taxnotes® international

Volume 96, Number 5 ■ November 4, 2019

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Reprinted from *Tax Notes International*, November 4, 2019, p. 433

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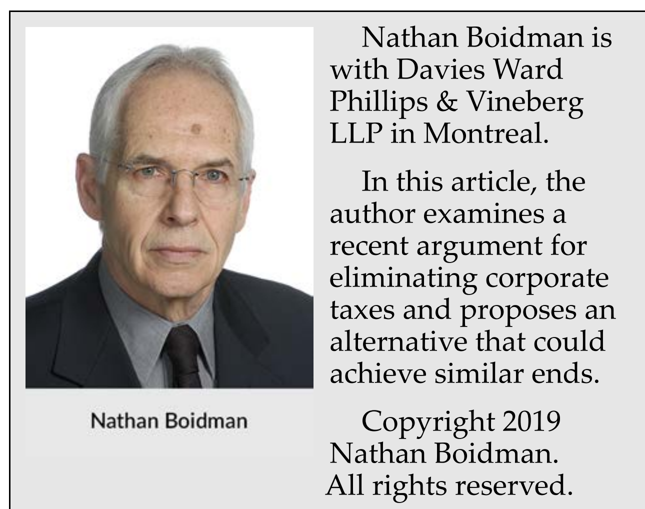

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In this article, the author examines a recent argument for eliminating corporate taxes and proposes an alternative that could achieve similar ends.

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Canadian business columnist and commentator Terence Corcoran suggests that eliminating the tax on corporate profits "would improve labour conditions, increase wages, stimulate growth and create jobs."[1]

That is because, he argues, corporate taxes are a cost that is passed "on to consumers and workers" or that leads organizations to "cut back on investments," which lowers productivity and, ultimately, limits high-paying job opportunities.

Among his various sources, Corcoran cites a 2014 report by Laurence Kotlikoff. Corcoran explains that the U.S. economist:

> estimated that eliminating corporate income taxes in the U.S. would produce "rapid and dramatic increases in American investment, output and real wages, making the tax cut self-financing to a significant extent."

Corcoran also cites Nobel Prize winners Milton Friedman and William Vickrey, Megan McArdle of *The Washington Post*, and economists associated with the School of Public Policy at the University of Calgary.

Alas, Corcoran laments that in light of prevailing political sentiment and initiatives by bodies such as the OECD, "the idea is admittedly unrealistic." But is that necessarily true? Or are there, perhaps, at least two factors that provide additional support for corporate tax abolition?

First, the OECD — the same body that in 2013 initiated the ongoing crusade against base erosion and profit shifting (to which Corcoran alludes) — previously authored a study that described corporate tax as the most destructive form of taxation.[2] The report focuses on the tax systems that best support GDP growth and suggests that corporate taxes are the most damaging type of tax in terms of economic growth (with the least harmful being residential property tax followed by consumption taxes and personal income taxes).

Second, consider whether there are mechanisms already accepted and in place — at least in Canada and the United States — that could serve as an effective proxy for abolition of corporate taxes.

Quite apart from the tax deferral that accelerated or immediate full depreciation of production facilities, machinery, equipment, and so forth provides,[3] both Canada and the United States provide full deferral of a branch tax — applicable to profits that foreign corporations earn from carrying on business in those countries directly (that is, without using a local subsidiary) — when the corporations reinvest those profits in the local business.[4]

[1] Terence Corcoran, "End Job-Killing Corporate Taxes and Free the FAANGS!" *Financial Post*, Oct. 11, 2019.

[2] *See* OECD, "Tax Policy Reform and Economic Growth" (Nov. 3, 2010).

[3] For full depreciation, see the 2017 Tax Cuts and Jobs Act.

[4] In the United States, see IRC section 884(a). In Canada, see section 219 of the Income Tax Act.

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For example, a foreign corporation carrying on business in a province such as Ontario or Québec will pay basic federal and provincial taxes at a rate of roughly 27 percent and, subject to possible tax treaty reduction, a branch tax at the rate of 25 percent on the remaining 73 percent (ultimately, 18 percent). However, if the 73 percent residual is reinvested in the Canadian business, that branch tax does not apply. The United States has a similar system, but the basic combined (federal and state) rate ranges from a low of 21 percent to a high of 34 percent and the branch tax rate, subject to treaty reduction, is 30 percent of the residual.

The suggestion here, an alternative way to obtain the benefits of corporate tax abolition that Corcoran describes, is to extend the concept of a tax exemption for reinvested business profits to all corporations (not just foreign) and all corporate taxes (not just the branch taxes of foreign corporations). This exemption should not only apply to business carried on by corporations, but also to sole proprietorships, partnerships, trusts, and so forth.

Although the devil is in the detail, these details have, at least in part, already been addressed by the specific rules that the countries have enacted to implement the branch tax exemption for reinvested profits. Therefore, the notion cannot be dismissed out of hand as unrealistic or impractical.

That said, would any in-depth consideration of the notion raise questions that might attract wider interest while also transforming the idea beyond the intended scope to focus on objectives not contemplated by Corcoran's original commentary? Consider, for example, the following.

Should the deferral require reinvestment that creates a set number of jobs? That question brings to mind the political controversy in the United States regarding whether the two-year (2004 and 2005) concessionary tax rate on the repatriation of billions of dollars in offshore profits by Fortune 500 companies under IRC section 965 had the intended effect of creating U.S. jobs.

Should the reinvestment focus on rural areas, favored states or provinces, or specified industries? Those questions have long been part of our fiscal policy debates and, while worthy, would deprive the notion of its basic simplicity.

It could be argued that the branch tax deferral is simply intended to parallel the result when a foreign corporation operates in Canada through a Canadian subsidiary (or in the United States through a U.S. subsidiary) and does not distribute its after-base corporate tax profits to its foreign parent, thus deferring a secondary 25 percent tax in Canada (or 30 percent in the United States, both subject to treaty reduction) on the residual applicable to dividends that Canadian corporations (or U.S. corporations) pay to foreign shareholders. However, that deferral is available whether the Canadian (or U.S.) subsidiary reinvests the residual in its business or uses it for passive investments not linked to the business. In contrast, the branch tax exemptions require reinvestment in the business.

At a more philosophical and macroeconomic level, is a profitable firm's next investment necessarily the best use of the capital it has generated? Again, this question takes us far beyond simply crafting a proxy for abolishing corporate tax.

Finally, putting aside the substantive choices suggested above, the proposed rule would need to address several technical issues that are not necessarily dealt with in the branch tax rules. Most pivotal of these is how to establish criteria to distinguish investments in the business that qualify for a reinvestment exemption from mere passive investments. Although both Canada and the United States have substantial judicial and administrative experience making this distinction for direct and indirect tax rate determinations under both domestic and foreign tax rules, making the determination to establish whether a reinvestment qualifies for exemption raises the stakes to a whole new level. ■

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