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Post-election outlook— US corporate tax

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The election of Donald J. Trump as the next US President and the Republican sweep of the House of Representatives and the Senate create the very possibility of significant US tax legislation in the next two years.

Trump and House tax platforms

Trump made an effort during the campaign to bring his tax platform closer to the House Republican blueprint of House Speaker Paul Ryan and Ways and Means Committee Chair Kevin Brady. Both plans share many similarities, although the House plan is more detailed.

The key proposals from a business perspective include the following*:

- **Corporate tax**—The House plan would cut the US corporate tax rate to 20% while Trump proposes a 15% rate.

- **Pass-through rate**—The House plan proposes a 25% rate on active business income from a pass-through (partnership, S corporation) after assigning some portion as compensation. Trump has offered differing information on this issue. He has proposed extending the 15% corporate rate to pass-throughs, but only "small businesses" would enjoy the rate and pass-through treatment. "Large businesses" would be required to be taxed as C corporations to get the lower rate. Trump has not offered an explanation on what the "large business" threshold would be.

- **Business incentives**—Both plans would generally repeal all business incentives except the R&D tax credit. Both would also repeal the alternative minimum tax, although the House plan would retain the 90% limitation on net operating losses.

* Please see our recent tax alert—"Post-election US tax outlook"—for a discussion on potential US personal tax changes.

- **Depreciation**—The House plan provides for full business expensing as part of an effort to reshape the business tax code into more of a consumption tax. Businesses would not be allowed to take an interest deduction in excess of interest income, with an exception for the financial and leasing industries. Trump offers a narrower expensing provision only for manufacturing equipment if the company forgoes interest deductions.

- **International tax**—The international proposals show the greatest divergence. The House plan would create a 100% dividends-received deduction and repeal Subpart F so that offshore income would essentially be free of US tax. Trump proposes to eliminate deferral so that all foreign income would be taxed in the US immediately, but at the low 15% corporate rate. Trump would impose a one-time 10% tax on unrepatriated earnings while the House plan would apply an 8.75% rate on cash and cash equivalents and 3% on all other earnings. The House plan also seeks to make the US tax border adjustable in a move to make business taxes more like a consumption or value-added tax.

Potential impact on Canadian businesses operating in the United States

Canadian businesses operating in the US—either directly or through subsidiaries—currently do so in a high-tax environment. The top US federal corporate tax rate in 35%, and the combined state tax can drive an effective US corporate tax rate into the mid-40%. The impact of high US corporate tax rates is that Canadian companies seek to minimize their US operations and footprint in order to minimize US tax. Under either the House Plan or the Trump Plan, US corporate tax rates would decline considerably; this would allow Canadian businesses to restructure their US operations to allow for more US activity.

Both plans' international tax proposals focus on tax reform for US parent companies and the taxation of income earned in foreign (non-US) affiliates outside the US. While neither focuses on US subsidiaries of foreign parents, Congressional Republicans were not in favour of the US Treasury Department's recently finalized Section 385 regulations, which could result in US subsidiaries paying additional US tax.[**] Chairman Brady stated recently that President-elect Trump should withdraw these regulations. When Trump becomes President on January 20, 2017, his Treasury Department could seek to modify or repeal these rules. Alternatively, Congress—which will be controlled by Republicans—could seek to repeal them through legislation. Either result would benefit Canadian businesses by allowing greater flexibility when leveraging US subsidiaries.

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[**] For more information on these regulations, see our recent tax alert "Final US related-party debt regulations will impact US subsidiaries of Canadian parent companies"