

Canada Urged to Stop Tax Rate Race to the Bottom

Posted on Jul. 10, 2018

By Amanda Athanasiou

Rumors that the U.S. Tax Cuts and Jobs Act would mean a Canadian capital exodus have proven unfounded, according to one campaign group. But some tax professionals aren't so sure.

The passage of the TCJA was met with renewed critiques of what many consider to be an uncompetitive corporate tax regime and predictions that [NextEra Energy Partners' Canadian asset sell-off](#) won't be the last. Even before the TCJA, companies were [fleeing the country, citing burdensome taxes](#).

But Canadians for Tax Fairness (CTF) has called evidence of capital flight anecdotal and said in a [July 4 release](#) that net investment actually flowed north in the first quarter of 2018. Canadian direct investment in the United States in the first quarter of 2018 was less than half the long-term average at C \$4.1 billion, while direct investment from the United States to Canada was higher than the long-term average at C \$7.9 billion, CTF said, citing data from Statistics Canada. Data for the second quarter won't be released until September.

Canada shouldn't be worried about the new U.S. tax system for several reasons, CTF said. The difference between the U.S. and Canadian corporate tax rates is small, and "states are already raising taxes to take advantage of that tax room," something the provinces would likely do if Canada's rate dropped, CTF said. Further, there are loopholes that permit Canadian corporations to maintain effective tax rates far below the headline rate of 26.5 percent, it said. Companies take advantage of tax havens with 0 percent rates, and Canada provides lots of nontax cost advantages for businesses, like the public health care system, it added.

The group submitted a [brief](#) to Minister of Finance Bill Morneau, urging the federal government to engage with other governments to stop the corporate tax race to the bottom, claiming that it's a destructive cycle that leaves all jurisdictions worse off. It's a "classic collective action problem, and the solution is always cooperation," the brief says.

Morneau said in his February budget speech that the government will ensure that Canada remains the best place to invest, and he has reportedly defended Canadian tax rates. But the IMF said in June that [Canada's "weak external competitiveness" could limit potential growth](#) and that lower tax rates in the United States could lessen Canada's attractiveness for investment. The *Financial Post* reported in March that foreign direct investment fell in 2017 to its lowest level since 2010.

There's a reasonable debate to be had about the scope of the TCJA's effect on Canada, though disentangling that effect from the uncertainty created by North American Free Trade Agreement negotiations presents a challenge, said Aaron Wudrick, federal director of the Canadian Taxpayers Federation. If tax competitiveness matters, "major tax reform in Canada's

primary trading partner and competitor for investment is going to have an impact,” he said.

The long-term trend doesn't prove the case CTF is making with one quarter of data, said Kim Moody of Moodys Gartner Tax Law LLP. If the group could see the amount of private capital that is leaving Canada, hopefully they would be concerned, he said, adding that it's too soon for that kind of data to show up in the Statistics Canada reports. “Every day our firm is giving advice to Canadians on how they could deploy their capital outside of Canada” for better returns in a friendlier environment, he said. “It is very concerning.”