TAX POLICY TRENDS

September 2020

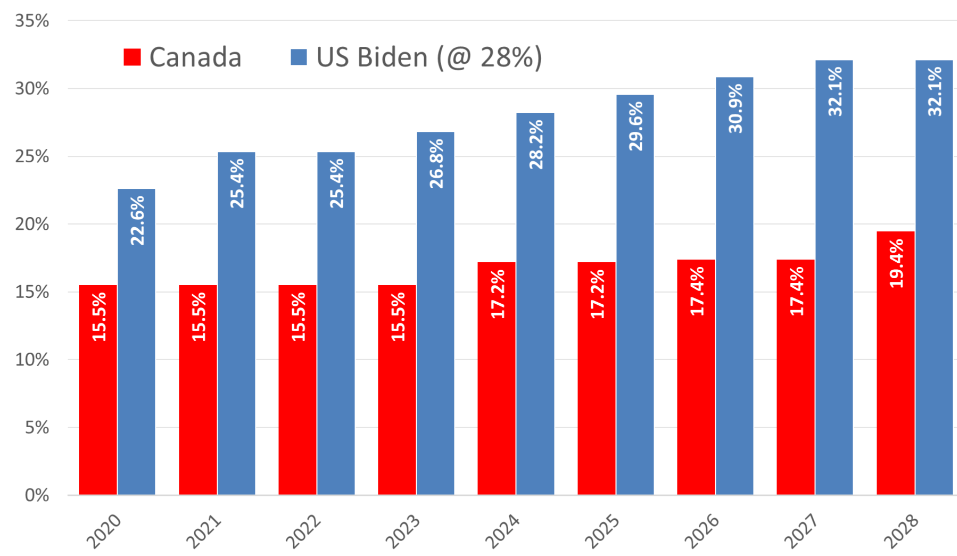
IMPLICATIONS OF A BIDEN WIN FOR U.S. CORPORATE TAX POLICY AND COMPETITIVENESS – U.S. COMPETITIVENESS TO DECLINE

With the upcoming U.S. election in November the potential for a dramatic change to corporate taxes in the U.S. is a real possibility. This would follow close on the heels of the 2018 overhaul of the U.S. corporate and personal tax system under the Tax Cuts and Jobs Act (TCJA). Biden's plan would ostensibly be enacted in 2021—following a successful bid for the presidency—and would lift the U.S. large corporate rate to 28%, partially unwinding the rate reduction enacted in the TCJA that saw the U.S. large corporate rate fall from 35% (1993-2016) to 21%.[1] As shown in the graph, this would raise the current U.S. marginal effective tax rate on large corporations from 22.6% in 2020 to 25.4% in 2021, reducing U.S. investment and productivity.

However, a more substantial increase to the U.S. METR will begin to accumulate in 2023 as another of the TCJA's cornerstone provisions is set to wind down, the allowance of full expensing for investments in machinery. This temporary measure—also known as 100% bonus depreciation—was extended across most industries starting in 2018, to remain in full force until January 1, 2023, after which it will be reduced at an annual rate of 20% until completely withdrawn in 2027. As the figure shows, though Biden's rate reduction will raise the U.S. METR roughly 2.8% compared to 2020, in fact it is the expiration of the TCJA expensing provision which will have a much greater impact on the large U.S. corporate METR raising it an additional 6.7%.

[1] https://taxfoundation.org/joe-biden-tax-plan-2020/

Corporate Marginal Effective Tax Rates on Capital Under Joe Bidens Provisional Tax Plan 06/2020



Authors calculation

As a response to the U.S. TCJA expensing provision, Canadian policy makers adopted a similar series of accelerated capital cost allowances in 2018's Fall Economic Statement along with full expensing for machinery across most industries. The introduction of this policy effectively tripled the previous half-year convention CCA rate applied on new investments. This implied that newly acquired capital—other than machinery—could be deprecated at 1.5 times the CCA rate in the first year, as opposed to the previous ½ rate. Clean energy and manufacturing and processing machinery is also fully expensed in the first year, directly mirroring the U.S. provision. Additionally, similar to the TCJA, these measures were adopted

UNIVERSITY OF CALGARY
THE SCHOOL OF PUBLIC POLICY

The School of Public Policy
University of Calgary Downtown Campus
906 8th Avenue S.W., 5th Floor
Calgary, Alberta T2P 1H9

Authors: Jack Mintz and Philip Bazel
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on a temporary basis to remain in full force until 2024, after which they will be gradually phased out, providing no benefit after 2027.

The phased withdrawal of Canadas temporary accelerated depreciation regime is designed to coincide with that of the U.S., allowing Canada to maintain a competitive advantage relative the U.S. through 2028. This advantage will be maintained whether or not Biden wins, though a rate increase in the U.S. would extend Canadas lead. But there are additional factors to be considered in the winding down of Canada's capital investment incentives.

Like the U.S., Canada's tax on capital will increase beginning in 2024, after prolonged economic weakness due to the COVID-induced recession. Investment competitiveness will fall as the METR rises, keeping other factors the same.

In turn, less investment will reduce labour productivity, affecting the ability of companies to pay wages.

While Canada arguably competes most directly with the U.S. for investment capital, the withdrawal of accelerated depreciation will also alter its competitive standing relative to other international jurisdictions.

Among 34 OECD nations Canada currently enjoys the 21st ranking (1st represents the highest METR, 34 the lowest) in 2020.

However, with the estimated 2028 METR values for the U.S. and Canada—holding the remaining OECD constant—Canada would rank 15th.

In addition to the issue of competitiveness we must also consider the distortionary effects associated with targeted capital investment incentives. Accelerated depreciation and expensing for short-lived capital creates distortions in capital allocation, by encouraging more investment in the favored assets classes than would otherwise occur. This redirects investment in the economy away from areas where it might have otherwise gone had the returns to investment not been altered by such incentives.

Moving into the U.S. election we are sure to hear much discussion of the Biden tax plan. While the rate cut is likely to take centre stage, and all but certain to be used as a bludgeon on both sides, it will be interesting to see if either party is tracking the more substantial decline approaching U.S. competitiveness.

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