The U.S. Election Hangover: What Canadians Can Expect on the Tax Front from a Trump Presidency

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The world woke up to what, for many, was a surprising outcome to the U.S. Presidential election. Not only was Donald Trump elected President but the Republications will have firm control of all legislative branches of government for the first time since 1928.

The Republican control of both houses of congress is a critical difference between the results of the 2016 election and most previous elections. With different parties in charge of each house of congress and the presidency, a national budget requires a fair amount of "horse trading" to get a broad agreement on tax legislation that the President is willing to sign into law.

Based on the campaign rhetoric, it would appear as though the incoming Trump Administration will be primarily focused on immigration, homeland security, dismantling Obamacare and trade agreement matters. Therefore, it may be amenable to tweaks to its proposed tax plans from the Congress.

In Canada, a majority government's Prime Minister and Finance Minister initiate tax changes through the Budget Speech. By contrast, in the U.S., most tax legislation starts at the committee level at one or both houses on Congress. Therefore, prior proposed legislation which had originated in the Republication controlled House Ways and Means Committee has been referred to in conjunction with the Trump tax plan for the foregoing analysis.

The following discussion is not intended to be a comprehensive review of all of the Trump plan. Rather, it is a brief overview with a specific emphasis on changes which could impact Canadian individuals and businesses.

Individual Taxes for Expatriate Americans in Canada

Repeal of Net Investment Income Tax

With the proposed repeal of most elements of the Affordable Health Care Act (i.e. Obamacare), the 3.8% tax on net investment tax may be repealed for years beginning in 2017.

> Planning Idea: U.S. persons in Canada should consider delaying the recognition of net investment income until 2017. This could include delaying the sale of capital gains and accelerating capital losses.

Other individual tax provisions may include a reduction of most U.S. tax rates including the reduction of the highest federal tax rate from 39.6% to 33%. Personal exemptions may be eliminated and the standard deduction may be increased. There is a proposed cap on itemized deductions of $100,000 for single individuals and married persons filing separate returns. As well, there are proposals to reduce capital gains taxes.

Tax Tip: U.S. expatriates who are high charitable donors should consider the cap on itemized deductions when donating.

Estate Taxes

Trump and the Republican Congress have proposed eliminating death taxes based on the fair market value of property held by a U.S. citizen on death. In its place, Trump has proposed a system whereby a deemed disposition of assets in an estate with a fair market value in excess of $10 million would generate a capital gains tax. Small businesses and family farms would be excluded from the $10 million threshold.

Planning Idea: If the Trump Estate Tax Plan comes to fruition, a window of opportunity may open for high net worth U.S. citizens to gift wealth to the next generation without concern for estate and gift tax. The window could close if a subsequent administration reintroduces said taxes.

Pass Through Entities

Trump has proposed a 15% tax on pass through entities which retain business profits. Small business owners would not be subject to a second level of tax on a distribution.

Congress has proposed a 25% pass through rate.

There are significant concerns that the low rate will discourage entrepreneurs from taking salary, subject to tax at rates up to 33%, and incentivize employees to become contractors. Both of these results would be inconsistent with the intent of the proposal.

Some work will have to be done to prevent abuse of the proposed system. If and when ironed out, an analysis of the cross-border impact of the proposal can be considered.

Corporate Tax Changes

Basic Changes

Trump has proposed reducing the Federal corporate tax rate from 35% to 15%. Congress has proposed 20%. Adding in an average 7% state tax rate which may be deductible on a federal return and a 5% treaty withholding rate on repatriated profits, the U.S. and Canadian corporate tax rates should be fairly close to each other.

Traditional cross-border planning would dictate determining a basis for apportioning more of the global profits of a Canadian-based multinational to Canada as opposed to the U.S. This has been because the U.S. federal, state and repatriation rate generally exceeds 40% whereas the Ontario rate was 26.5%. Should the proposed changes become law, Canadian-based multinationals should be relatively tax neutral in most cases.

Corporate Alternative Minimum Tax (“AMT”) and Net Operating Loss “NOL” Carryovers

Trump and Congress have both proposed a repeal of the corporate AMT.

Under current law, NOLs can be carried back two years and carried forward 20. Trump has not proposed any changes to the NOL system. Congress has proposed eliminating NOL carrybacks and allowing indefinite NOL carryforwards. There would be an inflation adjustment component to the NOL carryforward as well as a limitation of the NOL carryforward to 90% of taxable income.

Comment: In a tax plan which largely creates greater deficits, a revenue raiser such as an elimination of NOL carrybacks will likely be included as an offset.

Write-Off of Capital Equipment

Trump has proposed that firms engaged in U.S. manufacturing may elect to deduct the full cost of capital investments in Year One. The election cannot be revoked for the first 36 months.

Under Trump’s proposal, businesses which elect Year One expensing will lose their ability to deduct net interest expense.

Congress’ proposals would extend the Year One write-off to all businesses and would allow for a carryforward of non-deductible interest expense.

Both proposals advocate the elimination of the Section 199 deduction for domestic production activities.

International Tax Provisions Impacting U.S. Based Multinational Corporations

There has been significant attention paid to U.S.-based multinational corporations with profits parked offshore. Unlike Canada's exempt surplus system, the U.S. taxes repatriated profits at full U.S. rates.

The U.S. approach to the taxation of its multinationals has led to a series of high profile inversion transactions where U.S. companies "merge" with foreign companies and move their head offices offshore. There is also an estimated $1.4 trillion of offshore profits of U.S.-based multinational corporations such as Apple and Microsoft which could be brought back to the U.S. to help stimulate the domestic economy.

Democrats have attempted to fight the trend by proposed tougher anti-inversion legislation. Republicans have consistently blocked legislation, advocating instead a complete overhaul of the system to be more aligned with other industrialized countries such as Canada.

Trump has proposed a 10% tax on deemed repatriated profits. Congress has proposed a rate of 8.75% on cash repatriations and 3.5% on noncash assets which can be paid over 8 years at the election of the taxpayer.

Trump has not proposed a change to the taxation of U.S.-based multinationals other than in the area of deemed repatriations. On the other hand, Congress has proposed a full exemption from U.S. tax for dividends from foreign subsidiaries, much like Canada's exempt surplus system.

Final Comment

The foregoing discussion was not intended to be a comprehensive analysis. As noted, it is not clear which, if any, of Trump or Congress' proposals will become law. What is clear is that the nonpartisan Tax Policy Center has estimated the cost of Trump's plan as $6.15 trillion over 10 years. Notwithstanding the U.S. Treasury's seemingly endless ability to print money, the plan may require significant adjustments to become law.

At Zeifmans LLP, we will be carefully monitoring the legislative process and will bring you our best ideas for how to plan your U.S. tax affairs as the law evolves.