FINANCIAL POST

January 20, 2017

What Donald Trump's tax reform proposals could mean for Canadians

By Jamie Golombek

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It's official - Donald J. Trump has been sworn in as the 45th president of the United States. With the Republicans having a majority in both the House of Representatives and the Senate, it's just a matter of time before President Trump attempts to proceed with his tax reform proposals. Let's take a look at the impact two of the Trump tax measures may have on Canadians.

Tax rates

Trump's tax plan calls for a reduction in the number of U.S. federal income rate brackets from the current seven brackets to only three: 12 per cent, 25 per cent and a top rate of 33 per cent for individuals with income over US$112,500. This top tax rate would be nearly 7 per cent lower than the current top U.S. rate of 39.6 per cent. Of course, most states also impose a state income tax, with California's rate being the highest at 13.3 per cent; however, seven states, most notably Florida, have no personal income tax whatsoever.

The question some high-income Canadians have been asking is whether Trump's proposed top tax rate reduction could put pressure on our federal or provincial governments to lower our top tax rates?

You'll recall that, in Canada, for 2017, we have five federal tax brackets: zero to $45,916 (15 per cent), $45,916 to $91,831 (20.5 per cent), $91,831 to $142,353 (26 per cent), $142,353 to $202,800 (29 per cent), with anything above that being taxed at 33 per cent, the new high-income bracket introduced by the government in 2016.

AP Photo/Patrick Semansky Donald Trump steps out to the portico to be sworn in as 45th president of the United States. In addition to building a wall along the U.S.-Mexico border, Trump also wants to upgrade infrastructure in the U.S.

Each province also has its own set of provincial tax brackets. The effect of federal and provincial taxes means that the top marginal tax rate for high-income earners is over 50 per cent in six provinces, with Nova Scotia taking the top honours at a combined 2017 top marginal tax rate of 54 per cent.

Much has been written about how high the tax rate can go before it becomes a psychological barrier to work. For example, the 1966 Carter Commission felt that once the top rate exceeded 50 per cent, it threatened productive effort.

For highly-skilled Canadian workers and professionals that are mobile, a newly-lowered top U.S. federal tax rate compounded with a strong U.S. dollar could make Trump's America more attractive - at least from a financial point of view - to Canada's top talent. Take, for example, an Ontario high-income medical specialist paying tax at 53.5 per cent on her income above $220,000 who's contemplating job offer at a Miami hospital. By relocating to Florida, not only could she be paid in U.S. dollars but that income would be subject to tax at a top rate of 33 per cent – that's more than 20 per cent lower than her current, combined federal/Ontario rate.

While lower taxes wouldn't be enough for most people to consider a move to the U.S. - in fact, much of the immigration discussion has been of Americans moving north - Trump's tax cut could put some pressure on our governments to lower rates to ensure that Canada remains competitive and can continue to attract and retain top talent.

Estate tax

The other area that President Trump has promised to reform is the estate tax system. Unlike Canada, the U.S. has an estate tax that applies to the fair market value of an American's assets upon death. The U.S. estate tax was enacted in 1916 and was already repealed once: for the year 2010, but it was resurrected as of Jan. 1, 2011. There is an exemption equal to US$5.49 million indexed annually to inflation, such that very few estates actually owe any estate tax.

Lily Batchelder, a professor of law and public policy at NYU School of Law, in her recent paper, Fixing the Estate Tax, explains that the purpose of the estate tax was to address the fact that the income and payroll tax system "allows recipients of large inheritances to exclude the entire amount they inherit from their tax returns, while children who do not start out so lucky, and have to live solely off their earnings rather than their inheritances ... pay both of these taxes on everything they earn." The estate tax was designed to correct this inequity by taxing large wealth transfers, beyond the exemption amount.

But in recent years, due to a drop in the estate tax rates and an increase in the exemption, the revenue associated with the estate tax has been waning, declining from a peak of 2.6 per cent of U.S. federal revenues in 1972 to 0.6 per cent today. Professor Batchelder cites an example of a U.S. couple who transfers US$12 million to their children in 2017 and pays only US$400,000 (3 per cent) in wealth tax.

Canada doesn't have an estate tax on death. Instead, we tax only the unrealized appreciation of assets (other than your principal residence) upon death as well as the fair market value of your RRSP/RRIF.

High-net-worth U.S. citizens living in Canada, including dual citizens, and non-U.S. citizens who own "U.S.-situs property" such as U.S. real estate or shares in U.S. companies at the time of death may be subject to U.S. estate tax. If Trump follows through on his promise to repeal the U.S. estate tax, then much of the complex planning currently being done, often involving setting up trusts and corporations to get around the estate tax, will no longer be necessary.

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References

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