate does lead to massive economic growth in the U.S., as predicted by the White House, then the demand for Canadian goods and services will likely rise. It remains to be seen how the U.S. will tax non-Americans who provide goods and services to Americans — and that is a lot of Canadians — but the most likely scenario is that things will not be competitive under Trump's America-first policy.

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